CHICAGO INTERNATIONAL ARBITRATION CENTER

What law will apply to the dispute in arbitration?

By Kristen Hudson

There are several different laws that may apply in an international arbitration. The first step in understanding which law should apply is to distinguish between the law that will resolve the actual substantive dispute between the parties and the law that will govern the validity of the agreement to arbitrate and the conduct and procedural rules of the arbitration itself. These are often different sets of legal principles. In addition, it is important to understand which law applies to enforcement of an award entered at the conclusion of the arbitration. Each of these topics is addressed further below.

1. *The Law Applicable to the Merits of the Parties' Dispute*

Because arbitration is a creature of contract, the first source of potential law applicable to the merits of the dispute is the parties' agreement itself. The contract may contain a choice of law clause that specifies which law is to apply to the dispute between the parties. That choice might include, for example, the national law of one of the parties or a neutral nation's law. The choice may include the application of an international convention, for example, the U.N. Convention on the International Sale of Goods (the CISG), or the parties may choose to opt out of the application of the CISG or certain of its provisions. In other instances, the parties could designate one choice of law for a particular issue in the transaction, and another law for other issues. For example, the tribunal could apply the CISG to issues concerning breach of contract but rely on another set of principles to decide tort issues, such as fraud or unfair competition.

The parties are not required, however, to select a particular nation's laws to govern the dispute. The parties may decide that the *lex mercatoria* – general principles of transnational law, trade usages, and customary commercial law derived from the medieval law of the merchant – should apply to the dispute. These principles are collected in the modern-day UNIDROIT Principles of International Commercial Contracts promulgated by the International Institute for the Unification of Private Law in Rome, and parties may agree that to have these principles apply in the choice of law provision.

Other possible choices of law include Sharia law, which is Koran-based guidance and teachings for those that practice Islam. It is also possible for the tribunal, if expressly empowered to do so, to decide a case *ex aequo et bono*, *i.e.*, with equity, fairness, and sense of natural justice, without the need to refer to any legal rules. In short, one benefit to arbitration is that the parties are empowered to select which legal principles should apply to a dispute between them, and that choice should guide the analysis of which law applies to the dispute at issue.

In the absence of an express choice, the tribunal may be required to apply choice of law principles in the jurisdiction to determine the applicable law. These principles typically consider certain factors in deciding the law applicable to the merits, including the parties' nationalities, the place of performance of the contractual obligations, and the place and subject matter of the arbitration.

2. *The Applicable Procedural Law*

In a typical arbitration provision, the parties will designate the seat of arbitration, *i.e.*, the City and State where any arbitration will take place and designate whether the arbitration will be administered under a particular arbitral institution. The parties are, of course, free to designate the law of their choice to apply to the validity of the arbitration agreement and arbitration procedure within the arbitration clause itself. This law need not be the same law that governs the merits of the dispute. For the avoidance of doubt, it is generally the best practice to include a choice of law clause in the arbitration provision. This solution, which is recommended by the Hong Kong International Arbitration Center, for example, is simple and avoids the uncertainty explained below as to which law should govern the procedural aspects of the arbitration. The parties may also implicitly select the law of the seat to govern by selecting an arbitral institution that has a rule making the seat of the arbitration the default choice of law applicable to arbitration procedure, such as the Australian Center for International Commercial Arbitration's Article 23.

In the absence of an express choice of law embedded in the agreement, there are two potential options for the law to apply to arbitration procedure: either the law of the seat of arbitration or the law governing the main contract. Under the traditional view, the law of the seat of arbitration, or the *lex arbitri,* would likely determine arbitration procedure and the validity of the parties' agreement to arbitrate. The *lex*

arbitri is the set of laws that govern arbitration procedure, including validity and scope and court supervision and support of the arbitration. Each country has its own *lex arbitri* that forms part of that country's domestic law. For example, if an arbitration provision does not contain its own choice of law provision but designates Chicago, Illinois, USA as the seat of arbitration, the U.S. Federal Arbitration Act, 9 U.S.C § 1, *et seq*., (the FAA) will be the *lex arbitri,* and serve as the legal framework for challenges to the validity of the agreement to arbitrate, confirmation of an arbitration award, and other procedural matters, such as the appointment of arbitrators and the issuance of subpoenas.

If the agreement contains an express choice of law clause, authorities are split on whether the express choice of law clause will override the application of the *lex arbitri*. In cases that have applied the *lex arbitri* to questions of arbitration procedure instead of the parties' express choice*,* the result is usually driven by the application of the separability doctrine—a principle in international commercial arbitration that the agreement to arbitrate is separable from the container agreement and from the validity of the agreement as a whole. (Separability principles may apply to challenges to the validity of arbitration agreements under the FAA as well as the UNCITRAL Model Law, for example). This basic presumption is a long-standing and widely accepted principle to preserve the arbitral tribunal's jurisdiction where there may be a challenge to the contract as a whole. Application of the *lex arbitri* to the substantive and procedural aspects of the arbitration are often also justified under a conflicts of laws analysis as the law most closely connected to the dispute.

