DISSERTATION

„The Impact of Mandatory Rules in International Commercial Arbitration“

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Für Birgit und Emil

Abbreviations

AFDI	Annuaire Francais de Droit International
AJCL	American Journal of Criminal Law
AJIL	American Journal of International Law
ALI	American Law Institute
All ER	All England Law Reports
Am. Rev. Int. Arb.	Amercian Review of International Arbitration
ArbInt	Arbitration International
AWD	Außenwirtschaftsdienst des Betriebsberaters
BerGesVR	Berichte der Deutschen Gesellschaft für Völkerrecht
BB	Der Bebriebsberater
BGB	(deutsches) Bürgerliches Gesetzbuch
BG	(schweizerisches) Bundesgericht
BGE	Entscheidungen des Schweizerischen Bundesgerichts
BGH	(deutscher) Bundesgerichtshof
BGHZ	Entscheidungen des Bundesgerichtshofs in Zivilsachen
CMLR	Common Market Law Review
ECLR	European Competition Law Review
ECR	International Commerce Review
Fn	footnote
FS	Festschrift
GYIL	German Yearbook of International Law
HarvLRev	Harvard Law Review
Hess. LAG	Hessisches Landgericht
HS	Handelsrechtliche Entscheidungen
ICLQ	International and Comparative Law Quarterly
ICSID	International Centre for Settlement of Investment Disputes
ICSID Rev	ICSID Review – Foreign Investment Law Journal
ILM	International Legal Materials
IntALR	International Arbitration Law Review
IPR	Internationales Privatrecht

IPRax	Praxis des Internationalen Privat- und Verfahrensrechts
JBl	Juristische Blätter
JDI	Journal du droit international
JZ	JuristenZeitung
LAG	Landarbeitsgericht
MichLR	Michigan Law Review
NILR	Netherlands International Law Review
NJW	Neue juristische Wochenschrift
no.	marginal number
OGH	Oberster Gerichtshof
RablesZ	Rabels Zeitschrift für ausländisches und internationales Privatrecht
RdC	Recueil des Cours
RIW	Recht der internationalen Wirtschaft
SchiedsVZ	Zeitschrift für Schiedsverfahren
U.Chi.L.R.	The University of Chicago Law Review
Vand.J.T.L.	Vanderbilt Journal of Transnational Law
VirginiaJIL	Virginia Journal of International Law
WM	Wertpapier-Mitteilungen
YBCA	Yearbook of commercial arbitration
YbPrivIntL	Yearbook of Private International Law
ZvglRWiss	Zeitschrift für Vergleichende Rechtswissenschaft

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I. THE PROBLEM

Parties to international contracts will invariably agree to resolve their disputes by arbitration. One reason for this choice will be their expectation to be able to exercise a greater measure of control over the arbitral tribunal than they would over a national court. This will also apply to the application to the law the arbitrators are to apply to a contract. It is a fundamental principle of contractual freedom that the parties are free to choose the applicable law they wish the tribunal to apply to their case. In most cases, the arbitral tribunal will be obliged to follow this choice. However, national legislators enact rules of law they intend to be applicable regardless of the otherwise applicable law. Such mandatory rules in most cases protect fundamental interests of states which the legislators consider to important to be circumvented by the choice of law of the parties. Before national courts of the states which enacted such laws, the application will be natural consequence of the national conflict of laws rules. If the dispute is to be decided before foreign courts, this will be substantially different. As will be set out in detail in this thesis, legislators and courts have elaborated rules according to which national courts will apply foreign mandatory rules.

Most modern systems of arbitration law, however, provide a detachment of the arbitrators from the conflict of laws systems of the *lex arbitri*. Therefore, the rules established for the application of foreign mandatory rules do not apply in arbitration. The absence of such rules would, however, lead to the situation that the parties could circumvent the application of rules which may be essential for the interests of states. Further, one party may invoke a mandatory rule claiming that the rule has a certain impact on the contractual relationship with the other party which the arbitral tribunal must take into consideration.

The arbitral tribunal in such a situation must decide whether and under which circumstances it will apply mandatory rules of law both of the *lex causae* and of third legal orders. The examination of the rules which arbitral tribunal shall follow in such a case is the subject of this thesis.

II. THE CONCEPT OF THE DISSERTATION

The rules for the application of mandatory rules have been established by domestic courts applying domestic conflict of laws rules. As will be shown in the first part of this thesis, these rules differ to a certain degree between systems of civil law and those of common law.

This dissertation will therefore in a comparative approach first examine the rules providing for the application of mandatory rules of third states (as the arbitrator has no forum and therefore no domestic conflict of laws rules to apply, all mandatory rules are *foreign* to the arbitrator) before domestic courts. The rules established in Austria, Germany and Switzerland will be examined as examples for the approaches taken in civil law countries. Further, the approaches taken in the United Kingdom and the Unites States will be assessed as the most relevant common law systems.

In a second step, the relevance of mandatory rules on the arbitrability of disputes will be addressed. It will be examined whether and to what extent national legislators can prevent a dispute from being arbitrated at all due to rules of domestic law.

In a third step, the thesis will attempt to derive a rule for the application of mandatory rules by arbitrators from the various examined national systems. Though these systems vary, it will be shown that there are certain common elements which are required by all systems and which provide for a coherent rule which arbitrators can use as guidance when deciding on the application of a mandatory rule. Also the relevant jurisprudence of arbitral tribunals will be examined to determine which of the elements of the suggested rule have already been applied.

In a final step, the relevance of mandatory rules in setting aside procedures will be studied. This chapter will deal with the consequences it may have if an arbitrator fails to apply a mandatory rule in arbitral proceedings.

III. DEFINITION OF MANDATORY RULES IN CIVIL LAW

As a general proposition, liberal states will - to a varying extent - grant parties the possibility to conclude contracts creating mutual obligations. However, states also pursue interests which are estimated higher than the freedom of private parties to conclude contracts. To protect these interests states limit the parties' freedom of contract by enacting rules from which parties cannot derogate by agreement. Examples of such rules are manifold: Rules for consumer protection, rules for the protection of labourers, the prohibition of cartels and unfair competition or boycott legislation. However, not all of these rules qualify as mandatory rules in the sense described here below.

The term "mandatory rule" is used throughout jurisprudence and literature without, however, always giving it clear contours and a meaning of its own. Therefore, the first task before discussing the influence of mandatory rules on commercial arbitration is to define the term "mandatory rule" and to delimitate it from related concepts.

The problem posed by the notion of mandatory rules, at least in continental European doctrine, is that the criteria by which a mandatory rule is defined partially overlap with the criteria for establishing its applicability.

The traditional conflict of laws rules based on *Savigny's* teachings sought to assign to every relationship a seat. Therefore, *e.g.* tort issues (as the relationship between the tortfeasor and the injured party) were assigned to the place at which the tort had taken place (the seat of the relationship). The law at the place of the tort would therefore govern the claims of the injured party against the tortfeasor. A contract is governed by the law with the closest connection to the contract, which according to the Rome Convention, is the law of country of the party performing the characteristic element of the contract. In the examined civil law systems the applicable law is determined by all-sided conflict of laws rules ("*allseitige Kollisionsnormen*"). Such rules determine that to

specific facts or legal figures (e.g. the legal capacity of parties, the formal validity of a contract, the existence of rights *in rem*) a specific national law is applied, e.g. the existence to a right *in rem* is determined by the law of the place in which the thing is located when the acquisition of the right *in rem* is completed, the law applicable to a contractual relationship is governed by the law of the country to which the contract has to closest relationship. This concept therefore applies foreign or domestic law to international cases based on objective criteria and under the same circumstances. There is no preference for the *lex fori*. This concept is based on the idea of the inter-changeability of systems of civil law[1], which in turn was originally based on the idea that systems of civil law were non-political and neutral.[2] Modern authors argue that even civil law systems are politically charged and therefore the decision of legislators to apply rules of foreign civil law is a political decision based on liberalism.[3]

However, this system was established to determine the applicable law balancing the interests of private parties. States, however, issue rules which are not part of the system of law designed to balance the interests of parties but which serve superior interests of the community. Legal relationships between private parties, however, may also have an impact on these superior interests of third parties. States did not wish to abandon its possibilities to protect these over-individual interests by enacting all-sided conflict of laws rules which determine foreign law as the applicable law. The assumed neutrality and inter-changeability of civil law systems does not apply these rules.[4] This is shown by such provisions as Art 7(2) Rome Convention, which states that "*nothing in this Convention shall restrict the application of the rules of the law of the forum in a situation where they are mandatory irrespective of the law otherwise applicable to the contract*." Such rues intervene in the relationship between private parties. Beyond this, states may also have an interest that their mandatory rules are not only applied by their own judges but also by foreign judges and arbitrators. However, before determining

[1] The term "civil law" in this thesis means both the civil law systems as legal systems opposed to common law systems and civil law in the meaning of the law governing the legal relationship between private parties.
[2] *Kropholler,* Internationales Privatrecht 16.
[3] *Sonnenberger* in MünchKomm BGB X[4] Einl IPR, no 13.
[4] *Basedow,* RabelsZ 52 (1988) 8 (19).

under which circumstances to apply such rules they must necessarily be distinguished from the law which is applied to a legal relationship by all-sided conflict of laws rules.

A. DISTINCTION DRAWN BETWEEN PUBLIC AND CIVIL LAW

One distinction between the law applicable by all-sided conflict of laws rules and mandatory rules is found in the distinction between public law, i.e. laws by which a state obliges its subjects, and civil law.[5] This distinction, however, cannot be found consistently in every legal system and the differences between civil and common law systems make it useless[6] Further, even in civil law systems it is not always clear whether rules pertain to the individual or the other group. The distinction along the lines of the differentiation of public and private law is therefore futile.

B. DISTINCTION DUE TO THE LEGISLATIVE INTENT OF THE RULE

A second approach distinguishes mandatory rules from the otherwise applicable rules of law solely by reference to the legislative intent of the rule to be applied to the facts of a specific case. *Lorenz* defines mandatory rules solely by stating that they are rules that apply regardless of the otherwise applicable law because the state enacted them with this legislative intent.[7]

This attempt is based on a correct assumption. National legislators enact mandatory rules with the intent that they be applicable to a legal relationship regardless of the otherwise appliable law. This definition, however, fails to define the term. One needs to define the term mandatory rule to then know whether it applies to a legal relationsship regardless of the otherwise applicable law.[8] It is therefore not sufficient to refer only to

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[5] Which is a distinction which was made by the German Supreme Court in early Judgements, see BGH, 11 February 1953, BGHZ 9, 34.
[6] *Frank,* RabelsZ 34 (1970) 56 (71); *Radtke,* ZVglRWiss 84 (1985) 325 (328).
[7] *Lorenz,* RIW 1987, 569 (578).
[8] *Schurig,* RabelsZ 54 (1990) 217 (228).

the legislative intent of a rule to define it as a mandatory rule despite the fact that mandatory rules reflect a legislative intent of legislator regarding its mandatory application.

C. The Interests Served by Mandatory Rules

The most meritous distinction is to be made by focusing on the interests which a rule serves. The essence of this criterion is that a mandatory rule serves over-individual public purposes of national or economical policies. [9]

Many rules from which parties cannot derogate arguably serve over-individual policies. Social policies protecting weaker parties may be reflected in norms of labour law, tenancy law or the like. However, not all of these rules are internationally mandatory rules. The distinction is blurred by rules that merely serve the regeneration of a contractual equilibrium that has gone lost due to commercial reality and the effective weaker bargaining position of specific parties and therefore effectively serve private parties. Several approaches have been made to point out the line between the two groups of rules.

Basedow divides the rules that protect state interests into rules that protect *groups* (such as consumers, tenants, etc.) and rules that protect *institutions* (such as the national economy).[10] While the *group* interests always are opposed to the interests of other concerned groups in one national setting, the state is left to enact mandatory rules that apply merely in domestic cases, as the interests of foreign *groups* were not considered by the national legislator.[11] In the case of the rules protecting i*nstitutions* however, there is a necessity to protect these values in international cases.[12] Thus, rules protecting *institutions* are what are to be considered mandatory rules in the sense used by the

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[9] *Martiny* in MünchKomm BGB X[4] Art 34, no 13; *Radtke,* ZVglRWiss 84 (1985) 325 (328); *Neumeyer,* RabelsZ 25 (1960) 649 (653); Stellungnahme Max-Planck-Institut, RabelsZ 47 (1983) 595 (669); *Sumampouw,* RabelsZ 30 (1966) 334 (342).
[10] *Basedow,* RabelsZ 52 (1988) 8 (17f).
[11] *Basedow,* RabelsZ 52 (1988) 8 (27).
[12] *Basedow,* RabelsZ 52 (1988) 8 (29).

author. Rules protecting specific *group* interests are merely national *ius cogens* and only applicable as part of the *lex fori* or *lex causae*.

Kreuzer divides the two groups into rules with an economic macro- and a microfunction. A rule with an economic macrofunction is aimed at protecting the economy as a whole while rules with microfunctions protect the balancing of interests of individuals. Only rules of the former group qualify as mandatory rules.[13]

Of course, all these approaches necessarily generalize. When faced with an individual rule the judge or the arbitrator will have to interpret the rule and seek to establish the legislative intent and the direction of impact ("*Stossrichtung*") [14] to decide to which of the two groups a rule pertains.

Numerous rules may also serve both individual and over-individual policies. In this case, it seems the most purposeful approach to treat only those rules as mandatory rules which to a larger extent protect over-individual interests.[15] As set out below, in doubt a rule should not be treated as a mandatory rule (*infra* section III.E.).

