The Applicability of International Law as Governing Law of State Contracts

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ABSTRACT

Whether international law is applicable to govern state contracts has long been discussed from different perspectives. This article revisits this issue from the perspective of powers of courts and arbitral tribunals in applying international law. To this end, the article examines the choice of laws rules applicable in a number of courts and arbitral tribunals to determine whether they have the power to apply international law to state contracts in three situations: where the parties have chosen international law; where the parties have chosen only a national law; and where the parties have not chosen a law to govern the contract. The article concludes that a national court has no power to apply international law while arbitral tribunals are obliged to apply international law where it has been chosen by the parties. Most arbitral tribunals may also apply international law where the parties have not made a choice of law. However, where the parties have chosen only a national law to govern the contract, most courts and tribunals have no power to apply international law to it, except for special cases where the rules governing the court or the arbitral tribunal allow otherwise. While this article focuses on the applicability of international law, most of the discussions in it will equally apply to other forms of non-national law, in particular the choice of *lex mercatoria*, which is also found in a number of state contracts.

Introduction

This article revisits the issue of whether international law may serve as the governing law of state contracts. In other words, it examines whether courts or tribunals hearing a state contract dispute may apply international law to determine issues arising from it. With its own methodology of assessment, this article will demonstrate that there are circumstances in which tribunals are authorised and even required to apply international law to state contracts and other circumstances in which courts or tribunals may *not* apply international law to state

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contracts. It is important that this threshold question be correctly understood and resolved so that international law will only be applied to state contracts in appropriate situations.

1. Methodology

The applicability of international law to state contracts has been extensively discussed. Opposite views have been expressed and will continue to co-exist. Many authors including Bowett,[1] Greenwood,[2] Higgins,[3] Jennings,[4] Lauterpacht,[5] Mann,[6] Schwebel,[7] and Weil[8] are of the view that international law is applicable to state contracts. On the other hand, another group of authors such as Amerasinghe,[9] Brownlie,[10] Delaume,[11] Grigera-Naon,[12] Sornorajah,[13] Suratgar,[14] and Toope[15] argue that international law is not applicable to state contracts. These commentators have examined the issue and reached their conclusions from different angles. For example, Weil and Dupuy have advocated the application of international law based on the nature of state contracts as long-term contracts involving a sovereign state as a contracting party. On the other hand, authors such as Grigera-Naon and Sornorajah have argued against the applicability of international law on the basis of the lack of rules in international law on contractual issues. Other authors, such as Toope,[16] have

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1 D Bowett, 'State Contracts with Aliens: Contemporary Developments on Compensation for Termination or Breach', (1988) 59 *British Year Book of International Law*, 49-53.

2 C Greenwood, 'State Contracts in International Law – The Libyan Oil Arbitrations' (1982) 53 *British Year Book of International Law*, 27-81.

3 R Higgins, *Problems and Process: International Law and How We Use It?* (Oxford University Press, 1994) 54.

4 R Jennings, 'State Contracts in International Law' (1961) 37 *British Year Book of International Law,* 156-82.

5 E Lauterpacht, 'The World Bank Convention on the Settlement of International Investment Disputes' (1968) 653, *Recueil D'etudes de Droit International en Hommage a Paul Guggenheim*; E Lauterpacht, 'International Law and Private Foreign Investment' (1996) 4 *Indiana Journal of Global Legal Studies,* 259.

6 F Mann, 'The Proper Law of Contracts Concluded by International Persons' (1959) 35 *British Year Book of International Law* 34-57; F Mann, 'The Law Governing State Contracts' (1944) 21 *British Year Book of International Law,* 11-33.

7 S Schwebel, 'The Law Applicable in International Arbitration: Application of Public International Law' (1994) 7 *ICCA Congress Series,* 562, 565.

8 P Weil, 'The State, The Foreign Investor and International Law: The No Longer Stormy Relationship of a Menage a Trois' (2000) 15 ICSID Rev, *Foreign Investment Law Journal,* 401.

9 C Amerasinghe, 'State Breaches of Contracts with Aliens and International Law' (1964) 58 *American Journal of International Law* 881-913; C Amerasinghe, 'Issues of Compensation for the Taking of Alien Property in the Light of Recent Cases and Practice' (1992) 41 *International and Comparative Law Quarterly,* 22-65.

10 I Brownlie, *Principles of Public International Law* (Oxford University Press, 6th ed, 2003), 525.

11 G Delaume, 'The Proper Law of State Contracts Revisited' (1997) 12 *ICSID Rev – Foreign Investment Law Journal* 1; G Delaume, 'The Pyramids Stand – The Pharaohs Can Rest in Peace' 8 *ISCID Rev – Foreign Investment Law Journal,* 231.

12 HA Grigera-Naon, *Choice of Law Problems in International Commercial Arbitration* (J.C.B. Mohr, Paul Siebeck, 1992) 144 .

13 M Sornorajah, *The Settlement of Foreign Investment Disputes* (Kluwer, 2000) 255.

14 D Suratgar, 'Considerations Affecting Choice of Law Clauses in Contracts between Governments and Foreign Nationals' (1962) 2 *Indian Journal of International Law,* 273.

15 S Toope, *Mixed International Arbitration: Studies in Arbitration between States and Private Persons* (Grotius Publications, 1990) 75-97.

16 Ibid.

rejected the applicability of international law to state contracts on the traditional ground that private investors could never be subjects of international law and contracts with them cannot be assimilated to treaties. On the contrary, Higgins[17] and Schwebel[18] have argued for the application of international law to state contracts based on their perception of a developing trend of international law to extend beyond its traditional subjects of only states and international organisations.

Amongst these different approaches, the most appropriate methodology, it is submitted, is the one adopted by Mann since the early days of this debate. Mann held the view that whether international law may apply to a state contract is a question for the rules of private international law applicable in the particular case. This point was first made by him in 1944[19] and subsequently re-stated in 1959 as follows:

> The question whether and under what circumstances it is open to an international person and a private person to submit their contract to public international law relates to the doctrine of the proper law in private international law rather than to public international law.[20]

This is the legally correct approach because it forces one to ask whether, under the rules of private international law applicable in the circumstances, the contracting parties may choose international law to govern their contract and, more importantly, whether the court or tribunal hearing the dispute may apply international law to the contract. This, it is submitted, is the fundamental question. Courts and arbitral tribunals in each jurisdiction no doubt must comply with the choice of law rules that bind them. A failure to do so may expose the judgment or award to being set aside or not enforced.[21] If under such rules, the court or tribunal does not have the power to apply international law to the contract, then regardless of the nature of the contract, the merits of international law or any other factors favouring the application of international law, international law is simply inapplicable. Conversely, if under the relevant choice of law rules, the court or tribunal must give effect to a choice of international law by the parties or is otherwise required to apply international law, then

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[17] Higgins (n3) 54.
[18] See Schwebel (n 7).
[19] Mann, 'The Law Governing State Contracts' (n 6) 19.
[20] Mann, 'The Proper Law of Contracts Concluded by International Persons' (n 6) 45.
[21] For courts, see P Nygh, *Autonomy in International Contract* (Clarendon Press, 1993) 33, quoting Gaudron J of the Australian High Court in *Oceanic Sun Line Special Shipping Co. Inc. v Fay* (1988) 165 CLR 197 (High Court of Australia) and Diamond J in *The Heidberg* [1994] 2 Lloyd's Reports 287 (QB), 303; G Petrochilos, *Procedural Law in International Arbitration* (Oxford University Press, 2004) 2. For arbitral tribunals, see Article V(1)(e) of the New York Convention; A J Van de Berg, 'Some Recent Problems in the Practice of Enforcement under the New York and ICSID Convention' (1987) 2 *ICSID Rev – Foreign Investment Law Journal* 439, 446-7. Also see generally FA Mann, 'Lex Facit Arbitrum' in P Sanders (ed) *International Arbitration Liber Amicorum For Martin Domke* (Nijhoff, 1967) 157; FA Mann, 'State Contracts and International Arbitration' (1967) 42 *British Year Book of International Law* 1-38; W Park, 'The Lex Loci Arbitri and International Commercial Arbitration' (1983) 32 *International and Comparative Law Quarterly,* 21-52.

regardless of how unattractive international law may be in the circumstances, international law is applicable to the contract.

Having posed the right question, Mann, however, only made some general observations without examining this issue in detail. For example, he simply stated that most systems would respect a choice of international law by the parties.[22] However, as conflict rules for each forum may vary, such a generalisation is unconvincing, particularly when unsupported by a close examination of the specific rules in each forum. This article will provide this missing link by examining the conflict rules in some specific fora to ascertain whether they allow the application of international law to state contracts. Because this article can only cover a limited number of fora, it is proposed that the position of arbitral tribunals and, as a contrast, national courts in five jurisdictions being England, France, Germany, Switzerland and the United States be examined. Hence, the terms 'courts' and 'tribunals' as used in this article shall refer to those in these five jurisdictions. In addition, tribunals at the International Centre for Settlement of Investment Disputes ('ICSID') and the Iran United States Claims Tribunal ('IUSCT') will also be discussed as they often deal with state contracts in the relationship with international law. While it is difficult to generalise, the position in these established common law and civil law fora should be indicative.