In other cases, where the selected seat of arbitration is in one country and another country's substantive law is selected, some courts and tribunals have applied the express choice of law over the application of the *lex arbitri,* in effect overriding the *lex arbitri*. At least one court has held that the choice of a particular country's law to the main agreement was an implied choice that that the same law should also apply to the agreement's arbitration provision. This view rests on the concept of the parties' autonomy in contracting for the law that will govern the dispute.

In either case, in selecting which law should apply to an agreement that contains an arbitration provision, consideration should be given to whether the selected state is a signatory to the New York Convention. Courts in states that are signatories to the New York Convention (discussed further below) may also look to its provisions for

guidance in determining whether the parties have entered into a valid agreement to arbitrate. This is because a valid agreement to arbitrate is a prerequisite to enforcement of an award at the conclusion of the arbitration. Article II of the New York Convention requires that an agreement to arbitrate be in writing and signed by the parties.

In sum, when determining the law applicable to the validity of the agreement to arbitrate, look first for an express choice of law clause within the agreement to arbitrate, and then next to the law of the seat of arbitration and the law of the main contract. At a minimum, the interpretation of this question under the law of the *lex arbitri* may shed light on which law will govern the substantive and procedural aspects of the dispute.

With respect to the procedure and conduct of the arbitration itself, including, for example, method of examination of witnesses, handling of documents and discovery, and motion practice, the *lex arbitri* is usually not specific enough to provide guidance. For this set of rules, the parties will look to the institutional rules of the designated arbitral institution that will administer the arbitration. Or if the parties are proceeding in *ad hoc* fashion, the UNCITRAL Arbitration Rules or the International Bar Association's Rules on the Taking of Evidence in International Arbitration can provide helpful guidance. For ethical issues and consideration, the parties can also look to the IBA's Rules of Ethics for international arbitrations.

3. The Law Applicable to Enforcement of the Arbitration Award

No discussion of choice of law in arbitration would be complete without an understanding of the law applicable to the recognition and enforcement of the arbitration award. The United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, or New York Convention, provides guidance on recognition and enforcement of an arbitration award in the 168 states that are currently signatories to the Convention. The New York convention deals with two main topics, the enforcement of valid agreements to arbitrate (as noted above), and recognition and enforcement of foreign arbitral awards. The Convention requires contracting states to recognize and enforce arbitration awards rendered in sister signatory states in the same way the state would enforce a domestic judgment.

Chapter 1 of the FAA includes provisions for the enforcement of arbitral awards that are made in the United States, while Chapters 2 and 3 of the FAA incorporate the New York and Panama Conventions, respectively, both of which provide procedures for the recognition and enforcement of final arbitral awards governed by those conventions.

Recognition and enforcement are distinct concepts under the Convention. Recognition of an award means to give the award legal status, and thus preclusive effect preventing claims and issues determined by the award from being relitigated. Enforcement is the process by which the judgment creditor can begin *execution* against the judgment debtor's assets. Execution is a distinct concept from enforcement. Execution is governed by the domestic laws in the country where the judgment debtor's assets are located. Where the arbitral award provides for an award of money damages, the judgment creditor will often seek recognition and enforcement of the award in a jurisdiction where the judgment creditor's assets are located, and then use the execution remedies available under that state's domestic law.

The party seeking to enforce an award must provide an authentic or certified copy of the award and arbitration agreement to begin the enforcement process. With award in hand, the Convention provides only a few, exhaustive grounds for a court to refuse enforcement. These grounds are 1) incapacity and invalidity, 2) lack of notice or fairness, 3) arbitrator exceeded grant of authority, 4) tribunal or procedure was not within scope of agreement, 5) the award was not yet binding or final, 6) the subject matter of the dispute was not arbitrable, and 7) the award violates public policy. The party resisting enforcement bears the burden of proof, but the latter two grounds (arbitrability and public policy) may be raised *sua sponte* by the enforcing court. Notably, none of the grounds for refusal to enforce are based on mistake of law or fact; the grounds for refusal focus instead on the fairness of the process and opportunity to be heard. The lack of available challenge to the merits of the award results in the vast majority (98 percent by some estimates) of international arbitration awards being enforced or paid.

Additional sources:

- Margaret Moses, The Principles and Practice of International Commercial Arbitration, (3d ed. 2017)
- The UNIDROIT Principles of International Commercial Contracts, *available at* www.unidroit.org
- The United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980) (the "CISG"), *available at* https://uncitral.un.org/en/texts/salegoods/conventions/sale_of_goods/cisg
- Federal Arbitration Act, https://www.law.cornell.edu/uscode/text/9
- The 1996 English Arbitration Act, *available at* https://www.legislation.gov.uk/ukpga/1996/23/contents
- The UNCITRAL Model Law on International Commercial Arbitration, *available at* https://uncitral.un.org/en/texts/arbitration/modellaw/commercial_arbitration
- The UNCITRAL Model Arbitration Rules, *available at* https://uncitral.un.org/en/texts/arbitration/contractualtexts/arbitration
- IBA Rules of Ethics for International Arbitrators, *available at* https://www.ibanet.org/MediaHandler?id=DAD036E7-AF03-4BFC-806B-6A5CA4A0775A
- IBA Rules on the Taking of Evidence in International Arbitration, *available at* https://www.ibanet.org/resources
- The U.N. Convention on the Recognition and Enforcement of Foreign Arbitral Awards, *available at* https://www.newyorkconvention.org/