Some authors nevertheless expand the goals potentially to be furthered by mandatory rules to such rules that that protect social values, *e.g.* rules of consumer protection and labour law.[16] This is justified by the argument that also in these areas states are not concerned so much with the contractual relationships of parties, but are implementing certain social-political goals. This argument, however, does not hold water: The stabilization of contractual *equilibria*, which is the goal of these rules, is best achieved by the rules of the *lex causae.*

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[13] *Kreuzer,* Ausländisches Wirtschaftsrecht 83; along these lines also *Junker,* IPRax 2000, 65 (70).
[14] Hess. LAG 16.11.1999, IPRax 2001, 461 (467); to this judgement: *Benecke,* IPRax 2001, 449 (452); *Martiny* in MünchKomm BGB X[4] Art 34, no 13.
[15] *v.Bar/Mankowski,* Internationales Privatrecht I² § 4 no 95.
[16] *v.Hoffmann,* RabelsZ 38 (1974) 396 (408).

D. The definition in EC Regulation No 593/2008[17]

Art 7(1) Rome Convention does not contain a definition of the term "mandatory rule". It merely refers to the mandatory character of the rules which is used, however, as a connecting factor and not as an element of the definition of the rule.

Art 9 EC Regulation No 593/2008 on the Law Applicable to Contractual Obligations (Rome I), which supersede the Rome Convention in December 2009 seeks to eliminate the uncertainties caused by the lack of the definition of mandatory rules. According to Art 9 EC Regulation No 593/2008 a mandatory rules are defined as

provisions the respect for which is regarded as crucial by a country for safeguarding its public interests, such as its political, social or economic organisation, to such an extent that they are applicable to any situation falling within their scope, irrespective of the law otherwise applicable to the contract under this Regulation.

This definition is obviously based on the judgement of the ECJ in Arblade[18] in which the ECJ had already referred to the character of such norms *as crucial by a country for safeguarding its public interests, such as its political, social or economic organization.* The definition in Art 9(1) therefore has two elements: The first refers to the interests protected by mandatory rules. The second refers to their mandatory character and the fact that they are to be applied regardless of the otherwise applicable law.

The first of these two criteria is the more important. As mentioned above, a distinction has been made between rules that protect over-individual policies and rules that re-establish a contractual equilibrium that has been distorted by commercial reality. Art 9(1) refers to the public interests of a state. This has been interpreted to exclude all rules of the second category.[19] This is a legitimate interpretation, especially as the article

[17] Regulation (EC) No 593/2008 of 17 June 2008, OJ L 177/6.
[18] ECJ, Judgement 23 November 1999, C-369/9 and C-376/96, ECR 1999, I-8453, para 30.
[19] *Heiss*, JBl 2006, 750; *Beulker,* Eingriffsnormenproblematik 43.

refers to the political, social or economic organization of a state. However, it is not impossible to interpret the definition in a broader manner arguing that also rules that protect individuals can serve public purposes.[20] It will remain to be seen which of the two approaches is taken by national courts and the ECJ. It must, however, be borne in mind that the ECJ interpreted Art 17 of the Council Directive on Commercial Agents, which deals with the compensation of agents, to be a rule which accordingly protects the undistorted competition in the internal market and is therefore a mandatory rule.[21] This interpretation is excessive. It may be true that the compensation of commercial agents also and indirectly protects commercial agents. Nevertheless, it primarily serves the interest of the individual commercial agent and his (allegedly) commercially inferior position towards the principal, which is why its classification as mandatory rule is at least doubtful.[22]

The second criterion for the definition of a mandatory rule is that the enacting state requires that it applies irrespective of the otherwise applicable law. Therefore, a rule in question must also be examined as to its legislative intent. Also in this aspect the judgment of the ECJ in Ingmar is relevant.[23] In that case, the ECJ following the Advocate General Léger justified the mandatory nature of Art 17 of the Directive on Commercial Agents by reference to Art 19 of the Directive which states that parties cannot derogate from the application of Art 17. However, Léger and the ECJ seem to ignore the distinction between internal and internationally mandatory rules and, even worse, seem to deduce from the internally mandatory character of a rule that it is also internationally mandatory.[24]

It is to be welcomed that finally a definition, although in broad terms, has been found for mandatory rules. However, before this definition will finally suffice to eliminate all ambiguities, it will be necessary for the ECJ to rule on the issue.

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[20] *Bonomi,* YbPrivIntL 2008, 285 (293ss).
[21] ECJ, Judgement 9 November 2000, C-381/98, paras. 23ss.
[22] *Sonnenberger* in MünchKomm BGB X[4] Einl IPR, no 62.
[23] ECJ, Judgement 9 November 2000, C-381/98.
[24] *Schwarz,* ZVglRWiss 101 (2002) 45.

E. In doubt, a rule is not mandatory

As detailed above, the treatment of mandatory rules as a set of rules distinct from the otherwise applicable law is an exception. This exceptional character must be regarded when attempting to determine the mandatory character of a rule. A state may further its political goals by enacting mandatory rules but it must be clear that a rule is mandatory as both the parties and the judges or arbitrators must be able to ascertain without doubt whether a rule is applicable to their contract or not. It may not be overlooked that mandatory rules will usually have a very grave impact on a contractual relationship – more often than not invalidating it – so that a rule claiming application must do so clearly.[25]

F. The *Lex Fori* as the Relevant Law for Determining the Mandatory Character of a Rule

In accordance with the above criteria it is possible to determine whether a rule is mandatory or not. No uniform answer has, however, been given to whether the mandatory character of rule is determined by the *lex fori* or by the law of the enacting state.

Some authors leave it to the law of the enacting state to determine whether a rule should be a mandatory rule. *Lorenz* argues that the enacting state determines whether a rule is mandatory or not. This is a distinct matter from determining whether a law can be applied abroad which is a matter for the conflict of laws rules of the *lex fori*.[26] This approach ignores that the foreign law may not know the concept of mandatory rules or may define mandatory rules very much differently than the *lex fori*.[27] If a foreign judge is to lend his authority to implement the ends of a foreign legislator, it should also be left to the *lex fori* whether a rule is to be considered mandatory or not.

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[25] *Lorenz,* RIW 1987, 569 (579); *Siehr,* RabelsZ 52 (1988) 41 (92).
[26] *Lorenz,* RIW 1987, 569 (578).
[27] *Martiny* in MünchKomm BGB X^4 § 34 BGB, no 10.

G. Internal Mandatory Rules and International Mandatory Rules

As will be described below, international mandatory rules (which are referred to in the following merely as mandatory rules) apply under certain circumstances to any legal relationship. An international mandatory rule is equipped with legislative intent and binding force which goes beyond that of the other rules of law of a state. For an international mandatory rule to apply, it is no prerequisite that the parties chose the national law of the state which enacted the mandatory rule. An international mandatory rule can apply regardless of the parties' choice of law. The reason for this is that when enacting an international mandatory rule, a state is seeking to realize public and collective interests which would be hampered if parties could simply opt-out by choosing a different system of law. The enacting state puts its interests above the freedom of the parties and the law of other states.

An internal mandatory rule, on the other hand, is a rule which the parties cannot opt out of once they have chosen a system of law. However, parties can opt out of internal mandatory rules by choosing the law of a different state. These rules mostly are inherent to the system of private law which cannot be changed by the parties. Examples of such rules are form requirements for contracts and general clauses such as the prohibition of contracts which contravene *bonos mores*.

IV. THE APPLICATION OF MANDATORY RULES

Above, the qualitative features of mandatory rules have been described. These features distinguish mandatory rules from the otherwise applicable law to the contract. The next question that therefore must be answered is when and how to apply such mandatory rules.

In the following the doctrine on the application of foreign internationally mandatory rules will be examined. Thereafter, the approaches taken in the jurisprudence of the examined legal systems will be analyzed. This section will deal only with the application of foreign mandatory rules before national courts. Their application by arbitral tribunals will be dealt with in a later section (*infra* section VI.).

A. THE "SONDERANKNÜPFUNGSTHEORIE"

Except for the few proponents of the "Schuldstatutstheorie"[28] according to which all mandatory rules of the *lex causae* and only those are applicable, there is consensus that the qualitative differences of mandatory rules and the policies they implement make a distinct conflict of laws treatment of mandatory rules necessary.

There is, however, no uniform opinion on the form of the application of foreign mandatory rules. There is a stronger – though not complete – consensus on various connecting factors which are put into relationship to one another differently depending on the point of view of the various authors.

The following connecting factors have been suggested:

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[28] The „Schuldstatut" is the German term for the *lex causae*.

The rule must have been enacted with the specific legislative intent of extraterritorial application ("Geltungungswille").[29]

There must be a close connection between the enacting state and the case before the court faced with the possible application of a foreign mandatory rule.[30]

The policy enforced by the mandatory rule must be compatible with the interests of the forum.

In the following, the elements mentioned above will be scrutinized and the theories as a whole will be judged by their practicability, especially with regard to the implementation of mandatory rules by arbitrators.

1. The legislative intent of extraterritorial application of the mandatory rule

The roots of the "Sonderanknüpfungstheorie" go back to the 1940's when this theory was developed in Germany by *Wengler* and refined by *Zweigert* and *Neumayer*.[31] According to these authors, the only connecting factor for the application of foreign mandatory rules was the legislative intent of the rule to find application before foreign courts.[32]

This approach was radical. It departed from the theory that the conflict of laws rules set out at the facts of the case and the applicable law is determined by conflict of laws rules which provide for the application of the law with the closest connection to the facts. It

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[29] *Wengler,* ZVglRWiss 54 (1941) 168 (183); *Siehr,* RabelsZ 52 (1988) 41 (92).
[30] Art 19 Swiss Law on Private International Law; *Vischer* in ZürchKomm IPRG² Art 19, nos, 205, 212.

[31] *Wengler,* ZVglRWiss 54 (1941) 168 (183); *Zweigert,* RabelsZ 14 (1942) 283; *Neumeyer,* BerGesVR 2 (1958) 35; *see* generally, *Coester* ZVglRWiss 82 (1983) 1 (8ss).
[32] *Wengler,* ZVglRWiss 54 (1941) 168 (181); *Zweigert,* RabelsZ 14 (1942) 283.

declares the unilateral intent of the rule to be applied in certain circumstances to be the sole factor for the application of the rule. The forum state is to apply foreign rules due to notions of international comity and reciprocity.[33]

The "will" of the enacting State that its rule should be applied by foreign courts may be explicitly stated in the rule itself, though this seems to be a rare occurrence. Otherwise, the intention of the enacting state must be found by interpretation of the rule or by recourse to the jurisprudence of that state.[34]

The use of the legislative intent of foreign rules as a connecting factor for their application abroad without the use of other connecting factors as supposed by *Wengler* must find its limits in international law.[35] Also *Kreuzer* has suggested that it would be sufficient that a rule has been enacted by a state within its jurisdiction to legislate for it to be applied. As international law, however, does not (yet) have sufficiently precise rules on jurisdiction to legislate, *Kreuzer* introduces the criterion of identity of interests between the enacting state and the forum state.[36]

The intent of extraterritorial application that a national legislator may "charge" a rule with finds a barrier in the national sovereignty of every state which prohibits other states from enacting legislation by which it expands its territorial jurisdiction to the territory of foreign states.[37] How strong the impact of national legislation with the legislative intent to be applied extraterritorially can be, was shown by the implications of the enactment of the U.S. Export Administration Act amending the Sections 376.12,

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[33] *Wengler,* ZVglRWiss 54 (1941) 168 (181).
[34] *v.Hoffmann,* RabelsZ 38 (1974) 396 (408); *Zweigert,* RabelsZ 14 (1942) 283 (288); *Siehr*, RabelsZ 52 (1988) 41 (92); *Benzenberg*, 152. .
[35] *Wengler* did not consider the close connection between the case and the enacting state to be a connecting factor but merely a filter to sift out rules which were only remotely connected to the case and for which a state did not have jurisdiction to legislate, *Wengler,* ZVglRWiss 54 (1941) 168 (185); see also *Zweigert,* RabelsZ 14 (1942) 283 (290ss).
[36] *Kreuzer,* Ausländisches Wirtschaftsrecht 90ss.
[37] *Drobnig,* RabelsZ 52 (1988) 1 (3).

379.8 and 385.2 of the Export Administration Regulations[38] by President Reagan. The Act prohibited persons under U.S. jurisdiction, including all companies owned or controlled by U.S. firms irrespective of their place of incorporation, from re-exporting machinery of U.S. origin without the permission of the U.S. government. The European Communities contented themselves with accusing the U.S. of a breach of international law,[39] while the U.K. took countermeasures as it considered its trading interests damaged[40] and France even confiscated the goods to be exported and shipped them to the U.S.S.R.. The application of this Act was also subject to legal discussion before the Dutch Arrondissementrechbank Den Haag in the "Sensor" case.[41] The Dutch court decided that it could not take the U.S. Act into consideration, reasoning that the U.S. Act was manifestly contrary to international law.

However, even within the ill-defined limits of international law, the sole reference to the legislative intent of the rule would potentially lead to the application of a multitude of rules or states only distantly connected to a case.[42] The use of the legislative intent as a connecting factor for itself would therefore not be practical. Secondly, the legislative intent is a connecting factor. It is for itself never the reason for the application of a foreign rule.[43] The forum judge does not apply foreign mandatory rules because the foreign legislator wishes him to do so. He does so because a conflict of laws rule of the forum permits him to respect the foreign legislative intent under certain circumstances and to apply the foreign rule. This conflict of laws rule uses the foreign legislative intent as a connecting factor for the application of the foreign rule.[44]

Also Art. 19 Swiss PILA and Art 9 (1) of Regulation 593/2008 both refer to the legislative intent of the foreign legislator. Art 19 Swiss PILA, however, explicitly sets

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[38] ILM 21 (1982) 864ss.

[39] European Communities: *Comments on the U.S. Regulations Concerning Trade with the U.S.S.R.*, reprinted in ILM 21 (1982) 891, 893.

[40] ILM 21 (1982) 840.

[41] Discussed *supra* section IV.D.(2)(b).