It should be emphasised at the outset that this article does not address the substantive issue of whether international law *should* apply as the governing law of state contracts. It merely discusses whether international law *may* apply as the governing law of state contracts, which is a more procedural question. It will now proceed to do so by examining various circumstances in which international law may potentially apply.

2. Choice of International Law

The first scenario to consider is where the parties choose international law, either alone or with a national law, to govern their contract. This choice is relatively common in state contracts.[23] However, such a choice of international law by the parties by itself is not conclusive that international law will apply to the contract. It is necessary that the court or tribunal, hearing the dispute, has the power to give effect to a choice of international law. If it does not have such power, it will disregard the choice of international law by the parties and determine the applicable law as if the parties had not made a choice in the contract.[24] The position of national courts and arbitral tribunals will now be considered in turn.

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[22] Mann, 'The Proper Law of Contracts Concluded by International Persons' (n 6) 46.

[23] See Hop Xuan Dang, *International Law as the Governing Law of State Contracts*, DPhil Thesis, University of Oxford, 2008.

[24] For example, an American court refused to apply a choice of the Uniform Customs and Practice for Commercial Documentary Credits ('UCP') for a letter of credit on the ground that the court was only authorised to apply national law and the UCP did not form part of national law: *Pubali Bank v City National Bank* [1985] 777 F. 2d 1340 (9th Circuit), confirmed in *TMTI v Empressa Nacional de Commercialization* [1987] 829 F. 2d 949 (9th Circuit), referred to in P Korysis, 'Choice of Law in the American Courts in 1987: An Overview' (1988) 36 *American Journal of Comparative Law,* 547-65.

A. National Courts

In practice, it has been rare for a national court to have to consider a contract containing a choice of international law. Disputes over such contracts, being international in nature and involving states, are often submitted to international arbitration, rather than domestic courts. However, it is useful to consider the position of national courts because, as will be shown below, it provides a contrast to the position of arbitral tribunals. In addition, the possibility of a contract governed by international law being adjudicated in a domestic court, however slight that may be, cannot be entirely excluded.

A national court in the jurisdictions considered in this article so far does not have the power to give effect to a choice of international law in a contract due to the restrictions in choice of law rules binding on them. For example, in determining the law applicable to contracts, English courts used to have to follow the *Convention on the Law Applicable to Contractual Obligations 1980* ('the Rome Convention'),[25] which, under Article 1(1), regulates only choices between 'laws of different countries'.[26] The unanimous academic and judicial view is that this limits the scope of the Rome Convention to only national legal systems, excluding international law.[27] Consequently, it is also accepted that the permissible choices of law for contracts in jurisdictions governed by the Rome Convention are limited to national legal systems, not international law.[28] This has been confirmed by the English Court of Appeal in *Shamil Bank v Beximco* as follows:

> The wording of article 1(1) of the Rome Convention ('The rules of this Convention shall apply to contractual obligations in any situation involving a choice between the laws of different countries') is not on the face of it applicable to a choice between the law of a country and a *non*-national system of law, such as the lex mercatoria, or 'general principles of law', or as in this case, the law of Sharia. Nevertheless, that wording, taken with article 3(1) ('A contract shall be governed by *the* law chosen by the parties') and the reference to choice of a 'foreign law' in article 3(3), makes it clear that the Convention as a whole only contemplates and sanctions the choice of the law of a country.[29]

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[25] The Rome Convention had the force of law in England pursuant to the *Contracts (Applicable Laws) Act 1990*. This has now been replaced by *Rome I Regulation*, which contains little change in this respect, as will be discussed later.

[26] Article 1(1).

[27] L Collins (ed) *Dicey, Morris and Collins on The Conflict of Laws* (Sweet and Maxwell, 14th ed, 2006) 1567-8; *Halpern v Halpern* [2007] 3 WLR 849 (CA).

[28] A Briggs, *The Conflict of Laws* (Oxford University Press, 2002) 159; P Lagarde, 'La Nouveau Droit International Prive des Contrats Apres l'entree en vigueure de la Convention du 19 Juin 1980' (1991) 80 *Revue Critique de Droit International Prive* 287, 300-1; K Boele-Woelki, 'The UNIDROIT Principles of International Commercial Contracts and the Principles of European Contract Law: How to Apply them to International Contracts?' (1996) *Uniform Law Review* 652, 664; MJ Bonell, *An International Restatement of Contract Law – The UNIDROIT Principles of International Commercial Contracts* (Transnational Juris Publications, 1994) 121-2; A Kassis, *Le Nouveau Droit Europeen des Contrats Internationaux* (Librairie Generale de Droit et de Jurisprudence, 1993) 351-2.

[29] *Shamil Bank of Bahrain EC v Beximco Pharmaceuticals Ltd.* [2004] 1 WLR 1784 (CA). This has been confirmed in *Halpern v Halpern* (n 27).

In fact, all relevant decisions by English courts involving choices of law for contracts concern only choices between domestic systems.[30] While English courts in some cases have referred to international law or some form of non-national law as the governing law of contracts, such cases all concern enforcement of awards made by international arbitral tribunals, rather than adjudication of the substance of a contract dispute based on international law.[31]

The same position was applied in French courts, as they too were subject to the Rome Convention. In Germany, the Rome Convention was implemented by the Introductory Code to the German Civil Code, which applied to 'situations that have a bearing on the law of a foreign country.'[32] This, in substance, is the same as the Rome Convention. Similarly, in Switzerland, Article 116(1) of the Swiss Federal Statute on Private International Law 1987 ('FSPIL') provides that a contract shall be governed by 'the law' chosen by the parties. The general view is that this is limited to national systems of law.[33] The position in the US is similar where the judicial attitude has been focussed on the choice of national laws to govern contracts.[34] The 'domestic law' attitude of US courts is reflected in the reference to the choice of 'the law of a state' in Section 187 of the Second Restatement (Contracts), which is said to reflect a nearly universal rule in the US.[35] Section 187 provides that '[t]he law of the state chosen by the parties to govern their contractual rights and duties will be applied...'.

This restrictive position of national courts on this matter has been criticised for a number of reasons such as being incompatible with the principle of party autonomy, unsuitable for international transactions and overly restrictive when compared with arbitral practices.[36] Such

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[30] *R v International Trustee and others* [1937] AC 500 (CA) 529; *Vita Food Products Inc. v Unus Shipping Co. Ltd* [1939] AC 277 (PC) 299; *Whitworth Street Estates Manchester Ltd. v James Miller and Partners* [1970] AC 583 (HL) 603 and in particular Lord Diplock in *Amin Rasheed Shipping Corporation v Kuwait Insurance Company* [1984] AC 50 (HL) 65. For a commentary on this, see FA Mann, 'England Rejects 'Delocalised' Contracts and Arbitration' (1984) 33 *International and Comparative Law Quarterly* 193-8.

[31] *Channel Tunnel Group Ltd. v Balfour Beatty Constructions Ltd* [1993] AC 334 (HL); *Orion Compania Espanola de Seguros v Belfort Maatschappij voor Algemene Verzekgrigeen* [1962] 2 Lloyds Reports 257 (QB); *Deutsche Schachtbau und Tiefbohr-Gesellschaft M.B.H. v Ras Al Khaimah National Oil* [1990] 1 AC 295 (CA).

[32] Article 3 of the Introductory Law to the Civil Code.

[33] In particular, in contrast with the use of 'rules of law' in Article 1871(1) concerning international arbitrations. See A Bucher, *Droit International Privé Suisse* (Helbing and Lichtenhahn, 1995) 106-7, 133.

[34] *Lauritzen v Larsen* (1953) 345 US 571 (US Supreme Court), 588-9; *Pubali Bank v City National Bank*, 1343 (*Pubali II – 1985*), confirmed in *TMTI v Empressa Nacional de Commercialization*, 953-4 (1987), NS referred to in Korysis (n 24).

[35] E Scoles et al, *Conflict of Laws* (West, 3rd ed, 2000) 875, 861 referring in fn 5 to a number of authorities adopting the Restatement; G Born, *International Civil Litigation in United States Courts* (Kluwer Law International, 1996), 654; P Borches, 'Choice of Law in American Courts in 1992: Observations and Reflections' (1994) 42 *American Journal of Comparative Law* 125, 136 referring to a number of American authorities such as *Tucker v RA Hanson Co., Inc.* (1992) 956 F. 2d 215 (10th Circuit) (New Mexico law); *Baxter International Inc. v Morris* (1992) 976 F. 2d 1189 (8th Circuit) (Missouri law). Also see M Gruson, 'Governing Law Clauses in Commercial Agreements – New York's Approach' (1980) 18 *Columbia Journal of Transnational Law* 323, 324 referring to a number of writings on this subject.