[42] *Vischer,* RabelsZ 53 (1989) 438 (451); *Zweigert,* RabelsZ 14 (1942) 283 (288).

[43] *Martiny* in MünchKomm BGB X[4] § 34 no 135; *Lorenz,* RIW 1987, 569; *Drobnig* in FS Neumeyer 159.

[44] *Coester,* ZVglRWiss 82 (1983) 1 (10).

out at the legislative intent of the foreign rule. This element is the first the judge is to assess when contemplating whether or not to apply a foreign mandatory rule. The recognition of the foreign legislator's intent that a rule be applied extraterritorially must be justified by a close connection between the facts of the case and the state enacting the rule.[45] Further, Art 19 Swiss PILA limits the application of foreign mandatory rules to those rules in the application of which one party has a legitimate and preponderant interest. This limitation refers especially to the situation of distress a party may be put in if a mandatory rule which can be enforced against it by a foreign state is not applied.[46]

2. The necessity of a close connection between the case and the enacting state

The necessity of a close connection between the facts of the case and the state which enacted the mandatory rule is commonly cited, however, does not find a uniform place in the Sonderanknüpfungstheorie. In the works of *Wengler* and *Zweigert*, this element is not a connecting factor for the application of foreign mandatory rules, but is a measure that restricts the applicability of foreign rules.[47] Accordingly, foreign mandatory rules are applied due to their legislative intent but as this would favour states which enact laws with an excessive scope of application, a corrective measure in the form of the close connection was necessary. The element of the close connection also serves to ensure that the state enacting the mandatory rule has a legitimate interest in its application to a specific case.[48] This legitimate interest, however, requires a closer connection than merely the respect for the limits of legislative jurisdiction granted to states under international law, though this is deemed sufficient by some authors.[49]

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[45] *Vischer,* RabelsZ 53 (1989) 438 (451).
[46] *Vischer* in ZürchKomm IPRG² Art 19 no 23.
[47] *Wengler,* ZVglRWiss 54 (1941) 168; see also *Zweigert,* RabelsZ 14 (1942) 283 (290ss).
[48] *Wengler,* ZVglRWiss 54 (1941) 168 (185).
[49] *Kreuzer,* Ausländisches Wirtschaftsrecht 91ss, considers the limits set out by international law to be sufficient.

From a systematic point of view, the close connection must not be considered a limiting factor reduced only to control excessive grasps for jurisdiction but as a connecting factor.[50] The forum state can decide autonomously how close the connection between the facts of a case and the enacting state must be and can require a closer connection than merely legitimacy under international law.[51]

There is, however, no universal rule on when a close connection between the facts of the case and the foreign mandatory rule is given. This evaluation will have to be divided into numerous rules which will be different depending strongly on the type of contract and the type of the mandatory rule and needs development by doctrine and jurisprudence.[52]

Article 7 Rome Convention requires a "close connection" between the "situation" and "the mandatory rules of the law of another country". This close connection is to be understood as a connection between the contract as a whole and not merely single provisions of it in order to prevent the "dismemberment of the contract".[53] Furthermore, this connection must be a genuine one, a criterion which is fulfilled "when the contract is to be performed in that other country or when one party is resident or has his main place of business in that other country."[54]

Regulation 593/2008 has replaced the element of a close connection used in the Rome Convention and now limits the application of mandatory rules to those of the law of the country where the obligations arising out of the contract have to be or have been performed. This, accordingly, was necessary as the UK, which had made a reservation to Art 7(1) Rome Convention, was afraid that the element of a close connection would

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[50] *Martiny* in MünchKomm BGB X[4] § 34 no 135; *Lorenz,* RIW (1987), 569 (582).
[51] *Wengler,* ZVglRWiss 54 (1941) 168 (189ss); *Lorenz,* RIW (1987), 569 (582).
[52] See on this *Martiny* in MünchKomm BGB X[4] § 34 no 141ss listing several categories of contracts and the criteria for the close connection; *Schnyder*, Wirtschaftskollisionrecht, no 334.
[53] Giuliano/Lagarde, Report on the Convention on the law applicable to contractual obligations, O.J. C 282, 31.10.1980, 1-50, Commentary to Article 7; *Czernich/Heiss*, EVÜ 175 (188).
[54] Giuliano/Largarde Report, Commentary to Article 7.

create uncertainty and would distort business in the financial markets.[55] This solution reflects the U.K. approach to the problem of supervening illegality under the law of the place of performance taken in *Ralli Brothers* (described below section IV.D.2.b). The U.K. approach and its “counterpart” in Art 9(1) is, however, are far narrower than the approach taken in Art 7(1) Rome Convention. There is no good reason why the *lex loci solutionis* should be the only law which can contain mandatory rules.[56] Undoubtedly, mandatory rules of this law will often be relevant, as performance takes place in this state and the performing party may therefore be factually subjected by the enacting state to its mandatory rules.[57] However, it unnecessarily restricts the application of mandatory rules of other states which may have a genuine and legitimate interest in the application of their mandatory rules. It may also burden a party which is factually subjected to rules of its state of domicile which will be enforced against it in a situation in which a foreign court is prevented from applying these rules as the performance takes place outside the state of domicile. The element of the close connection in Art 7(1) of the Rome Convention was a more flexible criterion which would have enabled the judge to take such situations into account. It may be true that this was a less foreseeable criterion for the parties, but it may not be forgotten that the application of mandatory rules protects over-individual interests that stand above the interest of the parties and is a not often used exemption to the system provided for in Regulation 593/2008. A more elaborate body of jurisprudence to the term “close connection” would have sufficed to enhance legal certainty for the parties without sacrificing dogmatic clarity.

3. The necessity that the rule must be compatible with the interests of the forum state

In addition to the two elements set out immediately above, a foreign mandatory rule must also to some extent be compatible with the interests of the forum state. The reason for this requirement is that the foreign mandatory rule stands out of the system of inter-

[55] Legal assessment of the conversion of the Rome Convention to a Community instrument and the provisions of the proposed Rome I Regulations of the Financial Markets Law Committee, retrievable at www.fmlc.org.
[56] *Bonomi,* YbPrivIntL 2008, 285 (293ss).
[57] *Martiny* in MünchKomm BGB X^4 Art 34 EGBGB, no 141.

changeability of systems of civil law and usually reflects selfish interests of the enacting state. The forum judge, however, has no interest in the enforcement of foreign interests.[58] Therefore, the foreign rule must to a specific extent also be compatible with the interests of the forum or even further them. It is disputed to what extent the interests must be compatible and whether the compatibility is a connecting factor or merely a barrier against the application of foreign rules that do not correspond to the interests of the forum state.

Sonnenberger and *Kreuzer* both consider that the interests served by the mandatory rule must be identical to the forum state and further interests of the forum.[59] Also other authors opine that if the values protected by the foreign rule are shared by the forum, the forum judge has no or less reason not to apply the foreign rule.[60] Both consider that this identity of interests is the primary connecting factor for the application of foreign mandatory rules.[61] A close connection and the legislative intent of the rule are of subordinate importance. Accordingly, the forum judge has no interest in applying foreign mandatory rules which protect values of foreign states. The only reason for the application of foreign mandatory rules can be that the interests of the foreign state they protect are also considered worthy of protection by the forum state.[62] Such interests may also lie in the coordination of international economic policies or in the safeguarding of reciprocity in the application of the forum's mandatory rules.[63] These authors therefore start the examination of foreign mandatory rules not with the legislative intent with which the rules are charged, but with the merits of the rule and the interest of the forum state in their application. Only if this criterion is fulfilled may the others be examined.

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[58] *Sonnenberger* in MünchKomm BGB X^4 Einl IPR, no 76.
[59] *Sonnenberger* in MünchKomm BGB X^4 Einl IPR, no 80; *Kreuzer,* AusländischesWirtschaftsrecht 91ss.
[60] *Grossfeld/Rogers,* ICLQ 32 (1983) 931 (943).
[61] *Sonnenberger* in MünchKomm BGB X^4 Einl IPR, no 82; *Kreuzer,* AusländischesWirtschaftsrecht 91ss.
[62] *Sonnenberger* in MünchKomm BGB X^4 Einl IPR, no 80; *Kreuzer,* AusländischesWirtschaftsrecht 91ss.
[63] *Kreuzer,* AusländischesWirtschaftsrecht 95ss.

Other authors also include an examination of the substance of the rule into their conflict of laws analysis. However, this is done in a last step of analysis after the legislative intent and the close connection have been determined.[64] To what extent the foreign rule must be compatible with the values of the forum is a matter of dispute.

Other authors do not consider the identity of interests to be an element of the conflict of laws rule but consider an examination of the substance of the foreign mandatory rules against the yardstick of the *ordre public* to be sufficient. [65]

The difference in method between the above approaches may make little difference in practice. Whether a rule is not applied in the first place as it does not fulfil the conflict of laws requirements or whether its application is prevented by the safety-net of the *ordre public* makes little difference. The more relevant point is the extent to which the foreign rule must be compatible with or even further domestic interests or whether it must merely not violate the *ordre public*.

Clearly, a foreign mandatory rule cannot be applied if it violates the *ordre public*. For the reasons laid out in the introductory paragraph of this chapter, this is however not enough. Beyond that it can legitimately be required that the foreign rule is compatible with the interests of the forum even though this requirement ought to be applied narrowly and with care.[66] If the foreign rule protects values of a foreign state which are not protected by the forum's laws, there is still no necessity of denying application of the foreign rule if the foreign value is not incompatible with the forum's values.[67] There is no necessity of a corresponding rule of the forum's law protecting this value. Before a foreign rule is denied application a certain measure of incompatibility must be reached.[68]

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[64] *Hentzen,* RIW 1988, 508 (510).
[65] See e.g., *Wengler,* ZVglRWiss 54 (1941) 168 (197ss); *Lorenz,* RIW 1987, 569 (582), *Schnyder*, Wirtschaftskollisionsrecht, no 232ss, 283,ss; *Zeppenfeld*, 128.
[66] *Bär*, 316ss; *Vischer*, RdC (1974-II), 24.
[67] *Hentzen,* RIW 1988, 508 (510).
[68] *Martiny* in MünchKomm BGB X[4] § 34 no 160; *Wengler*, ZVglRWiss 54 (1941) 168 (197ss).

4. Summary

Foreign mandatory rules may be applied under the following circumstances:

1. The foreign mandatory rule was enacted with the legislative intent to govern a specific case and to be applied before foreign courts.
2. The facts of the case must show a close connection to the enacting state.
3. The interests served by the foreign mandatory rule must be compatible with the values of the forum state.

These requirements are elements of a conflict of laws rule of the forum. It is therefore left to the forum judge to decide whether the requirements are fulfilled and a foreign law therefore can be applied. The order in which the judge examines the requirements is practically of lesser importance as foreign mandatory rules cannot be applied if any of the requirements is not met. However, from a dogmatic point of view it seems most stringent to set out at the legislative intent of the rule as this criterion. Even if the unilateral conflict of laws rule included in the foreign mandatory rule is irrelevant for the forum judge, the legislative intent to be applied is the most distinctive factor which is relevant for the application before the forum. The legislative intent that a rule be applied to a specific case will be justified by a close connection between the facts of the case and the enacting state. Before a rule can be applied, however, its merits must be examined. This latter criterion is vital as there is no harmony between the states of the international community on the regulation of the issues governed by mandatory rules and the interests pursued by their enactment. Therefore it is also not possible to establish an all-sided conflict of laws rule including only the first to criteria, despite the facts that this would enhance predictability for the parties to a contract.[69] A judge will therefore have to examine the substance of a rule and will have to compare it to the interests protected by the forum's legal system.

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[69] *Sonnenberger* in MünchKomm BGB X[4] Einl IPR, no 81.

B. Application of mandatory rules solely of the lex causae (“Schuldstatutstheorie”)

One concern that has been raised against the Sonderanknüpfungstheorie lies in the *dépeçage*, the splitting of the applicable law into the *lex causae* and into specific mandatory rules of third states that are applied only to specific aspects of the case which bears the danger of “denaturalization” of the legal relationship.[70]

The Schuldstatutstheorie is based on the notion that the *lex causae* includes not only the rules of private law which would be applicable under the conflict of laws rules of the forum but includes the entire legal order of that state including its mandatory rules.[71] This approach assumes no difference between rules of public and private law.[72] Accordingly, therefore, the *lex causae* governs every aspect of the contractual relationship, leaving no room to apply any mandatory rules of any other countries.[73] Mandatory rules of third states will not be applied but merely may be respected by the legal instruments of the *lex causae* concerning impossibility, hardship or suchlike *e.g.* para. 134 of the German BGB.[74]

As *Kegel* has correctly stated, the mandatory rules of the *lex causae* should not be applied to a contract just because they are part of the *lex causae*.[75] This criticism is supported by a number of reasons: Firstly, the theory is too blunt as it renders all mandatory rules of the *lex causae* applicable without distinction, thereby also applying those which did not have the will to be applied to a case with no connection to the enacting state.[76] Thus, if the parties have chosen a specific national legal order to govern their relationship for reason of neutrality, this approach will lead to unwanted consequences.

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[70] *Serick,* RabelsZ 18 (1953) 633 (649).
[71] *Reithmann/Martiny,* Internationales Vertragsrecht[5] no 446.
[72] *Mann* in FS Wahl 139 (145).
[73] *Mann* in FS Wahl 139 (146); *Stoll* in FS Kegel 623 (629) who however limits the application of this theory to norms that directly influence the contract without serving the state purposes mentioned above at section III.B.
[74] *Mann* in FS Wahl 139 (148).
[75] *Kegel/Schurig,* Internationales Privatrecht[9] 155.
[76] *Schubert,* RIW 1987, 729 (731, 732ss).

Secondly, conflict of laws rules were created to serve the interests of the private parties, *i.e.* to serve the balancing of private interests. The application of mandatory rules must follow different rules, as they do not serve the balancing of interests of the parties, but the enforcement of vital interests of states. Thus, the application of mandatory rules and the ascertainment of the applicable private law cannot be adjudged according to the same criteria.[77]

Thirdly, this theory may allow parties to evade mandatory rules which would otherwise be applicable to the case by simply choosing a legal order that does not contain such rules.[78]

C. To apply or to give effect to the foreign rule

The form in which a judge of forum is to take note of the foreign mandatory rule is subject to dispute. This dispute – in a nutshell – is on whether the rule should be applied as it would be by the courts of the enacting state or whether the forum judge should merely give it effect and apply it as a fact, *e.g.* as an impediment to the performance of a contract.

The first of these approaches would entail the application of a foreign mandatory rule including its legal consequences.[79] If a rule is to be applied by a forum judge due to a conflict of laws rule of the forum, then logically also the legal sanctions which this rule provides for must be applied. Of course, the application of the foreign rule must not be misunderstood to mean the sovereign enforcement of a law but only its enforcement against a contractual relationship.[80] Even when so applying foreign mandatory rules, the forum judge will not enforce penal sanctions or the like against one party but will only enforce it to the extent that the rule has civil law sanctions. Therefore, if the foreign

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[77] *Kreuzer,* Ausländisches Wirtschaftsrecht 82.
[78] *Kegel* in *Soergel,* BGB § 34 no 83.
[79] *Wengler,* ZVglRWiss 54 (1941) 168 (212).
[80] *Drobnig* in FS Neumeyer 159 (175).

mandatory rule declares a contract null and void, the forum judge is to apply this rule and declare a contact void according to the provision of the *lex causae* which provides for the nullity of contracts that violate statutory law and not to use other legal figures such as an impediment to performance of a contract. The foreign mandatory rule is considered to be a rule of the *lex causae*.[81] This is the only stringent consequence of the application of foreign mandatory rules via a conflict of laws rule of the forum.

A second approach refuses to apply foreign mandatory rules directly and only to take account of the effects of such rules. In this case, the legal consequences of the mandatory rule are not applied, but the forum judge decides how best to take foreign mandatory rules into consideration.[82] The language of Art 7(1) Rome Convention ("effect may be given") suggests that a forum judge need not necessarily apply the legal sanctions of a rule. The *Giulano Lagarde* Report mentions that this problem is "delicate" and is therefore not a helpful source for interpretation. Obviously, this instrument leaves the judge a measure of appreciation when deciding how best to incorporate foreign mandatory rues. He could, e.g., consider a foreign mandatory rule which declares a contract null and void merely as a fact and determine other legal consequences than nullity if the *lex causae* so provides. The German Supreme Court, as will be seen below, refuses to apply foreign mandatory rules. However, this does not mean that it merely takes the effects the rule has on the contractual relationship of the parties. The German Supreme Court takes a middle path and – while stating that it refuses to apply foreign mandatory rules – considers the substance of the foreign rule and the interests of the foreign state it protects. If these coincide with German interest, the Supreme Court will take the rule into account within the *lex causae* and declare the contract contrary to good morals. This is obviously more than merely taking the consequences of the existence of the rule into consideration as a fact. The German

[81] *Busse,* ZVglRWiss 95 (1996) 386 (391); *Radtke,* ZVglRWiss 84 (1985) 325 (339).
[82] *v.Westphalen,* NJW 1994, 2113 (2118), who argues that the principle of territoriality prevents states from applying foreign mandatory rules: *Vischer* in ZürchKomm IPRG² Art 19 no. 38.

Supreme Court is analysing the substance of the foreign rule and thereby taking a conflict of laws approach to the applicability of foreign rules.[83]

The results reached by following either of the two approaches may in many cases not be that different. Nevertheless, as a matter of dogmatic clarity the first of the two is more convincing. The second approach has its merit in cases in which foreign mandatory rules cannot be applied as they do not fulfil the conflict of laws rules but still need to be applied as a matter of fairness between the parties.[84] If a foreign rule factually prevents a party from performing a judge cannot be blind to this. In such circumstances it is justified to consider the foreign rule as a fact despite the fact that it cannot be applied. However, this should only be done, if an application of a foreign rule fails and the rule factually intervenes in the legal relationship of the parties, e.g. if one party is subject to a foreign mandatory rule which the enacting state can enforce against that party.

D. The Approaches of in Jurisprudence

1. Mandatory Rules in Continental European Case Law

a) Case law of the German Supreme Court

Just as the United Kingdom and Luxembourg, Germany made use of its right of reservation under Art 22 (1) (a) of the Rome Convention and therefore has not implemented Art 7 (1) of the Rome Convention.

This, however, does not necessarily mean that German courts are prevented from considering foreign mandatory rules. The German legislator deliberately created a legal gap ("*gewollte, offene Regelungslücke*") that jurisprudence is to close.[85]

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[83] *Kegel/Schurig,* Internationales Privatrecht[9] 156.
[84] *Radtke,* ZVglRWiss 84 (1985) 325 (340); *Martiny* in MünchKomm BGB X[4] § 34 no 68.
[85] *Reithmann/Martiny,* Internationales Vertragsrecht[5] no 442 with further references.

The German Supreme Court has repeatedly declined to apply foreign rules which it considers to be part of the public law of that country.[86] The German Supreme Court, however, does not entirely disregard foreign mandatory rules but has developed an approach which allows it to prevent hardship to the parties, while (at least at face value) upholding the dogma of the inapplicability of foreign public laws.

(1) The postulate of non-applicability of foreign public laws.

17.12.1959 (Russian Currency Laws) [87]

In its decision of the 17.12.1959, the German Supreme Court decided on a case concerning the applicability of Russian currency laws. The German Supreme Court held that they could not be applicable before German courts, reasoning that public law is strictly territorial and therefore bound to the territory of the enacting state. Only if the enacting state had the actual physical power to enforce its rules, would the German Supreme Court apply them.[88] Also if the rules merely balance the interest of parties, even those appertaining to public law, the German Supreme Court considered it possible that it may recognize their influence on a contractual relationship.[89]

16.4.1975 (Solchenizyn)[90]

In this case, the Russian author Solchenizyn had granted a German publisher the exclusive right to publish a book. Subsequently, he published it himself and the German publisher filed an action to prevent him from doing so. Solchenizyn claimed that the Russian monopoly on foreign trade forestalled any transfer of his rights to the German publisher.

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[86] See the examples immediately below; to the jurisprudence of the German Supreme Court see generally: *Meng,* Extraterritoriale Jurisdiktion 663; *Junker,* IPRax 2000, 65 (72).

[87] BGH, 17 December 1959, RabelsZ 25 (1960) 645.

[88] BGH, 17 December 1959, RabelsZ 25 (1960) 645 (648).

[89] BGH, 17 December 1959, RabelsZ 25 (1960) 645 (648).

[90] BGH, 16 April 1975, BGHZ 64, 183 (189).

The German Supreme Court held that the contract was valid as the Russian law could not be taken into consideration as it was limited to Russian territory.[91] The *situs* of the copyright could however not be limited to Russian territory.

In these decisions the German Supreme Court refused to apply or even to consider foreign mandatory rules due to its approach that foreign "public" laws only are applicable in the territory of the enacting state. The court found only two exceptions from this principle. Firstly, rules of foreign "public" law which served the balancing of the interests of parties. The German Supreme Court did not detail this exception any further. It is hard to consider public laws which balance the interests of private parties, which may be the reason why this exception has never been implemented in practice yet.[92] The second exception made refers to cases in which the enacting state has the actual power to enforce its mandatory rules. The theory on which this exception is based considers all mandatory rules applicable which the foreign state can actually enforce so that the forum judge cannot be blind towards them.

The refusal of the German Supreme Court to consider foreign mandatory rules based on the principle of territoriality has been criticized. The tenor of the criticism is that it may be correct that foreign mandatory rules only have territorial effect and could only be enforced in the territory of the enacting state but that German courts would not be enforcing foreign rules but only considering them and their effects on contractual relationships.[93] This principle has therefore been rejected by scholarship.[94]

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[91] BGH, 16 April 1975, BGHZ 64, 183 (189).
[92] *Beulker,* Eingriffsnormenproblematik 68.
[93] *Drobnig* in FS Neumeyer 159 (175).
[94] *Radtke,* ZVglRWiss 84 (1985) 325 (341); *Wengler,* ZVglRWiss 54 (1941) 168 (183); *Sonnenberger* in MünchKomm BGB X[4] Einl IPR, no 83 .

(2) Foreign mandatory rules considered under the lex causae

In other judgments the German Supreme Court – still refusing to apply foreign law directly – was willing to declare contracts as void pursuant to clauses included in the German civil code intended for cases of impossibility of performance pursuant to sec 275 German Civil Code or for immorality pursuant to sec 138 of the German Civil Code or due to the doctrine of frustration under sec 242 of the German Civil Code.

German Supreme Court 17.11.1994 (GDR Foreign Trade Monopoly)[95]

In this case the German Supreme Court decided a dispute between a consultant to the Technical University Ilmenau and that university deriving from the consultancy agreement concluded between these two parties in early 1990. The university argued - *inter alia* - that the consultancy agreement was void as the foreign trade regulations of the GDR prohibited universities from concluding agreements with foreign parties. The German Supreme Court held that the foreign trade regulations were to be considered mandatory rules. It further established that such rules could only be applied if they required application in the specific case, which it denied due to the fact that shortly after conclusion of the contract the foreign trade regulations of the GDR were repealed. In then held *obiter* that even if this had not been the case, the rules could only have been considered as a fact and perhaps rendered the contract void due to the impossibility of performance.

German Supreme Court 8.2.1984 (Delivery of beer to Iran)[96]

An Iranian and a German party agreed to export beer from Germany to Iran. The Iranian party claimed that it was unable to fulfil its obligations to the German party, as, after the revolution in Iran, trading with alcoholic drinks had been prohibited on pain of the death penalty. The German Supreme Court refused to apply the Iranian law or subject it to a

[95] BGH, 17 January 1994, BGHZ 128, 41.
[96] BGH, 8 February 1984, RabelsZ 53 (1989) 146ss with a discussion of *Baum*.

conflict of laws – analysis, but held that the commercial basis of the agreement between the parties ("*Geschäftsgrundlage*") was frustrated and therefore adapted the agreement.

German Supreme Court 21.12.1960 (Borax) [97]

In the well known Borax-decision, the German Supreme Court had to decide on the claim of a West German seller who had sold 100 tons of Borax (a chemical also used for weapons) to a West German buyer. Both parties knew that the chemical was destined for the Eastern block.

Under U.S. law, Borax that was exported from the U.S. was not allowed to be sold to the state parties of the Warsaw Pact. The final destination, however, was Rostock/East Germany. The buyer refused to oblige himself not to re-export the chemicals to Warsaw Pact states. Consequently, the seller would not deliver the chemical and the buyer sued. The German Supreme Court ruled that the contract was void for immorality pursuant to para 138 of the Civil Code. The interesting point, however, may be seen in the considerations of the German Supreme Court towards the reasoning of why the contract was immoral.

The German Supreme Court stated first that Germany had not enacted any laws that adopted the U.S. embargo laws. It went on to hold that even so the contract was immoral as the U.S. embargo had been put in place to protect all western states, including West Germany, from increasing the armament of the East Block. Thus, immorality was founded in the violation of the interests of the all western states and therefore also of Germany.

German Supreme Court 8.5.1985[98]

In this case, the plaintiff had acted as an intermediary for the defendant and had bribed local authorities to obtain a contract. The intermediary was to be reimbursed for the bribes by his commission payments. Such bribes were prohibited by local law. The contract contained a choice of German law.

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[97] BGH, 21 December 1960, NJW 1961, 822s.

[98] BGH, 8 May 1985, BGHZ 94, 268.

The German Supreme Court decided for defendant, holding that the agreement to reimburse bribes was immoral and therefore void pursuant to sec 138 German Civil Code. It decided that the German legal order was not endangered through the contract and the bribery, but that also German law disapproves of bribery, thus showing that there existed a common interest of both states in the fight against bribery.[99]

German Supreme Court 22.6.1972[100] (Nigerian cultural heritage)
In this case, the German Supreme Court had to decide a case in which a Nigerian company had insured the transport to Germany of masks and figures that formed part of the Nigerian cultural heritage with a German insurer. This transport of cultural objects had been declared illegal by the Nigerian legislator. After arrival in Germany, some objects were missing and the exporter sued the German insurer who claimed that the insurance contract was void due to immorality.

The German Supreme Court held at first – and in this point this case can be contrasted to the aforementioned – that the Nigerian export prohibition did not touch German interests.[101] It only protected Nigeria from being plundered by foreign collectors. Then it stated that laws such as the Nigerian one protected the interests of all states (citing a UNESCO treaty that was not in force in Germany at the time) in the preservation of their cultural heritage. Thus, the insurance contract was void, even though in this case the German Supreme Court expressly stated that German interests were not touched. The immorality was based on the interests of all states that cultural heritage should not be brought out of the country, which made the insurance contract objectionable enough to be declared immoral.

[99] BGH, 8 May 1985, BGHZ 94, 268 (271).
[100] BGH, 22 June 1972, NJW 1972, 1575 (1576).
[101] BGH, 22 June 1972, NJW 1972, 1575 (1576).

(3) Conclusion

The German Supreme Court maintains until present its dogma of the inapplicability of foreign mandatory rules. This dogma is of course correct. However, its application by the German Supreme Court is not. The application of a foreign mandatory rule does not entail the enforcement of rules of foreign public law, but merely their consequences on a private legal relationship. Even if the German Supreme Court would apply the Sonderanknüpfungstheorie, it would not need to enforce foreign penal, fiscal or other public laws but merely apply them to the extent they have consequences on the private legal relationship[102]

The above cases which declare contracts null and void for immorality are seen by some as an approximation towards the already mentioned "Sonderanknüpfungstheorie" as the Court explicitly compared the interests of the foreign legislator reflected in the rule and the interests of the German state.[103] This is different in cases in which the German Supreme Court decided on the impossibility of performance or frustration of the contract which entailed no substantive analysis of the foreign law.