[36] F Juenger, 'The Lex Mercatoria and Private International Law' (2000) 5 *Uniform Law Review* 171, 183; F Juenger, 'Contract Choice of Law in the Americas' (1997) 45 *American Journal of Comparative Law* 195, 203; Boele-Woelki (n 28) 666; P Nygh, 'Reasonable Expectations of Parties in Choice of Law' (1995) 251 *RdC* 268, 308; M Bonell, P Finn, D Robertson, L Nottage, *The UNIDROIT Principles of International Commercial Contracts: What do they mean for*

[footnote continued on the next page]

criticism, it is submitted, is justified. The rationale behind this restrictive judicial approach seems to be that, as noted by the English Court of Appeal in *Halpern v Halpern*,[37] contracts must exist in an adequate legal system enforceable by national courts. In this regard, international law is not considered such a system. The concern is that this may result in excessive legal uncertainty for the contract, compared to the 'alleged certainty and predictability' a national law may offer.[38] However, if it can be established (as has been done elsewhere)[39] that international law indeed has an adequate set of identifiable and enforceable legal rules that govern state contracts, then such concern would disappear and there is no reason why rules of international law cannot be enforced by national courts in the same way as national laws. This is true particularly given that national courts have enforced arbitral awards in which legal rules other than national laws were applied to contracts.[40]

Such criticism was apparently recognised at some point by the drafting committee of *Rome I Regulation* which has now replaced the Rome Convention. In a draft of *Rome I Regulation* issued in December 2005, the provisions of the Rome Convention—which tend against a choice of international law—were amended to become less restrictive. Unlike Article 1(1) of the Rome Convention, Article 1(1) of this draft of *Rome I Regulation* was no longer limited to the choices between 'laws of different countries'. Instead, Article 1(1) of this draft of *Rome I Regulation* provided more generally:

> This Regulation shall apply, in any situation involving a conflict of laws, to contractual obligations in civil and commercial matters.

It seems that this provision could be construed widely to extend to choices of law other than national laws. This is made clear in Article 3(2) of this draft of *Rome I Regulation* as follows:

> The parties may also choose as the applicable law the principles and rules of the substantive law of contract recognised internationally or in the Community.

According to the explanatory memorandum attached to this draft of *Rome I Regulation*,[41] this was to allow the choice of the UNIDROIT Principles of International Commercial Contracts, the Principles of European Contract Law, or a possible future Community instrument. However, the explanatory memorandum also specifically noted that this provision excluded *lex mercatoria*, which was considered to be not precise enough and other private codifications not adequately recognised by the international community. Although a

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Australia?, Working Paper, Sydney Centre for International Law, 2008 available at <http://sydney.edu.au/law/scil/documents/2009/SCILWP7Finalised.pdf>.

[37] *Halpern v Halpern* (n 27) [21-22]. Also see M Bonell et al (n 36).

[38] M Bonell et al (n 36), 5.

[39] Hop Xuan Dang, *International Law as the Governing Law of State Contracts*, DPhil Thesis, University of Oxford, 2008.

[40] *Channel Tunnel Group Ltd. v Balfour Beatty Constructions Ltd* (n 31); *Orion Compania Espanola de Seguros v Belfort Maatschappij voor Algemene Verzekgrigee*n (n 31) *Deutsche Schachtbau v National Oil Company* (n 31).

[41] Ibid 5.

choice of international law was not specifically mentioned, it seems at least arguable that these provisions in this draft of *Rome I Regulation* could be construed to enable a national court to recognise a choice of international law in contracts, particularly given that party autonomy was a key principle of *Rome I Regulation*.[42] At the very least, these changes indicated some positive progress towards recognising the power of national courts to do so.

Unfortunately, in the final draft of *Rome I Regulation* which was eventually adopted by the European Commission in June 2008, the entire paragraph in Article 3(2) of the 2005 draft referring to 'principles and rules of the substantive law of contract recognised internationally' was specifically taken out.[43] Instead, one additional recital was inserted into this *Rome I Regulation* that states:

> This Regulation does not preclude parties from incorporating by reference into their contract a non-State body of law or an international convention.[44]

Little explanation is provided on these changes. However, this is evidently a step back from the progress seen in the 2005 draft of *Rome I Regulation* with respect to the permissibility of a choice of international law in contracts. This has been described as 'regrettable' by some authors.[45] Incorporating, by reference, a non-state body of law into the contract is fundamentally different from making that body of law the governing law of the contract. Incorporation by reference merely means making specific rules terms of the contract while the contract must still be governed by some legal system.[46] For example, the parties may incorporate a convention into the contract such that the terms of that convention become the terms of the contract. However, the contract must still be governed by a legal system, which may or may not uphold or recognise the terms of that convention.[47] Thus, the above recital in *Rome I Regulation* does not constitute a permission for parties to choose international law to govern a contract.

In theory, it may arguably be open to a court to construe *Rome I Regulation* as allowing a choice of international law on the basis that the restriction to the 'laws of different countries' has been removed and the word 'law' in Article 3(1)[48] could be broadly construed to include any system of law, including international law.[49] However, in light of the judicial practice so far and the drafting history of *Rome I Regulation*, it seems unlikely that national courts would be willing to do so. Thus, it appears that national courts will continue not to recognise a choice of international law in contracts at least in the foreseeable future.[50]

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[42] Recital 7 of the draft Regulation; Page 5 of the explanatory memorandum.
[43] The adopted text is available at <http://register.consilium.europa.eu/pdf/en/07/st03/st03691.en07.pdf>.
[44] Recital 13.
[45] M Bonell et al (n 36) 6.
[46] Collins (ed) (n 27) 1571-2.
[47] M Bonell et al (n 36), 6.
[48] This Article provides 'A contract shall be governed by the law chosen by the parties'.
[49] See more on the meaning of the word 'law' in the discussions of the *English Arbitration Act 1996* below.
[50] M Bonell et al (n 36), 6.

B. Arbitral Tribunals

In contrast to national courts, arbitral tribunals in the jurisdictions examined in this article have the power, and in fact the obligation, to give effect to a choice of international law in contracts. Most arbitration rules require arbitral tribunals to apply 'rules of law' as agreed by the parties. As will be explained shortly, the phrase 'rules of law' is meant to encompass international law or other forms of non-national law. For example, Article 17 of the ICC Arbitration Rules states:

> The parties shall be free to agree upon the rules of law to be applied by the arbitral tribunal to the merits of the dispute.

Giving effect to, or in some cases expanding on,[51] arbitration rules, arbitration laws consistently require tribunals to apply the 'rules of law' as agreed by contracting parties. This phrase is universally recognised as wide enough to include international law, consistent with the meaning given to it in the UNCITRAL Model Law on International Commercial Arbitration (adopted in 1985 and amended in 2006) ('Model Law') which contains 'rules of law' and 'law' in contrast with each other in Article 28 as follows:

> (1) The arbitral tribunal shall decide the dispute in accordance with such *rules of law* as are chosen by the parties as applicable to the substance of the dispute.
>
> (2) Failing any designation by the parties, the arbitral shall apply *the law* as determined by the conflict of law rules which it determines applicable. (Emphasis added.)

The difference between 'law' and 'rules of law' as used in the Model Law is explained in paragraph 35 of the Explanatory Note to the Model Law as follows:

> In addition by referring to the choice of 'rules of law' instead of 'law', the Model Law gives the parties a wider range of options as regards the designation of the law applicable to the substance of the dispute in that they may, for example, agree on *rules of law that have been elaborated by an international forum but have not yet been incorporated into any national legal system*. The power of the arbitral tribunal, on the other hand, follows more traditional lines. When the parties have not designated the applicable law, the arbitral tribunal shall apply *the law i.e the national law* determined by the conflict of law rules which it considers applicable (emphasis added).[52]

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[51] Article 34.1 of *The 2005 Rules of the Australian Centre for International Commercial Arbitration* only refers to a choice of 'law' by the parties. It has been said that even if this only refers to national law, it is expanded by the Model Law, which applies in Australia, to enable the parties to choose non-national law. See S Greenberg et al, *The 2005 Rules of the Australian Centre for International Commercial Arbitration – Revisited*, Legal Studies Research Paper No. 09/101, September 2009, available at <http://ssrn.com/abstract=1479348>.

[52] This essentially repeats the Report of the Working Group on International Contract Practices on the Work of Its Sixth Session in I Kavass and A Liivak, *UNCITRAL – Legislative History Documents of the Model Law of International Commercial Arbitration* (Institute for Legal Information, New York 1985), 26–0–1, 26–0–21 where the choice in Article 28(1) between 'rules of law' and 'law' was considered. For more information, see A Broches, *Commentary on*

[footnote continued on the next page]

The Model Law has been adopted in over 50 jurisdictions.[53] Many non-Model Law jurisdictions have also adopted the wording of the Model Law on this issue. For example, Article 1496 of the French Code of Civil Procedure ('CCP') and Article 187(1) of the Swiss FSPIL, both authorise arbitrators to make decisions according to 'rules of law' chosen by the parties. In addition, the rules of leading international arbitration centres similarly require tribunals to apply the 'rules of law' as chosen by the parties.[54] ICSID tribunals are also required to apply the 'rules of law' as agreed by the parties.[55] That this phrase includes rules of international law has been recognised in a number of ICSID cases.[56] In the US, the Inter-American Arbitration Commission Rules of Procedure, adopted by the *Federal Arbitration Act 1925*, also give the parties complete freedom concerning choices of law.

However, the use of the phrase 'rules of law' in an arbitration law is not necessarily essential to enable arbitral tribunals to apply international law. It seems that arbitral tribunals may also apply international law even where the arbitration law in that jurisdiction only refers to 'law', rather than 'rules of law'. An example is the *English Arbitration Act 1996*, Section 46 of which provides:

> (1) The arbitral tribunal shall decide the dispute:
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> (a) in accordance with the law chosen by the parties as applicable to the substance of the dispute; or
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> (b) if the parties so agree, in accordance with such other considerations as are agreed by them or determined by the tribunal (emphasis added).

A number of commentators have stated that a choice of international law is not allowed under Section 46(1)(a) because it is not a choice of 'law'.[57] This narrow construction of the word 'law' was apparently borrowed from the context of Article 28 of the Model Law where, as explained above, 'law' only means domestic law. On the other hand, some of these

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the UNCITRAL Model Law on International Commercial Arbitration (Kluwer Law and Taxation Publishers, Deventer 1990), 141-9; H Holtzmann and J Neuhaus, *A Guide to the UNCITRAL Model Law on International Commercial Arbitration: Legislative History and Commentary* (Kluwer Law and Taxation, 1989), 764-807.

[53] <http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/1985Model_arbitration_status.html>.

[54] The Arbitration Rules of the ICC (Article 17(1)), the LCIA (Article 22(3)) and German Institution of Arbitration (DIS) (Section 23).

[55] Article 42(1) of the International Centre for Settlement of Investment Disputes (ICSID) Convention. For more detailed comments, see C Schreuer, *The ICSID Convention: A Commentary* (Cambridge University Press, 2001) 558-66.

[56] *AGIP Spa v The People's Republic of Congo* (1979) 1 ICSID Reports 306; *Kaiser Bauxite v Jamaica* (1975) 1 ICSID Reports, 296.

[57] L Collins (ed), *Dicey and Morris on the Conflict of Laws* (Sweet and Maxwell, 13th ed, 2000) 606; S Shackleton, 'The Applicable Law in International Arbitration under the new English Arbitration Act 1996' (1997) 13 *Arbitration International* 375; J Mustill and S Boyd, *Commercial Arbitration* (Butterworths, 2001) 50, 124, 328; S Sutton and J Gill, *Russell on Arbitration* (Sweet and Maxwell, 22nd ed, 2003) 66.

commentators suggest that a choice of international is permitted under the *English Arbitration Act 1996* but under the cover of 'other considerations' in Section 46(1)(b).[58]

Without disputing the permissibility of a choice of international law under Article 46 of the *English Arbitration Act*, it is submitted that the above reasoning, based on a narrow construction of the word 'law', does not seem convincing. It is necessary to discuss the interpretation of the word 'law' in this context because it has implications on the power of a tribunal to apply international law in the absence of a choice by the parties, which will be discussed later.

First, the phrase 'other considerations' in Section 46(1)(b) is definitely not meant to include a choice of international law. The Report of the Departmental Advisory Committee responsible for drafting the *English Arbitration Act 1996* (the 'DAC Report')[59] made it clear that this phrase was used to replace the Latin phrases used in the Model Law to describe general notions of fairness and justice such as '*ex aequo et bono*' and '*amiable composition*', often referred to as 'equity clauses'. The DAC Report also stated that in such a case, the parties could not appeal to a Court because there would be no 'question of law'.[60] It is clear from the case law and literature[61] that equity clauses are not meant to cover legal principles. Therefore, the phrase 'other considerations' in Article 46(1)(b) was clearly meant to refer to non-legal concepts such as general justice and fairness and therefore could not include international law. To put international law under this heading would be to stretch the natural meaning of these words.[62]

Secondly, there is no reason to assume that the word 'law' used in the *English Arbitration Act 1996* was intended to refer to only domestic systems as in the Model Law. While the nuance was intended in the Model Law (where both 'rules of law' and 'law' are used in contrast), there is no evidence that that was also meant in the *English Arbitration Act* (where only 'law' is used). The DAC Report makes no specific reference to this issue. In fact, the Report said that the *English Arbitration Act* 'reflects much, though not all, of the Model Law' on this issue.[63] It then refers to only two deviations from the Model Law. First, it does not allow arbitrators to take into account trade usages. Secondly, it avoids the Latin expressions of *ex aequo et bono* and *amiable composition* and uses in their stead 'other considerations'. If the subtle meaning of 'law', as opposed to 'rules of law', had been intended, it would be difficult to imagine why such an important point was not highlighted in the DAC Report. Unlike the

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[58] Collins (ed), *Dicey and Morris on the Conflict of Laws* (n 57) 606; Mustill and Boyd (n 57) 50, 124.

[59] DAC, 'DAC Report on the draft English Arbitration Act' (1997) 13 *Arbitration International* 275.

[60] Ibid 310.

[61] See *Czarnikow v Roth, Schmidt* [1922] 2 KB 478 (KB); *Overseas Union Insurance Ltd v AA Mutual International Insurance Co. Ltd.* [1988] 2 Lloyd's Reports 63 (QB); S Boyd, 'Arbitrator not to be bound by the Law' Clauses' (1990) 6 *Arbitration International* 122.

[62] The Court of Appeal in *Occidental v Ecuador [No 1]* (2006) QB 432 (CA) also mentioned that the 'other considerations' in Section 46(1) (b) only referred to 'non-legal' considerations.

[63] Some authors are of the same view. See Sutton and Gill 619 where it is said the *English Arbitration Act* is similar to Article 28 of the Model Law in this respect; also see M Rutherford and J Sims, *Arbitration Act 1996: a Practical Guide* (FT Law and Tax, 1996) 157.

Rome Convention which expressly limits choices of law to 'laws of different countries',[64] the *English Arbitration Act* contains no such explicit limitation. Had the legislature wished to limit the scope of 'law' only to domestic systems, it could have easily done so by express words. Indeed, the English Court of Appeal in *Occidental v Ecuador (No.1)* in 2006 recognised, without any detailed discussion, that the term 'law' in Section 46 is wide enough to encompass international law. This case involved the question whether English courts had jurisdiction to hear, under section 67 of the *English Arbitration Act 1996*, an application to set aside an arbitral award rendered by a tribunal constituted under the BIT between the US and Ecuador. In discussing what law governed the arbitration agreement between the investor in the case and the Ecuadorian Government, the Court of Appeal stated:

> It is common ground that English private international law recognises an agreement to arbitrate substantive issues such as the present according to international law … and it is also clear that the present is such. (The words 'in accordance with the law' in section 46(1)(a) and 'the law determined by the conflict of laws rules which it considers applicable' in section 46(3) of the Arbitration Act 1996 are capable of having this broad meaning, and section 46(1)(b) now adds further to the flexibility of arbitration, by permitting an agreement to arbitrate issues in accordance with other, non-legal considerations).[65]

Thirdly, the fact that the *English Arbitration Act 1996* was designed to maximise party autonomy[66] supports a broad construction of the word 'law'. In particular, Section 46 concerning choice of law is a non-mandatory section, which means that it only provides a default position and the parties are free to agree otherwise. The intent of the Act therefore must be to place no limit on the freedom of the parties concerning choice of law. In light of this policy, it is submitted that Section 46 should be construed broadly and the term 'law' should be construed to mean any rules of law, whether domestic or international. This submission is indeed consistent with the latest academic view on this issue expressed in the most recent edition of Dicey, Morris and Collins on the *Conflict of Laws*. Unlike the previous edition,[67] this new edition states that the term 'law' in Section 46(1)(a) includes both a national system and public international law.[68]

In practice, there have been cases where arbitral tribunals gave effect to a choice of international law by contracting parties, as they were required to do.[69] Such arbitral practice has been well received by national courts.[70] Notwithstanding courts do not give effect to a choice of non-national law themselves, they seem willing to enforce arbitral awards

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[64] Article 1(1).
[65] *Occidental v Ecuador* [No 1] (n 62) 458.
[66] Section 1(b).
[67] Collins (ed), *Dicey and Morris on the Conflict of Laws* (n 57) 606.
[68] Collins (ed), *Dicey, Morris and Collins on The Conflict of Laws* (n 27) 731.
[69] AGIP Spa v The People's Republic of Congo (n 51); also see Schwebel (n 7).
[70] For a discussion of the positive judicial attitude in different jurisdictions see D Rivkin, 'Enforceability of Arbitral Awards Based on Lex Mercatoria' (1993) 9 *Arbitration International* 67.

upholding choices of non-national rules, including international law. Megaw J stated the following in as early as 1962:[71]

> Thus, it may be, though perhaps it would be unusual, that the parties could validly agree that a part, or the whole, of their legal relations should be decided by the arbitral tribunal on the basis of a foreign system of law, or perhaps on the basis of principles of international law; for example, in a contract to which a Sovereign State was a party. It may well be that the arbitral tribunal could properly give effect to such an agreement, *and the Court in its supervisory jurisdiction would also give effect to it*, just as it would give effect to a contractual provision in the body of the contract that the proper law of the contract should be some system of foreign law. Indeed, it might be another way of achieving the same result, and I see no reason why an arbitral tribunal in England should not, in a proper case, where the parties have so agreed, apply foreign law or international law [emphasis added].