How strong these tendencies really are may be doubted. After all, the German Supreme Court is not clearly taking a conflict of laws approach when deciding on their application.[104] It is merely considering the substance of the foreign rules without detailing whether it considers the foreign rule applicable or not. Of course, if the German Supreme Court considers the substance of foreign rules, it must – in some way or another – consider these rules applicable and must have taken a conflict of laws approach to decide whether the foreign rule is applicable.[105] To this extent the German Supreme Court is actually taking a conflict of laws analysis. The German Supreme

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[102] *Drobnig* in FS Neumeyer 159 (175).
[103] *Reithmann/Martiny,* Internationales Vertragsrecht[5] no 453; *Zimmer,* IPRax (1993) 65 (67).
[104] *Beulker*, Eingriffsnormenproblematik 75.
[105] *Schurig,* RabelsZ 54 (1990) 217 (243); *Kreuzer,* Ausländisches Wirtschaftsrecht 79.

Court, however, is creating an approach of its own.[106] Its approach is to fill out a general clause of its national law with values of a foreign legislator that it has adopted as its own.[107] This adoption can be considered to include a conflict of laws approach. This application is however not a pure one, as the application of foreign rules is not executed by their direct application and also not via the rule of para 134 BGB, which would at least show the acceptance of the foreign rule as a rule of law and not merely as a fact as the consideration via para 138 shows.[108]

b) Dutch Case Law

Tough the present thesis does not include Dutch law in its scope, there is some jurisprudence of Dutch courts which is of relevance so that it should not be left out in this context.

The first case was decided in 1966 by the Hoge Raad in the Alnati-case,[109] which evolved from the following facts: In 1954, a time at which the Netherlands had not adopted the International Convention for the Unification of Certain Rules of Law relating to Bills of Lading (Hague Rules), a bill of lading was delivered by a Dutch company to its own agents as shippers in Antwerpen, Belgium, which had at that time ratified the Hague Rules, which accordingly were part of their *ordre public*. The bill of lading referred to a shipment of potatoes from France to Brazil, a part of which was damaged during transport. This damage was refunded by Dutch insurers, one of which lodged a claim against a carrier. The Bill contained a choice of Dutch law. The Hoge Raad eventually had to decide the matter, especially the applicability of the Belgian mandatory rules. The Hoge Raad held that a foreign state may have such an interest in the application of its rules to a case in a foreign court that a foreign court should take

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[106] *Basedow,* GYIL 27 (1984) 109 (123).
[107] *Reithmann/Martiny,* Internationales Vertragsrecht[5] no 453.
[108] *Zimmer,* IPRax (1993) 65 (66).
[109] The relevant excerpts from this case are reprinted in *Schultsz,* RabelsZ 47 (1983) 267 (273s), the Dutch original text can be found in Ned.Jur. 1967 no. 3, 16.

them into account, even if the parties have chosen other law to be applicable. It then went on to hold that the Belgian rules were not of such character.

The Dutch Hoge Raad did not analyse in detail the circumstances under which a foreign mandatory rule should be taken into account. It obviously considered that shared interests would be a prerequisite for the application of foreign mandatory rules, which shows a parallel to the Sonderanknüpfungstheorie.

This doctrine was further developed by to the so-called Sensor case,[110] where the application of an American export control act required written authorization by the Office of Export Administration for export or re-export to the U.S.S.R. of any oil and gas exploration, production, transmission of refinement goods of U.S. origin. The Dutch Supreme Court, after a lengthy elaboration on the various bases for jurisdiction under public international law and the denial of the applicability of any, adjudged that the American mandatory rule could not be applied as it was not in conformity with international law. It went on to hold, that Dutch courts – as a matter of principle – would apply foreign mandatory rules, if they had a sufficiently close connection to the Netherland. The precise methodology of the Dutch court is not quite clear. It denied the applicability of the U.S. rule *a priori* due to a violation of public international law. It did not consider any elements of the Sonderanknüpfungstheorie. It held *obiter* that a close connection would be a prerequisite of the application of a foreign mandatory rule. The Hoge Raad, therefore, refined its approach in this case as it held that foreign mandatory rules with a close connection to the forum state could be applied, though this connection was not existent in the case at hand. This case clearly shows a conflict of laws approach to the application of foreign mandatory rules.

c) Austrian Case Law

Early decisions of the Austrian Supreme Court dealing with the possibility of reviewing expropriations deny the power of Austria courts to re-examine a foreign act of

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[110] Judgement of the Arrondismentrechtsbank Den Haag from the 17.9.1982, RabelsZ 47 (1983) 141ss (in German translation).

expropriation[111] even when the expropriated goods had been removed from the territory of the expropriating state after expropriation.[112]

In a decision of 1961, the Austrian Supreme Court had to deal with a case concerning the applicability of Austrian currency law.[113] The Austrian Supreme Court held that if a contract was to be executed in Austria this rendered Austrian currency law applicable. It has been generalized to the rule that Austrian exchange control laws will always be applied by Austrian courts.

Concerning the application of foreign exchange control laws, the Austrian Supreme Court has held in various decisions that the application of foreign mandatory rules is possible, if the transfer of assets and thus the execution of the contract took place on the territory of the enacting state and if the assets were not located in Austria.[114] *Bydlinski* criticized these judgments as early as 1961 and suggested the use of the Sonderanknüpfungstheorie.[115]

On the 1.1.1979 the Austrian Private International Law Act came into force.[116] In its sec 1, it states that the law of the state with the closest connection to the case shall be applicable, thus creating the legal basis for the "Sonderanknupfüngstheorie" of Austrian national mandatory rules.[117] The Austrian Private International Law Act does not include a provision on mandatory rules. Therefore, its sec 1 and the application of the law of the closest connection can be implemented as a basis for the application of mandatory rules. The requirement of the application of the law with the closest

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[111] HS 2067, HS 2065; HS 2062.
[112] HS 5513.
[113] OGH, 24 June 1959, ZfRV 1961, 18.
[114] Decision of the OGH, 30 March 1976, 3 Ob 519/76, ZfRV 1977, 230 (232) with comment *Hoyer*; *cf.* Judgement of the OGH, 24 June 1959, 6 Ob 204/59, ZfRV 1961, 18 (20); *Verschraegen* in *Rummel,* Vor § 35 IPRG no 28.
[115] *Bydlinsky,* Commentary to the judgement of the OGH from the 24 June 1959, ZfRV 1961, 22 (24).
[116] BGBl 1978/304.
[117] *Verschraegen* in *Rummel,* Vor § 35 IPRG, no 20.

connection must be interpreted to mean that if a mandatory rule has an interest to be applied to a certain case, this interest creates the closest connection.[118]

Already in 1986 the Austrian Supreme Court held in a case concerning the applicability of an Austrian regulation on the maximum fees to be charged by real estate agents that sec 1 of the Private International Law Act provides for the application of the Sonderanknüpfungstheorie as described in the preceding paragraph.[119] It defined mandatory rules as rules by which the state directs its public interests and which intervene in private legal relationships to protect those public interests. It further held that the public interests justify that mandatory rules are applied regardless of the otherwise applicable law as the latter is determined serving the interests of the parties. It explicitly held that mandatory rules (in this case of the *lex fori*) are to be applied due to their legislative intent, which is to be read from the text of the rule or to be interpreted from it. In that case it held that the rule in question did not have the legislative intent to apply. This judgement clearly showed the application of the Sonderanknüpfungstheorie. Of course, this judgment is not relevant for the position of the Austrian Supreme Court on the application of mandatory rules of third states.

In its judgement of the 14.7.1993, the Austrian Supreme Court had to decide a case concerning the liquidation of an off-shore bank with its headquarters in St. Vincent that had subsidiaries in Austria and Liechtenstein.[120] As the bank did not have the necessary permission to carry out banking activities in Liechtenstein, the authorities in Liechtenstein ordered the liquidation of the bank. At the same time, the bank decided to liquidate itself. The Liechtenstein authorities had installed a liquidator as did the bank itself. Both liquidators claimed to represent the bank regarding the liquidation of assets located in Austria. The Austrian Supreme Court had to decide which of the two liquidators could legally represent the bank in proceedings in Austria.

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[118] *Verschraegen* in *Rummel,* Vor § 35 IPRG, no 20.

[119] OGH, 19 November 1986, 8 Ob 575/86; see on this judgement also *Reichelt,* ZfRV 1988, 82 (88).

[120] Judgement of the OGH, 14 July 1993, IPRax 1994, 377.

The Austrian Supreme Court declared that according to Austrian law the headquarters of the bank must either be in Liechtenstein or Austria, not however on St. Vincent, as these were the places where the actual business took place. The court of 2nd instance would thus have to determine which of the two places should determine the applicable law (§§ 12, 10 Austrian PILA).

It went on to hold that, if the headquarters were in Austria and Austrian law were applicable, the representative appointed by the bank was to represent the bank in Austrian proceedings.

If however, the headquarters were determined to be in Liechtenstein and its law were applicable, the question arose as to whether the appointment of the Liechtenstein representatives was valid. This act of appointment was a consequence of a mandatory rule of Liechtenstein banking law, designed to protect the banking trade and creditors. Just as before the Supreme Court determined whether the rule was a mandatory rule by reference to purpose and the interests it served. The Supreme Court decided that the rule in question fulfilled this prerequisite. It also held that the application of mandatory rules follows the Sonderanknüpfungstheorie and that the application of mandatory rules depends on their legislative intent and the close connection they have to the facts of the case. It held that the legislative intent of the rule creates the closest connection between the rule and the facts of the case. This reasoning presumably was chosen, as Austria had at the time of judgement not yet acceded to the Rome Convention. Therefore, there was no provision explicitly dealing with mandatory rules and the court referred to sec 1(1) Austrian PILA, which generally states that the law with the closest connection must be applied. Lastly, the Supreme Court held that the foreign mandatory rule must no violate the Austrian *ordre public*. Further, the Supreme Court held that the rule must be capable of being "*internationalized*", without defining this term further. However, the Supreme Court cites *Reichelt* who uses this term to describe merely that the foreign legislator wanted the rule to apply also before foreign courts;[121] this term therefore does not differ from the legislative intent required.

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[121] *Reichelt,* ZfRV 1988, 82 (86).

In that case, the Austrian Supreme Court only decided on mandatory rules of the *lex causae* and specifically stated that the application of mandatory rules of other third states is a question more difficult to answer.[122] However, as the Supreme Court explicitly held that mandatory rules are to be applied due to their legislative intent and their close connection to the facts of the case, there is no reason to suspect that the Supreme Court would decide differently if the mandatory rule had pertained neither to the *lex causae* or the *lex fori*.[123] Until the present date no case is known in which the Austrian Supreme Court would have done so. Since 1998 Austria is a party to the Rome Convention. A judgment based on article 7 (1) Rome Convention has not been rendered yet.

d) Swiss Case-Law

In early jurisprudence dating from the period before the enactment of the Swiss PILA Swiss courts essentially followed the same approach taken by the German Supreme Court and declared that application of foreign mandatory rules was limited by the principle of territoriality and that they therefore could not be applied by Swiss courts. Foreign mandatory rules would only be taken into account as facts and treated as such under the relevant provisions of the applicable law.[124]

Art 19 of the Swiss PILA, which allows for the implementation of the Sonderanknüpfungstheorie, brought a change to this approach. Swiss courts have repeatedly made use of this provision.

In 2001 the Swiss Supreme Court had to decide on the argued misapplication of EU competition law to an exclusive distribution agreement for Belgium, the Netherlands

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[122] Judgement of the OGH, 14 July 1993, IPRax 1944, 377 (379).
[123] *Ehricke,* IPRax 1994, 382 (386).
[124] Decision of the BGE, 4 February 1969, 95 II 109 regarding the refusal to apply Hungarian currency laws; see *Vischer* in ZürchKomm IPRG² Art 19 no 11 for further examples.

and Luxemburg.[125] The lower instances had denied a violation of EU competition law. The applicant argued that the lower courts had, however, omitted to examine Dutch and Belgian (domestic) competition law. The Supreme Court held that foreign mandatory rules could be applied in accordance with Art 19 Swiss PILA if they have a close connection with the facts of the case, which, in the case of competition law rules, is existent if the effects of a contract are felt on a market. As the lower instances had correctly defined the market not as an individual national market, but as a market consisting of various EU member states, it had correctly applied EU competition law and not national competition law.

This decision shows that Swiss courts, other than most states which enacted Art 7 Rome Convention, are willing to apply Art 19 Swiss PILA and to apply foreign mandatory rules.

In a more recent decision, the Swiss Supreme Court decided on the applicability of U.S. insolvency laws before Swiss courts and their impact on a contract subject to Swiss law. The Swiss Supreme Court confirmed that the relevant U.S. law had the legislative intent to be applied extraterritorially. The wife opened an account with a Swiss bank, which was active in both Switzerland and the U.S. Her husband was entitled to access the account. The husband than went bankrupt and his estate was subject to U.S. bankruptcy laws. According to these, the Swiss bank was ordered to provide certain information about the bank account to the U.S. authorities, which it could not do without violating Swiss regulations on banking confidentiality. The wife sued the bank for payment of the amounts on the account. The bank resisted the claim arguing that it would be subject to penalties under U.S. law (which could be enforced, as it was active also in the U.S.) if it made the payment. The court of first instance decided to modify the contract between the bank and the wife to the effect that the bank's payment obligation was suspended. The Supreme Court in detail examined whether the court's interpretation of Art 19 Swiss PILA was correct. It first scrutinized at length what requirements the connection between the facts of the case and the U.S. must fulfil to qualify as a close connection for

[125] Decision of the BGE, 7 May 2001, 4C.32/2001.

the area of bankruptcy law. It held that the fact that the wife, who was not subject to U.S. bankruptcy proceedings, was domiciled in the U.S. was for itself not sufficient. Further, as the husband was not party to the contract between the wife and the bank, his domicile in the U.S. was also not sufficient. It then held that the claim of the wife against the bank was possibly part of the husband's estate. However, the Supreme Court held that this was not relevant, as the Swiss PILA contains explicit regulations on bankruptcy of persons domiciled abroad with assets located in Switzerland. The Swiss legislator had in Arts 166ss Swiss PILA already issued rules which account for the interests pursued by utilizing Art 19 to apply the foreign mandatory rule. As there were more special rules for the case, the application of Art 19 Swiss PILA by the court of first instance was superfluous and did not respect the exceptional character of Art 19 Swiss PILA.