In a more recent case, *Deutsche Schachtbau und Tiefbohr-Gesellschaft MBH. v Ras Al Khaimah National Oil Company* (1990)[72] the English Court of Appeal—in deciding whether an arbitral award rendered in a Swiss arbitration under ICC Rules should be enforced—upheld the application by the arbitrators of 'internationally accepted principles of law governing contractual relations' as chosen by the parties. In *Channel Tunnel Group Ltd v Balfour Beatty Constructions Ltd* in 1993,[73] a reference to 'general principles of international trade law' in the governing law clause in the contract, although not the subject of the litigation, did not appear objectionable to the English House of Lords. French courts have also, on numerous occasions, refused to set aside arbitral awards that upheld the choice of *lex mercatoria*.[74]

In summary, the combination of arbitral rules and arbitration laws as mentioned above means that where the parties have chosen international law to govern their contracts, such a choice will be given effect to by arbitral tribunals under applicable arbitration laws and arbitration rules. In other words, the choice of international law is permissible before arbitral tribunals. This is a contrast to the position of national courts, where a choice of international law is not given effect in contracts.

3. Choice of a National Law

Where the parties choose a national law to govern their contract, courts and arbitral tribunals will apply that law to the contract, except for special circumstances such as where the choice

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[71] *Orion Compania Espanola de Seguros v Belfort Maatschappij voor Algemene Verzekgrigeen* (n 31) 264; Also see in *Dallal v Bank Melat* [1986] QB 441 (QB) 456 where the court held that public international law could not apply to a contract between two private parties and left open the issue whether it could apply to a state contract.

[72] *Deutsche Schachtbau v National Oil Company* (n 30).

[73] *Channel Tunnel Group Ltd. v Balfour Beatty Constructions Ltd* (n 31).

[74] See *Compania Valenciana de Cementos Portland SA v Primary Coal* (1992) *Revue de l'Arbitrage* 457 (Cour de Cassation) and *Norsolor v Pabalk* (1983) YCA 362 (Court d'Appel, Paris); *Fougerolle v Banque de Proche Orient* (1982) *Revue de l'Arbitrage* 183 (Court de Cassation) (although in these cases, there was no choice of law by the parties and the arbitrators themselves selected *lex mercatoria* as the applicable law).

is illegal or not *bona fide*.[75] This is made clear in the choice of law rules applicable in courts and tribunals considered in this article and needs no more explanations.[76] This also means that where the parties have chosen only a national law, courts and tribunals must apply that law alone to the contract and there is no place for international law. The application of any law other than the chosen one is beyond the power of courts and tribunals (except for special cases such as where the chosen system is silent on an issue or refers an issue to a different system of law, etc).

However, for state contracts, that is not the end of the matter. In fact, this is where the real controversy starts concerning the applicability of international law. A number of writers and tribunals have advocated the view that international law applies to a state contract even where the parties have chosen only a national law to govern it. In this context, the *Sandline* arbitration award[77] is a useful example to consider because it refers to all the reasons often cited for the suggestion that international law governs a state contract even where the parties have chosen only a national law.

This arbitration took place in Queensland, Australia[78] and related to a contract for military services between the Government of Papua New Guinea and Sandline, a foreign corporation. Sandline brought the arbitration to recover USD$18 million, allegedly due to it under the contract. In defence, PNG argued that the contract was unenforceable under English law, the chosen governing law of the contract, because it is illegal under the law of PNG, the place of performance. In the event, notwithstanding the parties had chosen English law to govern the contract, the tribunal held that international law was applicable. On that basis, it upheld the contractual claim of Sandline and awarded it the US $18 million sought plus interest.

Without discussing the merit of this decision, this article will now focus on whether the tribunal was correct in holding that international law was applicable to this contract. On this issue, the tribunal held as follows:

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[75] *Vita Food Products Inc. v Unus Shipping Co. Ltd* (n 30). For a general discussion of the autonomy of the parties in international transactions to choose the governing law, see A Redfern and M Hunter, *Law and Practice of International Commercial Arbitration* (Sweet and Maxwell, 4th ed, 2004) 94-7; J Lew, *Applicable Law in International Commercial Arbitration* (Oceana Publication, 1978) 75; or specifically in relation to state contracts, see E Paasivirta, *Participation of States in International Contracts and Arbitral Settlement of Disputes* (Lakimiesliiton Kustannus, 1990) 55-76.

[76] Article 3(1) of the Rome Convention and *Rome I Regulation*, Article 27(1) of the German Introductory Code to the Civil Code, Article 116(1) of the Swiss FSPIL. For American courts, see *Lauritzen v Larsen* (n 34) 588-9; *Odin Shipping Ltd. v Norlandsbanken Asa* US App Lexis 11098 (9th Circuit) and Section 187 of the Second Restatement. For arbitral tribunals, see Section 1051 of the German CCP, Article 187(1) of the Swiss FSPIL, Article 1496 of the French CCP, Section 46(1) (a) of the *English Arbitration Act 1996*, Article 33 of the Inter-American Commercial Arbitration Commission Rules of Procedure, given effect to by the *US Federal Arbitration Act 1925* and Article 42(1) of the ICSID Convention.

[77] *Sandline International Inc. v The Independent State of Papua New Guinea* (1998) 117 ILR 552.

[78] Australia, being a Model Law jurisdiction, has arbitration law that is, insofar as relevant, similar to the laws of the jurisdictions discussed in this article.

> But where a contract is concluded by a State, one enters the realm of public international law...
>
> The rules of international law in this case are clearly established and their application causes no difficulty. PNG submits that they have no application because the agreement between it and Sandline, a foreign citizen, does not attract international law. However, it is incontrovertible that PNG is an independent state and purported to contract in that capacity. An agreement between a foreign citizen and a state is an international contract, not a domestic contract. This Tribunal is an international, not a domestic, arbitral tribunal and is bound to apply the rules of international law. Those rules are not excluded from, but form part of, English law, which is the law chosen by the parties to govern their contract.[79]

The claim by Sandline in this case was clearly a contractual one—i.e. recovering a contractual debt. The tribunal discussed the application of international law—'for the purpose of determining the validity of a contract' and then held that the contract in the case 'was not illegal or unlawful under international law'.[80] Therefore, it seems clear that the tribunal applied international law in this case as the governing law of the contract. The tribunal gave three reasons for the applicability of international law to the contract in this case. First, as this is an international contract concluded with a state, international law is inherently applicable. Secondly, since the tribunal is an international tribunal, it is bound to apply rules of international law. Thirdly, rules of international law are applicable because they form part of English law as chosen by the parties. We will now examine whether these reasons are correct.

A. *Is a State Contract Inherently Subject to International Law?*

This view, as put forward by the tribunal, is not new. The theory that state contracts, also known as long-term economic development agreements, should by their nature be subject to international law, regardless of the will of the parties, was put forward as early as the 1950s[81] and in the 1960s by authors such as Jennings and Hyde.[82] Dupuy, the arbitrator in the *Texaco* arbitration in 1978, adopted the same view.[83] More recently, authors such as Weil[84] have also said that state contracts, being international in nature, naturally attract the application of international law. Weil stated the following:

> ... the investment contract has its roots, its Grundlegung, directly in the international legal order. It was not ... an internationalised contract solely by virtue of the will of

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[79] *Sandline* (n 77) 560.
[80] Ibid 563.
[81] T Huang, 'Some International and Legal Aspects of the Suez Canal Question' (1957) 51 *American Journal of International Law* 277-95, 285.
[82] Jennings (n 4); J Hyde, 'Economic Development Agreements' (1962) 105 *RdC* 271.
[83] *Texaco Overseas Petroleum Company v Libyan Arab Republic* (1978) 53 ILR 389, 455-6.
[84] Weil (n 8).

> the parties or the domestic legal order; it was by its very nature an international contract, that is to say, an international legal act. This assessment was based on economic and political realities. Whether the application of international law is based on the will of the parties or the constitutional system of the host state, or whether one considers it to be a reflection of reality, the actual outcome is the same: the legal relationship arising out of an investment and the law governing the relationship are matters within the international legal order.[85]

This view has been strongly criticised on the ground that there is nothing special about a state contract that warrants the application of international law where the parties have specified a different choice of law. Party autonomy should be respected in these cases.[86] Such criticism, it is submitted, is justified. Even if there is any merit, as a matter of policy, in applying international law to state contracts, this is not legally permissible where the parties have chosen only a national law. In that case, as discussed above, the tribunal is required by relevant laws and choice of law rules to apply the chosen law and nothing else. It simply does not have the power to apply international law. No arbitration laws or arbitration rules confer on arbitral tribunals any more power in case of state contracts than in other contract cases. The application of international law in this context would involve a tribunal purporting to exercise a power which it was not given in the first place. It is well known that the powers of an arbitral tribunal only derive from the parties and the legal rules that bind them.[87] The parties, by having chosen only a national law, have not given the tribunal the power to apply international law. As said above, no arbitration legislation or any arbitration rules give a tribunal this power. Therefore, there is simply no legal basis for a tribunal to apply international law in this case. To do otherwise would constitute an excess of power which may form a ground for seeking the annulment of the award.[88]

B. Does an International Arbitral Tribunal Possess an Inherent Jurisdiction to Apply International Law?

The second reason the *Sandline* tribunal gave was that, due to being an international tribunal, it has an inherent jurisdiction to apply international law, regardless of the will of the parties. Regrettably, it did not cite any legal basis to support this. It also did not explain what it meant by an 'international' tribunal. Presumably, it referred to a tribunal arbitrating an international dispute involving parties or matters from different states, as happened in this case.