Swiss case law shows that Swiss courts are willing to implement Art 19 Swiss PILA, and to take a conflict of laws – approach to foreign mandatory rules. Art 19 is a clear example of the Sonderanknüpfungstheorie set out above, which has also been emphasized explicitly by the Swiss Supreme Court.

2. The U.K. approach

The United Kingdom has opted to use its right under Art 22 para 1 of the Rome Convention and thus does not apply Art 7 para 1 of this instrument. English courts have repeatedly stated that they will only apply mandatory rules of English law or of the *lex causae* if this happens not to be English law.[126] The approach taken bears resemblance to the "Schuldstatutstheorie" developed under German law described above.[127]

However, this does not mean that English courts ignore all rules of law that are neither part of the *lex fori* or the *lex causae*. It will be shown in the following that English

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[126] *Dicey/Morris,* The Conflict of Laws II[13] (2000) 1244 referring to *Kleinworth, Sons & Co.* v. *Ungarische Baumwolle Industrie A.G.* 2 K.B. 678 (C.A.) (1939).
[127] *Vischer,* RdC (1992-I) 1 (172).

courts have nevertheless given effect to foreign mandatory rules. English courts do not address this issue as an application of foreign mandatory rules. As will be set out here below, English courts will instrumentalize the concept of public policy or will consider rules of the *lex loci solutionis*.

a) Illegality as a violation of the English *ordre public*

English courts have repeatedly decided cases in which a contract violated foreign law. In these cases, English courts did not apply the foreign rule. They did not adopt any conflict of laws analysis. To the contrary, they based their decisions on a very broad notion of the English *ordre public*.

In *Foster* v. *Driscoll*, a group of people in Great Britain formed a partnership with the sole purpose of smuggling whisky from Great Britain into the United States, which was illegal according to US law at the time of prohibition.[128] The Court of Appeal held that the partnership was illegal; however it reasoned that this was so by recourse to British public policy ("public morality"). Accordingly, English public policy would prevent English courts from recognizing a partnership which had been formed to violate foreign law, as this would justly give the United States a reason to complain to the English government and thus be in violation of England's obligations arising from international comity.[129] It seems that, in that case, the Court had no intention of applying US law, but merely took it into account while nullifying the contract due to English public policy.

In *Regazzoni v. Sethia*,[130] the House of Lords held a contract between an English company which agreed to sell 500,000 jute bags to a Swiss resident to be shipped from India to Italy to be illegal. While nothing in the contract was illegal by English law at first sight, both parties knew that the bags were to be re-exported to South Africa. At the time, however, India operated an embargo against South Africa due to its Apartheid

[128] Judgement of the Court of Appeal in *Foster v. Driscoll,* 13 December 1929, 1 KB 470 (CA); see on this case also *Hartley,* RdC 266 (1997) 337 (395).
[129] *Foster v. Driscoll,* per Lawrence, J., , 13 December 1929, 1 KB 470 (510) (CA).
[130] Judgement of the House of Lords in *Regazzoni v. Sethia*, 21 October 1957, AC (1958) 301.

regime and it was thus illegal under Indian law to export jute from India if the final destination was South Africa. The House of Lords held that it was contrary to English public policy to enforce a contract that violated the laws of foreign and friendly countries. The reason for the House of Lords giving effect to the law of India was international comity.[131] The distinction that can be made between *Foster v. Driscoll* and *Regazzoni v. Sethia* is that in the second case the purpose of the contract (the sale of jute bags from India to Italy) was not illegal and the parties had not concluded the contract with the intent of violating the Indian embargo regulation, while in *Foster v. Driscoll* the whole point of the contract was the smuggling of whisky. Nevertheless, the House of Lords decided that the contract would violate public policy.

A third case shows the technique of implementation of foreign mandatory rules by English courts. In *Lemenda Trading Co. v. Afrian Middle East Petroleum Co.*[132] the English Court of Appeal held that a lobbying contract that was in violation of the internal public policy of Qatar, without however violating a specific rule of law, could not be enforced in England. The reasoning was following: If a contract is in breach of foreign internal public policy, it can be enforced in England. It will, however, not be enforced in England if internal English public policy contained a rule to the same effect, as in this case international comity "combines" with English domestic public policy.[133] As the conclusion of contracts for the lobbying of English State-owned companies would be contrary to English domestic public policy, the Court decided that the contract was unenforceable.

In the above cases, English courts have utilized the English notion of *ordre public* in broader approach than the one foreseen under Art 16 Rome Convention. In essence, the rule established by *Foster* and *Regazzoni* is that contracts that have been concluded with the intent to violate mandatory rules of foreign law violate English public policy.[134] In

[131] *Hartley,* RdC 266 (1997) 337 (390).
[132] [1988] 1 Q.B. 448.
[133] See also the discussion of the *Lemenda* case in *Westacre Investments Inc* v. *Jugoimport-SDRP Holding Company* Yearbook Comm. Arb'n XXIVa 1999, 753 (765–766); *Collier,* CambridgeLJ 1988, 169 (171).
[134] *Kuckein,* ‚Berücksichtigung' von Eingriffsnormen 269.

Lemenda Trading the court expanded this rule to a certain extent, as also contracts which did not violate a specific rule of law but only the domestic public policy of a foreign country could be unenforceable. The concept or *ordre public* used by the English courts does not exclude a rule of foreign law because its application is considered repugnant from the point of view of the English judge. Both in *Foster* and in *Regazzoni*, English courts “imported” foreign mandatory rules into English law and in effect applied them to contracts. This utilization of the concept of *ordre public* includes a conflict of laws element. English courts declare contracts void for the reason of comity with other states, the rules of which are violated by contracts. By doing so they are recognizing foreign rules as rules of law and not only as facts.[135] Further, in *Lemenda Trading*, English courts decided according to the values protected by the rules of foreign states and compared them to those protected under English law.

b) Illegality under the *lex loci solutionis*

In addition to the rule set out in *Foster*, *Regazzoni* and *Lemenda*, English courts have treated contracts as illegal which violated a rule of the *lex loci solutionis*. This was decided in 1920 by the English Court of Appeal in *Ralli Bros. v. Compañia Naviera Sota y Aznar*,[136] a case that yet again concerned the chartering of jute, this time from India to Spain. The contract, legal at the time of conclusion, provided for half the freight to be payable at the time the ship left India and the other half when it arrived in Spain. After the contract had been concluded, Spanish law changed and rendered the payment of the full second half of the freight illegal due to Spanish price-control legislation that imposed a limit on the freight. The English company refused to pay more than the price legal according to the Spanish law; the Spanish company sued in England. The English

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[135] Contra *Collier,* Conflict of Laws 217 arguing that English public policy is in fact not including a rule of foreign law but excluding the rule of the lex causae which declares the contract enforceable. This argumentation seems artificial. If the foreign rule has no influence on the contractual relationship, there is no reason to exclude any rule of the *lex causae*. In fact it is the policy of the foreign state which English courts are recognizing.

[136] Judgement of the Court of Appeal, 17 December 1919, 2 KB (1920) 287 (CA).

Court of Appeal held that the proper law of the contract was English but, due to the Spanish price limitation, the English company was only to pay the limited freight.

The reasoning of this case is not quite clear. Warrington J. held that it was an "implied condition of the obligation" that the payment must be legal in the place where it should take place, an opinion obviously also approved by Scrutton J., who however added that England will not assist or sanction the breach of laws of other independent states.

While, on the one hand, it seems that the contract had partially been invalidated by a rule of English contract law, Scrutton J, also considers notions of international comity to be applicable and thus the invalidity does not arise solely from a rule of English law. The academic views divide on the question of whether it is a rule of English contract law due to which a contract is unenforceable if illegal at the place of performance or of whether it is a conflict of laws rule though the predominant view suggested by Warrington J. and other commentators is that the court applied English internal contracts law rather than a conflict of laws rule that rendered the contract unenforceable due to frustration.[137] If it is in fact merely a contract law rule, it will only apply if English law governs the contract. Thus, an English court would not declare a contract unenforceable or contrary to English public policy if it is governed by foreign law.

This discussion has become rather moot by Art 9(3) Regulation 583/2008. As stated above, this provision allows a judge to give effect to mandatory rules of the *lex loci solutionis* if they render the performance of a contract illegal.[138] This provision is a conflict of laws provision and therefore allows English judges to give effect to mandatory rules of the *lex loci solutionis* regardless of the law applicable to the contract.

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[137] Which is the conclusion *Hartley,* RdC 266 (1997) 337 (393) comes to; *Cheshire/North,* Private International Law 759; *Jackson,* Comparative Study 49 (62) *Collier,* CambridgeLJ 1988, 169 (171); *Dicey/Morris,* The Conflict of Laws II, 1248 are not so decisive and essentially leave the question open.

[138] *Cheshire/North,* Private International Law 761.

c) Conclusion

In conclusion, it can by remarked that English law does not acknowledge a form of application of foreign mandatory rules similar to the ones exercised in continental European jurisdictions. The tool used by English courts is English public policy, which essentially can "incorporate" foreign rules. However, the breach of these rules must apply on a very high level, such as the formation of a partnership solely for the violation of foreign law.

English public policy thus is not only a negative tool that prevents the application of foreign law which is incompatible with English notions of justice; it also has a positive side and partially fulfils the role of the theories of continental European law that seek to apply mandatory rules of third states. Of course, this instrument is blunter and may not lead to the legal certainty that was sought to be reached by the reservation to Art 7(1) of the Rome Convention. Mandatory rules need not necessarily form part of the public policy, though they often may. Hence, there will be mandatory rules of third states that fall short of the category and thus will not be enforced in England, though perhaps they would in continental Europe.

3. An obligation to apply mandatory rules of EC member states in the European legal space?

a) A stronger impact of mandatory rules in the European Union?

In the European Union, many legislative powers that usually form the integral part of a state's sovereignty have been passed over to the organs of the European Union. The question may be posed here as to whether or not a member state of the Union has a solidarity obligation towards other member states that obliges it to enforce its mandatory rules.[139] In any event, it ought to be considered whether member states are

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[139] *Drobnig,* RabelsZ 52 (1988) 1 (3).

under an obligation to apply mandatory rules of other member states if these rules were enacted to implement the goals of the EC Treaty.[140]

As *Sonnenberger* formulated, it would be illogical to draw the exclusive competence to enact rules to the organs of the European Union, thus preventing the member states from enacting their own rules, and then not to oblige each member state to apply the rules then enacted by the respective competent state.[141] He further argues that the rule formulated in Art 7 (1) of the Rome Convention is exceeded by such rules and an obligation for the member states exists to apply these rules, regardless of whether they have implemented Art 7 (1) of the Rome Convention or not.[142] For the European legal space, this extensive approach may be justified, as this is surely the most effective way to grant individuals the benefits of the EC Treaty.[143]

The European Court of Justice has not decided on exactly that matter yet, it has however decided on the applicability of EC directives in international cases. To grant the individual the benefits of EC law and to effectively establish a common market, the ECJ held that certain EC directives may have the character of mandatory rules. In the *Ingmar Case*,[144] the ECJ decided a case dealing with the application of Council Directive 86/653/EC on the co-ordination of the laws of the Member States relating to self-employed commercial agents[145] on the termination of an agency agreement between an English agent and a US principal, to which Californian law was applicable due to the choice of the parties. The ECJ held that the application of the Directive could not be set aside by the choice of a foreign law, but had to be applied where "the situation is closely linked to the Community".[146] It did not explicitly refer to Art 7 (1) of

[140] *Sonnenberger* in MünchKomm BGB X[4] Einl IPR, no 183.
[141] *Sonnenberger,* IPRax 2003, 104 (114).
[142] *Sonnenberger,* IPRax 2003, 104 (114); see also *Fetsch,* Eingriffsnormen 381.
[143] *Roth,* RabelsZ 55 (1991) 623 (665).
[144] *Ingmar GB Ltd. v. Eaton Leonard Technologies Inc.*, Case C-381/98, ECR I-9305 (2000).
[145] OJ L 382/17 (1986).
[146] *Ingmar GB Ltd. v. Eaton Leonard Technologies Inc.*, Case C-381/98, ECR I-9305, para 23-4 (2000).

the Rome Convention though it used the same methodology when deciding the case.[147] Thus, also Directives of the European Union can be mandatory rules in the sense usually used for national laws.[148]

b) The Influence of the European Law of Civil Procedure on the Application of Mandatory Rules

The only safe way for a state to ensure the application of its mandatory rules is to combine substantive rule with the grant of exclusive jurisdiction to its national courts. If another state does not respect this exclusive jurisdiction, the enacting state still has the possibility of denying the recognition of the foreign judgment.

This is fundamentally different in the realm of 'European civil procedure law'.[149] Firstly, in the area of application of these instruments, the member states have abandoned their rights to enact rules of exclusive jurisdiction outside the limits set by these instruments. Secondly, member states have strongly limited their rights not to recognize foreign judgments when these are contrary to national *ordre public*.