The view of the tribunal seems to derive from a related theory that a reference to international arbitration in a state contract has the effect of internationalising the contract and hence making international law applicable to the contract.[89] This theory, having been widely

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[85] Ibid 406.
[86] O Chukwumerije, *Choice of Law in International Commercial Arbitration*, 158; G Delaume, 'State Contracts and Transnational Arbitration' (1981) 75 *American Journal of International Law* 784-819; Toope (n 15) 83.
[87] Redfern and Hunter (n 75) 233.
[88] For example, under Article 52 of the ICSID Convention.
[89] *Texaco* (n 83) 454-5.

dismissed by authors in this field, has lost its force.[90] From this angle alone, this view of the *Sandline* tribunal seems to be without foundation.

But more importantly, from the perspective of the power of a tribunal, being an international tribunal *per se* is not the source of any power it may have. As said above, the powers of an arbitral tribunal derive from the will of the parties and the legal rules that govern its operations. On that basis, it could be said that the *Sandline* tribunal has the power to apply English law to the contract because (i) the parties so agreed in the contract and (ii) both the arbitration legislation of Australia,[91] the *lex arbitri*, and the UNCITRAL arbitration rules which govern the conduct of the tribunal,[92] empower the tribunal to give effect to this choice of law by the parties. No authority exists under Australian law to give the tribunal any additional power to apply international law. The same position obtains in the jurisdictions examined in this article. Being an international tribunal resolving an international dispute *per se* does not enable the tribunal to apply international law. Indeed, the legal rules on this issue are identical for both domestic and international tribunals in all jurisdictions: they are required to apply the law chosen by the parties, no more, no less. This conclusion would have the agreement of Lord Mustill who made the following statement when discussing the application of *lex mercatoria* to an international contract:

> ... the bluntest question which the client may pose is this: If the contract expressly stipulates a choice of governing law, and if the arbitrator is not an *amiable compositeur*, can the arbitrator properly apply the *lex mercatoria* in preference to the chosen law? The answer must surely be an equally blunt no. The arbitrator is mandated to decide the dispute in accordance with the contract; and the contract includes an agreement to abide by the denominated law. An arbitrator who decides according to some other law, whether a national or otherwise, presumes to rewrite the bargain. He has no right to do this. However good his motives, he does a disservice to the parties and to the institution of international arbitration.[93]

C. Is International Law Applicable because it Forms Part of English Law?

This proposition, advanced by the *Sandline* tribunal, stems from two established premises. First, it is accepted that where the parties have chosen a national law and that national law incorporates into it rules of international law, then the tribunal may apply international law as part of the law of the land.[94] Secondly, it is also accepted that customary international law forms part of the common law of England and English courts would apply it as part of

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[90] Greenwood (n 2) 51; Chukwumerije (n 86); Grigera-Naon (n 12) 132; A Fatouros, 'International Law and the Internationalised Contract' (1980) 74 *American Journal of International Law* 134, 136.

[91] The *International Arbitration Act 1974* of Australia adopts the UNCITRAL Model Law on International Commercial Arbitration, which provides in Article 28 that a choice of law by the parties shall be given effect to.

[92] Article 33 of the UNCITRAL Arbitration Rules.

[93] J Mustill, 'The New Lex Mercatoria: The First Twenty Five Years' in M Bos and I Brownlie (eds) *Liber Amicorum for Lord Wilberforce* (Clarendon Press, 1987) 167-8.

[94] A Broches, 'The Convention on the Settlement of Investment Disputes Between States and Nationals of Other States' (1972 - II) 136 *RdC* 331, 389; *Wena Hotels Ltd. v Egypt* (2002) 41 ILM 933.

English law.[95] This is known as the doctrine of incorporation in English courts.[96] It was on the basis of these two premises that the *Sandline* tribunal held that rules of international law were applicable to the contract in this case because the parties had chosen English law which incorporated rules of international law into it.

However, it is submitted that in combining these two premises, the tribunal overlooked one important link. While rules of customary international law form part of the common law of England and English courts should give effect to them, this is only relevant for issues which call for the application of international law. If it is an issue for which rules of international law are not applicable, this proposition is entirely irrelevant. Therefore, before applying international law as part of English law, an English court must be satisfied that international law is the applicable law for the issue concerned. The most recent authorities in which English courts have applied international law in this way have all involved issues for which international law is clearly applicable. For example, in the *International Tin Council* litigation,[97] issues arose in relation to the legal status and liability of the International Tin Council, an international organisation which was created by a treaty. As this was an organisation on the international plane, in order to examine its status, according to Kerr LJ in the Court of Appeal, 'the logical starting point must lie in international law'.[98] Nourse LJ also agreed.[99] In the *Pinochet* cases,[100] one of the questions was whether the applicant was entitled to immunity at common law from criminal prosecution as a former head of state. As this was an issue to which rules of customary international law were directly relevant, the House of Lords considered the position under customary international law as part of the common law of England.

Therefore, before applying international law as part of English law, it is necessary to ask whether international law is applicable to the issue at hand. This has been pointed out by authors such as Brownlie when he stated:

> It would seem that the courts must first make a choice of law depending on the nature of the subject-matter. Where it is appropriate to apply international law, rather than the law of the forum or a foreign law, then the courts will take judicial notice of the applicable rules... [101]

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[95] Brownlie, *Principles of Public International Law* (n 10) 41; M Shaw, *International Law* (Cambridge University Press, 5th ed, 2003) 128-35.

[96] *Trendtex Trading Corporation v Central Bank of Nigeria* [1977] 2 WLR 356 (CA), see in particular judgment of Lord Denning at 365; *Maclaine Watson v Department of Trade and Industry* [1989] 3 All ER 523 (HL); *R v Bow Street Metropolitan Stipendiary Magistrate, Ex parte Pinochet Ugarte* [2000] 1 AC 61 (HL); *Al-Adsani v Government of Kuwait* 103 ILR 420 (QB); *Al-Adsani v Government of Kuwait* 107 ILR 536 (QB); *R v Jones (Margaret)* [2007] 1 AC 136 (HL).

[97] *Maclaine Watson v Department of Trade and Industry* [1988] 3 WLR 1035 (CA).

[98] Ibid 1056.

[99] Ibid 1114-5.

[100] *R v Bow Street Metropolitan Stipendiary Magistrate, Ex parte Pinochet Ugarte* (n 96) 90, 110.

[101] Brownlie, *Principles of Public International Law* (n 10) 41.

Similarly, Shaw, in stating that international law forms part of English law, quoted the following statement by Blackstone:

> [t]he law of nations, *wherever any question arises which is properly the object of its jurisdiction*, is here adopted in its full extent by the common law, and it is held to be a part of the law of the land (emphasis added).[102]

Hence, in *Sandline*, the tribunal should have first sought to determine whether, as a matter of English law, rules of international law were applicable to the contractual issues in the case. If the tribunal had done that, it would have become evident that under English law, state contracts are subject to normal rules of private contract law. In the cases before English courts involving state contracts, normal rules of private law have been applied. For example, the case of *Marubeni v Mongolia*[103] in 2004, involved the issue of whether a contract, governed by English law, was binding on the Mongolian Government notwithstanding the Minister who signed it acted *ultra vires*. To determine this question, the English High Court applied rules of private agency law on apparent authority 'in the normal way'[104] and held that because the Minister had apparent authority to sign the contract, the contract was binding upon Mongolia. In 1979, in *Toprak v Finagrain*,[105] the English Court of Appeal faced the issue of whether a contract between a Swiss party and a Turkish state enterprise was unenforceable under English law because it would have been considered illegal in Turkey due to the absence of necessary licences. The court examined this question under the rules of private law on illegal contracts in *Ralli Bros*[106] and *Foster v Driscoll*[107] but held that the facts of the case fell outside those rules and the contract was therefore enforceable. Therefore, as noted by a commentator, there is no body of 'government contract law' separate from the general law of contract and state contracts—better known in English law as government contracts—they are simply subject to ordinary rules of English private contract law.[108] This is consistent with commentary provided by legal practitioners in Australia on the *Sandline* case as follows:

> The authorities, both international and in the United Kingdom, do not lead to the result that the contract between PNG and Sandline is to be judged by international law. On the other hand, the majority of cases support the view that where a question arises that is clearly within the province of international law, and that question can be answered only by reference to international law, the common law will incorporate

[102] Shaw (n 95) 129.
[103] *Marubeni and South China Ltd. v Government of Mongolia* [2004] 2 Lloyd's Reports 198 (QB).
[104] Ibid 216 (quote from F Reynolds, *Bowstead and Reynolds on Agency* (Sweet and Maxwell, 18th ed, 2006).
[105] *Toprak Mahsulleri Ofisi v Finagrain Compagnie Commerciale Agricole et Financiere SA* (1979) 2 Lloyd's Law Reports 98 (CA).
[106] *Ralli Bros v Compania Naviera Sota y Aznar* [1920] 2 KB 287 (CA).
[107] *Foster v Driscoll* (1929) 1 KB 470 (CA).
[108] C Turpin, *Government Procurement and Contracts* (Longman, 1989) 97-8. Also see Reynolds (n 99) 325.

> international law in so far as it is a clear rule of international law and one that can be incorporated without adaptation.[109]

For those reasons, it was unsound for the tribunal in *Sandline* to apply international law to the contract on the ground that international law forms part of English law. The authorities cited by the tribunal in support of this point do not support it at all. These cases include the *LETCO, SOABI* arbitrations[110] and the *Amoco* case.[111] The first two cases are ICSID cases where the application of international law is authorised by Article 42 of the ICSID Convention in the absence of a choice of law by the parties (as explained below). The *Amoco* case is a decision of the IUSCT which is authorised to apply international law under the Algiers Accords establishing it. Thus, the application of international law in those cases was based on the words of the treaties setting up the tribunals and not on the ground that international law forms part of English law.

Thus, none of the grounds advanced by the *Sandline* tribunal for applying international law to the contract seems justified. After all, this conclusion is hardly surprising. Party autonomy is a key principle in international arbitration. Choices of law are no exception. Hence, the short summary of the discussions above is that where the parties have chosen only a national law, there is generally no place for the application of international law to the contract.

D. Iran US Claims Tribunal ('IUSCT')

Finally, it is necessary to mention an exception to the rule discussed above. This is the case of the IUSCT which is based in The Hague and was set up under the 1981 Algiers Accords to resolve claims by the US Government or US parties against the Republic of Iran or Iranian parties following the hostage crisis between the two countries in 1979.[112] Concerning the law to be applied by the Tribunal to resolve disputes, Article 5 of the Algiers Accords provides:

> The Tribunal shall decide all cases on the basis of respect for law, applying such choice of law rules and principles of commercial and international law as the Tribunal determines to be applicable, taking into account relevant usages of the trade, contract provisions and changed circumstances.

This is then replicated in the arbitration rules of the Tribunal.

As can be seen, the above provision does not require the Tribunal to respect strictly the choice of law made by the parties, as in the case of other tribunals discussed so far. Instead, it

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[109] Corrs Chambers Westgarth, *Australia, the Sandline Affair Illegality and International Law*, available at <http://www.mondaq.com/australia/article.asp?articleid=12836>.

[110] *LETCO v Liberia*; *Societe Ouest Africaine des Betons Industriels (SOABI) v State of Senegal* (1988) 2 ICSID Reports 190.

[111] *Amoco International Finance Corporation v Iran* (1987) 15 IUSCTR 189.

[112] To read generally on the Iran US Claims Tribunal, see G Aldrich; C Brower and J Brueschke, *The Iran US Claims Tribunal* (Nijhoff Publishers, 1998). On the issue of applicable law, see J Westberg, *International Transactions and Claims Involving Government Parties – Case Law of the Iran US Claims Tribunal* (International Law Institute, 1991) 65-73.

authorises the Tribunal to apply any rule of law it deems appropriate amongst a combination of choice of law rules, principles of commercial law and international law as well as trade usages, contract provisions and changed circumstances. The discretion of the Tribunal is therefore significantly broad. This is why the Tribunal even has the power to disregard a choice of law in the contract and instead apply rules of international law if it considers that more appropriate. The two following examples will demonstrate this. First, in *CMI International Inc v Iran*,[113] while the contract expressly provided that it was governed by the law of State of Idaho, USA, the Tribunal held that in respect of the damages issue, the application of general principles of law, as part of international law, would be more appropriate than the law of Idaho. In this case, the claimant sued the respondent for failing to buy certain equipment that had been ordered. However, upon reselling part of the equipment, the claimant in fact made a profit above the price in the contract with the respondent. The claimant sought to recover damages from the respondent for the expenses incurred in re-selling. In doing so, it relied on the law of Idaho, the law of the contract, to refuse to take into account the profits it made on the re-sale. The tribunal declined to apply the law of Idaho and held that in its 'search for justice and equity', on the basis of the freedom it had under Article 5 of the Algiers Accords, it should not be 'rigidly tied to the law of contract'.[114] In the event, the tribunal applied general principles of law to take into account such profits in calculating the damages payable to the claimant. Similarly, in the second example, *Housing and Urban Services International Inc v Iran*,[115] the issue was whether the claimant, a partner in a partnership, was able to bring a claim on his own to enforce a right of the partnership. As the answer was negative under Iranian law, the governing law of the relevant contract, the Tribunal applied international law and held that the claimant, as a partner, could bring the action without the consent of other partners in the partnership.[116]

One may observe that such practice by the IUSCT is inconsistent with Dutch arbitration law, the *lex arbitri*. As the Tribunal is physically located in The Hague, it has been said that the Tribunal has its seat in the Netherlands.[117] Article 1054(2) of the *Dutch Arbitration Act 1986* provides, like many other arbitration laws, that a tribunal shall apply the law chosen by the parties. Therefore, one may argue that such practice by the tribunal of applying international law—where the contracting parties choose only a national law—violates the *lex arbitri* and makes the enforceability of its awards questionable. In fact, an English court has commented in *Dallal v Bank Melat* that the entire arbitration process before the IUSCT may be considered invalid because there was no written arbitration agreement signed by the contracting parties as required by Dutch arbitration law.[118] As technically correct as they might be, such

[113] *CMI International Inc. v Iran* (1983) 4 IUSCTR 263.
[114] Ibid 267-8. Also see the comments in Aldrich (n 112) 160.
[115] *Housing and Urban Services International Inc. v Iran* (1985) 9 IUSCTR 313.
[116] Ibid 330.
[117] Schwebel (n 7); D Caron, 'The Nature of the Iran – United States Claims Tribunal and the Evolving Structure of International Dispute Resolution' (1980) 84 *American Journal of International Law* 104, 146.
[118] *Dallal v Bank Melat* (n 71) 455.

arguments are unlikely to be upheld in practice. As the Court held in *Dallal v Bank Melat*, decisions of the IUSCT should be recognised and enforced because its competence derives from international law and practice. As the jurisdiction of the IUSCT was recognised by the US and Iran, the two countries to the relevant treaty, there was no reason why English courts should not give effect to the decisions of the Tribunal. In practice, awards of the IUSCT have consistently been recognised and enforced by the parties as well as by the courts.[119] Therefore, the application of international law by the Tribunal, notwithstanding a different choice of law by the parties, seems to be an accepted practice. However, this should be seen as an exceptional case due to the special wording of the treaty which established the Tribunal.[120]

4. No Choice of Law

Where the parties have not made a choice of law, it is left to the court or the tribunal hearing the dispute, to determine the law that is applicable. The question here is whether international law may be applied to the contract.

A. National Courts

In all the jurisdictions examined being England, France, Germany, Switzerland and the United States, where the parties have not agreed on the applicable law, national courts are required to identify the legal system most closely connected with the contract.[121] This is limited to domestic legal systems, not international law.[122] In the case of state contracts, this normally results in the application of the law of the host State where the contract is performed, given the substantial connection between the contract and that state.[123] No legislative changes are expected to happen in this area. *Rome I Regulation,* which replaced the Rome Convention from December 2009, does not contain any changes relevant to this issue.

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[119] *Ministry of Defense v Gould, Inc.* (1989) 887 F. 2d 1357 (9th Circuit); *Dallal v Bank Melat* (n 71).

[120] Schwebel (n 7).

[121] Article 4 of the Rome Convention; Article 117(1) of the Swiss FSPIL; Article 28(1) of the Introductory Code to the German CCP; In the US see *Downs v American Mut. Liability Ins. Co.* (1964) 251 N Y S 2d 19. This approach is reflected in Section 188 of the Second Restatement which has been adopted in most US states: see S Symeonides, 'Choice of Law in American Courts in 1994' (1995) 43 *American Journal of Comparative Law* 1, 3.

[122] Article 4 of the *Rome Convention* and Article 28(1) of the *Introductory Code to the German CCP*—refer to the choice of the 'law of the country'; Article 117(1) of the Swiss FSPIL and Section 188 of the Second Restatement (Contracts) refers to the choice of the 'law of a state'.

[123] Grigera-Naon (n 12) 114; Chukwumerije (n 86) 144; J Lalive, 'Contracts between a State or Stage Agency and a Foreign Company' (1964) 13 *International and Comparative Law Quarterly* 987, 993; Article 42 of the ICSID Convention; *Revere Copper and Brass v. Overseas Private Investment Corporation* (1978) 56 ILR 258; *Government of Kuwait v American Independent Oil Co.* (1982) 66 ILR 518; *Sapphire International Petroleum Ltd. v National Iranian Oil Company* (1963) 35 ILR 136.