As a consequence of this constellation, it is obvious that the member states must be able to rely on the courts of the other member states to implement their mandatory rules, as they have very limited means to do so themselves by granting themselves exclusive jurisdiction or by reviewing the judgments before enforcing them.[150]

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[147] *Verhagen,* ICLQ 51 (2002) 135 (140).

[148] See also *Grünbuch der Kommission über die Umwandlung des Übereinkommens von Rom aus dem Jahr 1980 über das auf vertragliche Schuldverhältnisse anzuwendende Recht in ein Gemeinschaftsinstrument sowie über seine Aktualisierung*, reprinted in *Das Gruenbuch zum Internationalen Vertragsrecht* (2004) 255 (295) (page 41 of the document) which suggests specifically stating this in a possible revision of the Rome Convention.

[149] Which is formed by Directive 44/2001, which supersedes the Brussels Convention of 1968 for all member States of the European Union except for Denmark and the Lugano Convention of 1988 which is open to member states of the European Union and the European Free Trading Association: for the influence of these instruments on mandatory rules see generally *Freitag* in Das Grünbuch zum Internationalen Vertragsrecht 166 (184).

[150] *Reithmann/Martiny,* Internationales Vertragsrecht[5] no 469.

It has thus been argued that, in the realm of these conventions, all member states have an obligation to implement the mandatory rules of the other member states.[151] Art7 (1) Rome Convention can therefore form, if it is read – as is suggested in this context – as providing for an obligation of judges to apply foreign mandatory rules, the substantial counterpart of the European instruments on civil procedure.

4. The U.S. approach

The U.S. approach to conflicts of laws in general seems diffuse at the first glance. There are numerous scholarly approaches to conflict of laws. Every state has enacted its own conflict of laws system and they are by no means all identical. Therefore, there is no such thing as a uniform "U.S. approach" to conflict of laws and therefore also not to the application of foreign mandatory rules. The approach taken for the sake of this thesis is therefore to analyze the underlying principles regarding the concept of mandatory rules. It is not submitted that the following outline of U.S. theories is exhaustive. U.S. case law shows that often various theories are not applied by courts purely but are intermingled with one another. It will therefore have to suffice to outline the theories here. The most interesting approach in the present context is *Brainerd Currie*'s theory of "interest analysis". Some relevant further modern methodologies which partially build on the theory of interest analysis will also be analysed, especially the approach of the Restatement (Second) of Conflict of Laws.

At the outset one notices that there are fundamental differences between continental European and U.S. conflict of laws theories. Only a short outline of the development of U.S. theories will be given here. The relevant modern theories will be discussed in more detail thereafter.

The teachings of Savigny and the development of a coherent system of conflict of laws rules which determined the applicable law by reference to the facts of the case did not

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[151] *Reithmann/Martiny,* Internationales Vertragsrecht[5] no 445; *Freitag* in Das Grünbuch zum Internationalen Vertragsrecht 166 (185).

have influence in the U.S.. *Beale*, the reporter for the Restatement (First) of Conflict of Laws (1934), based his theory on the notion that if a right is validly acquired under foreign law it is to be recognized everywhere if the foreign law is appropriate.[152] This approach was subject to severe criticism. *Cook* argued in his "local law theory" that foreign law cannot apply extraterritorially (as under Beale's theory). Local substantive law, however, may grant a remedy and therefore adapt the local law if a right has been acquired abroad. *Cavers* developed a methodology based solely on the interpretation of the substantive law. The application of a substantive law, accordingly, depended not on the contacts it had with the case, but on the underlying policies, the peculiarities of the case and the need for a just decision.[153] Thereafter, the most influential approaches and the ones considered most important for the subject of this thesis where taken by *Currie*, *von Mehren* and *Trautmann* and by the Restatement (Second) of Conflict of Laws.

a) *Brainerd Currie's* "Interest Analysis"

Currie developed an approach which is based fundamentally on the policies of a state reflected in its laws and in the application of laws based on these policies. He based his theory on the analysis of the decision of *Millikin v. Pratt*,[154] a case decided in Massachusetts in 1878. In that case Mrs. Pratt, who was resident in Massachusetts, agreed with a supplier resident in Maine to stand surety for her husband. Her husband defaulted and Mrs. Pratt was sued in Massachusetts. Under Massachusetts law, a woman could not stand surety for her husband, under Maine law she could. The Supreme Court of Massachusetts held that the *lex loci contractus*, thus Maine law, was to be applied and the contract was thus valid.

This is the lynchpin for *Currie*'s theory. He follows from the fact that Massachusetts had rejected a bill shortly before the judgment was rendered allowing women to stand

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[152] *Scoles/Hay/Borchers/Symeonides,* Conflict of Laws[3] 21; *Sonnenberger* in MünchKomm BGB X[4] Einl IPR, no 22.

[153] *Scoles/Hay/Borchers/Symeonides,* Conflict of Laws[3] 21; *Kegel/Schurig,* Internationales Privatrecht[9] 200.

[154] *Seth M. Milliken & others v. Sarah A. Pratt,* 125 Mass. 374; 1878 Mass. LEXIS 80.

surety for their husbands. Therefore, Massachusetts had subjected the security of commercial transactions to the protection of married women. Maine, on the other hand, had done exactly the opposite.[155]

The question Currie deduced from the case was: Did Massachusetts want to protect only the women of Massachusetts or did it want to protect all women? This is where *Currie* reaches the crux of his argument. He follows that Massachusetts wanted to protect merely its own women and not those of Maine.[156] Thus the decision of the court was wrong, as the court should have applied the Massachusetts law, as Mrs. Pratt was resident in Massachusetts. However, the Massachusetts law should not apply it if the woman is resident anywhere other than Massachusetts. But the theory of interest analysis logically requires also a second interest to be weighed. In this case, it was Maine's interest in the upholding of commercial contracts whenever the creditor was resident in Maine.

According to Currie, a court may come to three conclusions at this stage of its analysis: (1) only one of the states has an interest in applying its law ("false conflict"); (2) both states have an interest in the application of their rules ("true conflict"); (3) neither state has an interest in the application of their rules ("unprovided-for case").

In the first case the law of the interested state, which may also be a foreign state, is to be applied.

Currie however comes to the conclusion that in cases (2) and (3) the *lex fori* is also to be applied without weighing the interests of the affected states.[157] He justifies the application of the *lex fori* in cases of true conflicts by the idea that no state need subordinate its interests to those of another state. Accordingly, judges do not have the constitutional power to weigh governmental interests. In the last category of conflicts, the "unprovided-for cases", the law of the forum is to be applied as "*no good purpose*

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[155] *Currie,* Married Women's Contracts, U.Chi.L.R. 25 (1958) 227 (230).
[156] *Currie,* Married Women's Contracts, U.Chi.L.R. 25 (1958) 227 (234).
[157] *Currie,* Married Women's Contracts, U.Chi.L.R. 25 (1958) 227 (234).

will be served by putting the parties to the expense and the court to the trouble of ascertaining the foreign law".[158] Though this assertion seems practical and convincing at first, it has been criticized for the following reason: To find out if the other state is not interested, it is necessary to analyse the content of the foreign law and the underlying policies and to decide whether it has an interest in the application of its law or not.[159]

Currie's governmental interest analysis has met substantial critique throughout international scholarship for a multitude of reasons. For the field of the application of mandatory rules, not all are relevant.

However, to single out the relevant points of critique: *Currie's* approach is incapable of determining the policies that underlie the conflicting rules of law and in fact it will in many cases not be possible to determine the policy which underlies a rule.[160] Even if the underlying policies can be ascertained, it is not possible to delineate the law's intended territorial reach.[161] Thirdly, it may be doubted if the states that enacted the conflicting rules have an interest in the outcome of the case.[162]

The first point of criticism undoubtedly has its merits in cases in which a judge is to interpret the laws of foreign states. It may be noted at this point that also European conflict of laws require a national judge to interpret foreign laws and to ascertain the intent of foreign legislators.[163] Leaving this interpretation to a national judge has been subject to substantial critique also in Europe. However it is necessary to distinguish between the European approach, which requires the judge to detect merely the will of the foreign legislator in the extraterritorial application of its law, and the task of a judge applying *Currie's* interest analysis. In the latter case, the judge is to ascertain the spatial applicability of the rule and the "governmental interest", which consists of the

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[158] *Currie,* Stanford Law Rev. 10 (1957-58) 205 (232).
[159] *Scoles/Hay/Borchers/Symeonides,* Conflict of Laws ^{3} 33.
[160] *Juenger,* AJCL 32 (1984) 1 (35-36); *Brilmayer,* MichLR 78 (1980) 392 (393, 464).
[161] *Juenger,* AJCL 32 (1984) 1 (35); *Brilmayer,* MichLR 78 (1980) 392 (393, 464).
[162] *Kegel,* RdC 112 (1964-II) 91 (95,184), limiting this proposition to cases in which matters of public law are not at stake.
[163] *Supra,* section III.B (the extraterritorial "Geltungswille" of the mandatory rule).

evaluation of (1) the reasonableness of the unilateral wish of the state, that its rule is applied taking into account the elements of the case and (2) the intent of the foreign legislator.[164]

The second point, concerning the impossibility of interpreting the rule to pinpoint the spatial applicability of the respective rule, criticism is less substantial. If the underlying policy has been established it is an – admittedly difficult – matter of teleological interpretation to determine the spatial reach of a rule, which accordingly may not always depend on legislative intent.[165] At least for the cases usually envisaged by mandatory rules, *Brilmayer's* statement that "*legislators have no actual intent on territorial reach*" seems to go too far.[166] The teleological interpretation of a rule is basic to the judicial process. If a judge is capable of detecting the foreign policy underlying a rule, there is no reason why he should not also be capable of delineating its spatial reach.

The third point of criticism may be relevant for "normal" conflict of laws, not including norms charged with legislative intent that a rule be applied extraterritorially, and economic and social policies of the legislator. However, the mandatory rules that are the basic issue of this thesis are rules, the application of which is of fundamental importance to the enacting state, as their non-application may have detrimental effects. According to the mentioned continental "Sonderanknüpfungstheorie", a mandatory rule may be applied only if it protects specific values of the enacting state (*supra* section III.C). Thus, this point of criticism can find no justification for the rules that are of interest in the framework of this thesis.

b) The Functional Analysis

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[164] *Scoles/Hay/Borchers/Symeonides,* Conflict of Laws [3] 27.

[165] *Symeonides,* Ohio State LJ 1985, 549 (556).

[166] *Brilmayer,* MichLR 78 (1980) 392 (393).

The Functional Analysis shares many elements of *Currie's* governmental interest analysis.[167] Unlike *Currie's* approach however – and this seems to be the most significant difference – the Functional Analysis recommends the weighing of interests to then apply the rule of the state with the stronger policy.[168] If cases however cannot be resolved by analysing and weighing the conflicting policies of both 'concerned jurisdictions' the judge can amalgamate the two rules and create a multistate rule[169] or can – if the weighing of interests leads to no result – apply the *lex fori* if it is a concerned jurisdiction.[170]

The implementation of this theory is doubtlessly intellectually stimulating for a judge. Whether it is practical for every conflict of laws situation may be doubted, as the establishment of governmental interests for every conflict situation.[171]. This theory has not found significant judicial acceptance.[172]

c) The approach taken by the Restatement (Second) of Conflict of Laws.

§ 187 of the Restatement deals with cases in which a court considers applying laws of a state other than that chosen by the parties and accordingly reflects an accepted principle in the United States.[173] According to this provision, courts will apply the law of the state chosen by the parties to all issues which the parties could have resolved by an explicit provision in their contract. Further, according § 187(2), courts will also apply the law of the state chosen by the parties to issues which the parties could not have resolved by a provision in their contract. To the latter rule, however, there are two exceptions. The first is that the parties chose a law with no substantial relationship to the case. Of special relevance in this context is the second exception in § 187(2)(b), which allows a court to

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[167] *Scoles/Hay/Borchers/Symeonides,* Conflict of Laws[3] 43.
[168] *Scoles/Hay/Borchers/Symeonides,* Conflict of Laws[3] 43.
[169] *v.Mehren,* HarvLRev 88 (1974) 347 (365ff).
[170] *Scoles/Hay/Borchers/Symeonides,* Conflict of Laws[3] 44.
[171] *Scoles/Hay/Borchers/Symeonides,* Conflict of Laws[3] 46.
[172] *Petersen,* AJCL 46 (1998) 197 (215).
[173] *Borchers,* AJCL 42 (1994) 125 (136).

apply rules of states, which have a materially greater interest in the application of their rules than the state, the law of which the parties had chosen. Subsection 2 applies when two or more states have an interest in the application of their laws. It will not be applied if the contract is locate in only a single state.[174] If in such a case a legal order other than the one chosen by the parties represents a fundamental interest of another state, the forum court may consider applying it for this reason. Thus, while the Restatement recognizes that the legitimate expectations of the parties are of great value, it also acknowledges "*regard also must be had for 'fundamental interests' of states and for state regulation*".[175]

The wording of § 187(2)(b) provides for a three-prong test to determine the applicability of a rule: firstly it is necessary to ascertain whether the rule represents a 'fundamental policy' of a state other than the state the law of which was chosen by the parties and whether the state has the interest to apply this policy to the case. This determination requires an analysis of the interests of the affected state suggested by the above explained theories.[176] It is, however, determined by the legal principles of the forum whether a foreign policy if a fundamental one.[177] If this requirement is fulfilled, the judge must weigh the interests of the affected states in order to assess which state has the greater material interest, which - as mentioned above – is something that *Currie* regarded as impossible and which was the underlying principle of the proponents of the functional analysis.[178] The Restatement finally requires that the law of the 'other state' be the one applicable due to § 188 of the Restatement had the parties not chosen any law. § 188 determines the otherwise applicable law by evaluating certain contacts between the case at hand and facts of the case. The Comments to the Restatement, while

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[174] ALI, Restatement 564.
[175] ALI, Restatement 567.
[176] *Hartley,* RdC 266 (1997) 337 (379).
[177] ALI, Restatement 568.
[178] See e.g. the decision of the Texas Court of Appeal of 21 November 2002 in *Chesapeake Operating, Inc. v. Nabors Drilling USA, Inc.*, in which the court delivers a very detailed example of the implementation of section § 187 of the Restatement, retrievable at: http://www.14thcoa.courts.state.tx.us/opinions/htmlopinion.asp?OpinionId=77602.

not detailing what the contents of such policies may have, name consumer protection or rules rendering contracts illegal as examples.[179]

5. Introduction of U.S. elements to Continental European Theories

From the above outline of U.S. conflict of laws approaches some parallels can be seen in the continental European approaches to dealing with mandatory rules.