B. Arbitral Tribunals

Once again, the arbitral position bears a stark contrast to that in the courts. Where the parties have not agreed on a choice of law, with the exception of Germany where arbitral tribunals must apply the national law of the country most closely connected with the case,[124] all arbitration laws and arbitration rules consistently give tribunals the discretion to apply any 'rules of law' they consider appropriate which, as mentioned earlier, include international law. For example, Article 1496 of the French CCP provides:

> The arbitrator shall decide the dispute in accordance with the rules of the law chosen by the parties or, in the absence of such choice, in accordance with the rules of law he considers appropriate.

Arbitration rules of arbitration institutions consistently contain the same wording. For example, Article 22(3) of the arbitration rules of the LCIA provides:

> The Arbitral Tribunal shall decide the parties' dispute in accordance with the law(s) or rules of law chosen by the parties as applicable to the merits of their dispute. If and to the extent that the Arbitral Tribunal determines that the parties have made no such choice, the Arbitral Tribunal shall apply the law(s) or rules of law which it considers appropriate.

Article 17(1) of the arbitration rules of the ICC also provides similarly:

> The parties shall be free to agree upon the rules of law to be applied by the Arbitral Tribunal to the merits of the dispute. In the absence of any such agreement, the Arbitral Tribunal shall apply the rules of law which it determines to be appropriate.

It seems that the discretion of the tribunal in these cases is extremely broad. It may apply international law if it deems international law to be the 'appropriate' law to apply in the circumstances of the case. There seems to be no limitation on what the tribunal may consider as 'appropriate'. In theory, it is purely a matter of subjective judgment for the tribunal. However, as a matter of practice, such discretion should be exercised reasonably and the tribunal must give reasons for why it considers the application of international law to be 'appropriate' in the case. An example of this can be seen in the two IUSCT decisions described in the previous section, where international law was applied by the IUSCT because the Tribunal considered it more appropriate than the law chosen in the contract. In some other jurisdictions, the power of the tribunal is not so broad. They can apply international law only if international law has the closest connection with the case or its application is justified by an applicable conflict rule. For example, Article 187(1) of the Swiss FSPIL states:

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[124] Section 1051(2) of the German CCP: 'the tribunal shall apply the law of the State with which the subject matter of the proceeding is most closely connected'.

> The arbitral tribunal shall decide the case according to the rules of law chosen by the parties or, in the absence thereof, according to the rules of law with which the case has the closest connection.

Section 46(3) of the *English Arbitration Act 1996* states:

> If or to the extent that there is no such choice or agreement, the tribunal shall apply the law[125] determined by the conflict of laws rules which it considers applicable.

Article 33.1 of the UNCITRAL Arbitration Rules states:

> The arbitral tribunal shall apply the law designated by the parties as applicable to the substance of the dispute. Failing such designation by the parties, the arbitral tribunal shall apply the law determined by the conflict of laws rules which it considers applicable.

Finally, it is necessary to mention the position of ICSID tribunals, which is rather different from the above examples. In the absence of a choice of law by the parties to a state contract, ICSID tribunals are required by Article 42(1) of the ICSID Convention to apply the law of the host state and 'such rules of international law as may be applicable'.

Where international law is in harmony with the law of the host state on a particular contractual issue, no problem arises. In such a case, ICSID tribunals often comment that they are entitled to apply international law, although it is unnecessary to do so. For example, in *Benvenutti and Bonfant v Congo*[126]—where there was no choice of law agreement and the tribunal applied Congolese law—international law and equity (as it was authorised by the parties) resolved the dispute. In the event, the tribunal held that the principle of compensation for nationalisation as applied in this case was consistent with the Congolese Constitution, international law and equity.[127] It was obviously of little significance in such a case that the tribunal was empowered to apply international law in addition to the law of the host state.

Problems only arise where rules of international law are at odds with the law of the host state. It seems rather established in the ICSID jurisprudence that in such a circumstance, international law prevails. This was the finding of an *ad hoc* Committee established in 1985 under Article 52 of the ICSID Convention to consider the annulment of the award in *Klockner v Cameroon*.[128] In *Amco v Indonesia*,[129] the tribunal reaffirmed that international law in this situation plays the dominant role:

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[125] As discussed above, the term 'law' should be construed to include international law.
[126] *Benvenutti and Bonfant v The People's Republic of Congo* (1980) 1 ICSID Reps 330, 752.
[127] Ibid 758.
[128] *Klockner v Cameroon* (1983) 2 ICSID Reports 3, 112.
[129] *Amco Asia Corporation and Others v The Republic of Indonesia* (1984) 1 ICSID Reports 376, 569.

> This Tribunal notes that Article 42(1) refers to the application of host-state law and international law. If there are no relevant host-state laws on a particular matter, a search must be made for the relevant international laws. And, where there are applicable host-state laws, they must be checked against international laws, which will prevail in case of conflict. Thus, international law is fully applicable and to classify its role as 'only supplemental and corrective' seems a distinction without a difference. In any event, the Tribunal believes that its task is to test every claim of law in this case first against Indonesian law, and then against international law.[130]

This matches the words of an author of the Convention:

> The Tribunal will first look at the law of the host State and that law will in the first instance be applied to the merits of the dispute. Then, the result will be tested against international law. That process will not involve the confirmation or denial of the validity of the host State's law, but may result in not applying it where that law, or action taken under that law, violates international law.[131]

The same approach was taken in subsequent cases such as *Tradex v Albania*[132] and *CDSE v Costa Rica*.[133]

However, this approach sits rather uncomfortably with the wording of Article 42(1), which does not authorise an ICSID tribunal to apply international law to override the law of the host state. There is also no support for this approach in the drafting history of the Convention which contains conflicting accounts regarding whether international law was meant to be the overriding law.[134] Indeed, it is not difficult to see, as recorded in the history of the Convention, that the developing countries at the conference would not have agreed to a text of Article 42(1) expressly giving priority to international law in this case.[135] Therefore, it is only fair to say that it was never agreed as to what law an ICSID tribunal is authorised to apply in this context. It has been observed in the literature that in this circumstance an ICSID tribunal should declare Article 42(1) inoperative and rely on principles of private international law to find the appropriate applicable law.[136] There seems to be some merit in this view. This is similar to the case of contracts with choice of law clauses, which refer to both a national law and international law without specifying which one is to prevail in case of conflict. The

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[130] Ibid 580.

[131] Broches 'The Convention on the Settlement of Investment Disputes Between States and Nationals of Other States' (n 94) 392.

[132] *Tradex v Albania* (1999) 14 *ICSID Rev – Foreign Investment Law Journal* 197.

[133] *Compania del Desarrollo de Santa Elena v Costa Rica* (2000) 15 *ICSID Rev – Foreign Investment Law Journal* 169.

[134] While the Chairman's Report dated 9 July 1964 appears to say that the intent is for international law to prevail over national law (ICSID, *History of the Convention: Convention on the Settlement of Investment Disputes between States and Nationals of other States, Documents concerning the Origin and the Formulation of the Convention* (International Centre for Settlement of Investment Disputes, Washington 1968), 571), he is quoted elsewhere as giving primary importance to the national law of the host state: Sornorajah (n 13) 272.

[135] ICSID, *History of the Convention: Convention on the Settlement of Investment Disputes between States and Nationals of other States, Documents concerning the Origin and the Formulation of the Convention* (n 134) 569-71.

[136] G Elombi, 'ICSID Awards and the Denial of Host State Laws' (1994) 10 *Journal of International Arbitration* 61, 68.

intent in these cases seems to be that they can be both applied only to the extent they are mutually complementary. However, where the two systems conflict, the parties never reached an agreement on the law that the tribunal should apply. In that case, the tribunal should rely on the applicable conflict of laws rules to determine the applicable law as if the parties had never made a choice of law. An ICSID tribunal in this context should act likewise. It is true that ICSID tribunals are often said to operate in a 'self contained' system separate from the law of the seat.[137] However, in this situation where it has no other rules to turn to, it seems most advisable that the tribunal should look to the conflict rules of the seat of the arbitration to determine the applicable law in the circumstances. It is possible, and in fact likely, that the arbitration law of the seat will, as mentioned above, give the tribunal a broad discretion to apply whichever legal rules the tribunal considers appropriate and hence, the tribunal may ultimately apply international law to the issue. Nevertheless, in so doing, the tribunal at least acts upon a legitimate legal source of power being the law of the seat, rather than an artificial construction of Article 42(1) of the ICSID Convention.

Conclusion

This article has sought to demonstrate the circumstances where an application of international law to a state contract is permissible and circumstances where this is *not* permissible. The foregoing discussions have shown that in the jurisdictions examined, a choice of international law is impermissible before national courts and is likely to remain so for the foreseeable future. On the contrary, such a choice is permissible and must be given effect to in all arbitral fora. In addition, most arbitral tribunals, but not courts, are authorised to apply international law to a contract where the parties have not made a choice of law agreement. Finally, where the parties have chosen only a national law for the contract, international law cannot be applied to the contract in most circumstances.

[137] Mann, 'State Contracts and International Arbitration' (n 21) 13-4; Toope (n 15) 115.