Both the Sonderanknüpfungstheorie and the above described approach of *Currie*, the functional analysis and the Restatement do not determine the applicable law by applying the law which is designated by an all-sided conflict of laws rule. To the contrary, the starting point of the U.S. theories is the policy of the rule. Also in the Sonderanknüpfungstheorie, the first step that a judge is to take is to ascertain the legislative intent of the foreign mandatory rules. He will then determine whether a close connection exists and examine the substance of the rule and its compatibility with the interests of the forum.

Both theories demand the ascertainment of a policy and the interest of the state in the application of the rule and imply that the spatial reach of a rule is identifiable by interpretation of the underlying policies.[180] Both approaches are therefore functional as they determine the applicability of rules by their content. It has been rightly recognized by a number of the authors of the Rome Convention, that article 7(1) in fact entails a

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[179] ALI, Restatement 568; *Tele-Save Merchandising Co.* v. *Consumers Distributing Co.*, 814 F.2d 1120, for the qualification of equal bargaining power as ‘fundamental interest’;. *Winer Motors, Inc.* v. *Jaguar Rover Triumph, Inc.*, 208 N.J. Super. 666 (673f); *Headquarters Dodge v. General Motors Corp.*, 1992 U.S. Dist. LEXIS 20197, both showing that the protection of franchisees may be a fundamental interest; *North American Bank, Ltd. v. Schulman*, 123 Misc. 2d 516 qualifies usury laws a laws of a ‘fundamental interest’; for the qualification of the prohibition of noncompetition covenants see *Maxxim Med., Inc. v. Michelson*, 51 F. Supp. 2d 773**.**

[180] *v.Hecke* in FS Mann (1977) 183 (185); *Guedj,* AJCL 1991, 661 (683).

measure of governmental interest analysis.[181] *Drobnig* has stated that *Currie's* governmental interest analysis is a useful tool when it comes to dealing with competing state interests reflected in mandatory rules,[182] though he considers that this theory does not appropriately take into account the interests of the parties.[183]

The element of the close connection between the facts of the case and the state which enacted the rule are no so clearly stated in U.S. doctrine. However, it is clear that also under U.S. law the close connection between a case and the enacting state is a necessary element to justify the policy of the state.[184]

When a rule is found to be applicable, the Restatement and the Functional Analysis indicate that a weighing of the policy is to take place to determine the applicability of the rule. The Sonderanknüpfungstheorie does not. If a mandatory rule of the forum governs the case due to its scope of application, the judge will apply it and disregard the foreign rule. This essentially is *Currie's* approach to the "true conflicts" case. In this case, both approaches depart from a truly functional approach and give way to the prerogatives of the forum.[185] This difference can be explained by the fact that the U.S. theories do not distinguish between mandatory rules and otherwise applicable rules. The policies of foreign sovereigns are taken into account in the normal process of determining the applicable law. Therefore, the policies considered by the Functional Analysists and by the Restatement may not always be of such vital importance as those protected by mandatory rules.

[181] *Lagarde,* VirginaJIL 22 (1981-82) 91 (103); *Delaume,* VirginiaJIL 22 (1981) 105 (113, 119); *Audit,* AJCL 27 (1979) 589 (602, 603); *Juenger,* The Problem with Private International Law (1999) 20.
[182] *Drobnig* in FS Neumeyer 159 (163).
[183] *Drobnig* in FS Neumeyer 159 (165).
[184] ALI, Restatement 568.
[185] *Guedj,* AJCL 1991, 661 (684).

V. The Influence of Mandatory Rules on International commercial Arbitration

A. The Arbitrability of Issues governed by Mandatory Rules.

National legislators may seek not only to regulate the substance of a dispute by issuing mandatory rules, they may also seek to limit the fora in which disputes involving these rules may be decided in order to ensure that their mandatory rules are applied. In such a case, the matter may not be arbitrable.

The term arbitrability used in the context of this thesis means objective arbitrability and thus refers only to restrictions on the subject matters that can be subjected to arbitration under national laws. Such restrictions on the subject matter are mostly imposed for reasons of public policy, as states consider some matters too sensitive to be resolved by arbitrators. Of specific interest in the context of this thesis is the impact of mandatory rules on the arbitrability of disputes, specifically whether disputes in which mandatory rules play a role are arbitrable at all and under which circumstances states can and will restrict the arbitrability of disputes by issuing mandatory rules.

The first step to answer the above posed questions is to determine which law governs the issue of arbitrability. In a second step it must then be determined whether and how mandatory rules of that or a third legal orders influence the arbitrability of a dispute.

The law determining the arbitrability of a dispute may be a different one depending on whether a judge or an arbitrator is faced with answering the question which law to apply.

Then a brief overview will show which sets of rules have been proposed to govern the question of arbitrability (*see* immediately below) both from the perspective of a national

judge and from that of an arbitrator. Thereafter, the question of the arbitrability of issues connected to mandatory rules will be examined (*infra* 2.).

1. The Law Governing the Issue of Arbitrability.

The question of arbitrability may arise before national courts at two stages in the arbitral process. It may be raised as an objection to the jurisdiction of an arbitral tribunal as justification of the jurisdiction of a national court to which claims have been submitted. Secondly, it may be raised after the arbitral proceedings in a setting aside procedure or as an objection to the enforcement of an award. Before arbitral tribunals, the question will usually arise at the beginning of the proceedings, probably in a challenge of the tribunal's jurisdiction over a certain subject matter.

According to which law the court or tribunal is to turn to answer the question of arbitrability is subject to debate. As a distinguished scholar commented, "*agreement on the conclusion that there is disagreement seems to be the only common denominator that one can find between arbitrators, courts and publicists…*". [186]

In the following, the various approaches will be outlined both from the view of national courts and from that of arbitral tribunals.

a) Conflict of Law Approaches

In civil law countries, two legislative approaches in national arbitration laws to the designation of the law applicable to arbitrability can be distinguished.[187] The first is the determination of the arbitrability by reference to the disposability of the rights involved in the dispute. If the parties have the legal capacity to settle the dispute, they can also submit such disputes to arbitration. Whether or not parties can dispose of their rights regularly necessitates a conflict of law analysis to determine the law which governs this

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[186] *Böckstiegel,* Public Policy and Arbitrability 177 (184).
[187] *Lew/Mistelis/Kröll,* Comparative International Commercial Arbitration 194.

question. The second approach determines the arbitrability of a dispute by a substantive rule of the *lex fori* which is applicable to any questions of arbitrability (*see infra* section b).

(1) Application of the lex fori or the law of the seat of arbitration.

The application of the *lex fori* to the determination of the arbitrability of disputes is provided for by Art V(2)(a) NYC and 36(1)(b)(2) of the UNCITRAL Model Law. These provisions, however, only refer to the enforcement of the award. Therefore, at least in the realm of the New York Convention and in those countries which base their arbitration law on the Model Law, the *lex fori* is decisive for deciding on the arbitrability of the dispute underlying the award in the enforcement stage.

For the situation in which a judge has to decide on an objection to the jurisdiction of a tribunal based on the lack of arbitrability of the dispute, the NYC provides no such guidance. Art II(1) NYC obliges judges to refer parties to arbitration unless the dispute is not capable of settlement by arbitration, but does not define the law which is to determine whether a dispute can be settled by arbitration. It has been proposed to apply the *lex fori* to both situations nevertheless.[188] In a noteworthy article, *Arfazadeh* also concludes that the *lex fori* is decisive for the arbitrability of a dispute. However, he reaches this conclusion by viewing arbitrability merely as a jurisdictional issue and arguing that if a court is faced with an objection to its jurisdiction based on the existence of an arbitration clause, it can only find that a dispute is inarbitrable if the court itself has exclusive jurisdiction to decide the dispute which also excludes arbitration. In this case, the court can only apply the *lex fori* as this is the only decisive law for its jurisdiction. A further approach leading to the sole application of the *lex fori*

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[188] *Epping,* Die Schiedsvereinbarung im internationalen privaten Rechtsverkehr nach der Reform des deutschen Schiedsrechts (1999) 207 with further references; *Schlosser* in FS Fasching (1988) 405.

is to see the arbitration agreement solely as a procedural issue which therefore can only be governed by the (procedural) law of the forum.[189]

Also various courts have applied the *lex fori* to the question of arbitrability:

The Italian Supreme Court recognized that article II(3) and article V(2)(a) of the NYC referred to the two distinct situation just mentioned, but then went on to hold that "as Article V expressly refers to the law of the forum, the same should apply to Article II, para. 3. Here too, the judge shall apply his own law when deciding whether the dispute is capable of settlement by arbitration and whether parties will be referred to arbitration"[190]

The Belgian Court of First Instance held that, due to "a consistent interpretation of the Convention", the law referred to in article V(2)(a) and article II(3) shall be the same, namely that of the forum.[191] Belgian courts have however also decided differently, so that a clear line of jurisprudence cannot be ascertained in Belgium.

Also the U.S. Supreme Court has regularly applied U.S. law to the question of arbitrability without dealing with a conflict of laws – analysis.[192] In *Mitsubishi v. Soler Chrysler-Plymouth* it addressed the arbitrability of U.S. antitrust claims solely from the perspective of the U.S. Sherman Act despite the fact that the place of arbitration was Japan.[193]

English doctrine and jurisprudence have not (yet) established a coherent approach to arbitrability. The matter is not addressed in the U.K. Arbitration Act.[194] English courts

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[189] This is the situation in Austria, which has, however, enacted a substantive rule on arbitrability, see *Hausmaninger* in *Fasching,* Kommentar ZPO² IV/2 § 582 no 62; *Zeiler,* Schiedsverfahren § 582 no 5.
[190] Corte di Cassazione, (Judgement 27 April 1979), YBCA 6 (1981) 229 (230).
[191] Tribunal de Commerce (Judgement 20 September 1999) YBCA 25 (2000) 673 (675).
[192] *Yu,* IntALR 1999, 1ss providing an overview of U.S. jurisprudence.
[193] 472 U.S. 614.
[194] *Veeder* in *Paulson,* International Handbook of Commercial Arbitration (1997) Suppl. 23, 20ss.

have established that certain types of illegal contracts cannot be arbitrated under English law.[195] Further, matters involving "interests of the state" may not be arbitrable if they are intended to be enforced by specific organs operating under the auspices of the state.[196] English courts would presumably apply English law to determine whether a specific matter is arbitrable, though jurisprudence on this point is lacking.[197]

The *lex fori* approach has been criticized as the consistency that the decisions just mentioned see between article II and V of the NYC, is illusory, because the court ruling on the question of arbitrability according to article II need not necessarily also be the court ruling on the enforcement of the award.[198] Further, if the seat of arbitration is in a country other than the one in which the court deciding on the objection is, the application of the *lex fori* cannot decide whether the arbitration clause is valid for an arbitration according to the *lex arbitri*. This may lead to a negative or a positive conflict as either both the court and the arbitral tribunal may reach different conclusions on the arbitrability of the dispute and assume jurisdiction.[199] Therefore, it may be more efficient to apply the *lex arbitri* when a court is faced with the arbitrability of a dispute which is to be arbitrated abroad.[200]

An arbitrator, when faced with one party invoking the non-arbitrability of the dispute, has however no *lex fori* to apply. In numerous examples, arbitrators have nonetheless applied the law of the seat of the tribunal to ascertain the arbitrability of the dispute.[201] The seat of the tribunal may however have no inner connection to the case and may have been chosen for reasons of neutrality and thus be a poor choice for ascertaining the arbitrability of the dispute.[202] The only significance for the arbitrator can be deduced

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[195] *Mustill/Boyd,* Commercial Arbitration 74.
[196] *Mustill/Boyd,* Commercial Arbitration 74.
[197] *Mustill/Boyd,* Commercial Arbitration 75.
[198] *Hanotiau,* ArbInt 12 (1996) 391 (399).
[199] *Poudret/Besson,* Comparative Law of International Arbitration² 288.
[200] *Poudret/Besson,* Comparative Law of International Arbitration² 288.
[201] ICC Case No. 6162, YBCA 17 (1992) 153 (158); ICC Case No. 8910, JDI 127 (2000) 1085 (1086).
[202] *Schwarz,* ICSID Rev. 9 (1994) 17 (26).

from his obligation to render a valid award and thus must respect rules of the *lex arbitri* that restrict arbitrability and would finally lead to the setting aside of the award.[203]

(2) The Law Governing the Arbitration Agreement

Another approach considers the law governing the arbitration agreement to be the law also governing the question of validity of the arbitration agreement.[204] It is of course not easy to define to which law the arbitration agreement is subject to. In the absence of an explicit choice, it will usually be the law applicable to the substantive contract[205] or the *lex fori*[206]. This approach, accordingly, respects the will of the parties to the largest extent possible as they could choose to subject their arbitration agreement to a liberal law which declares the dispute arbitrable.

In a case before the Brussels Court of Appeal, it distinguished between the law applicable at the enforcement stage, according to article V(2)(a) NYC, and the situation covered by article II (3) NYC.[207] While during the former, the *lex fori* was to be applied the latter was to be decided on the law governing the arbitration agreement.

This view was not adopted by the Belgian Supreme Court in its most recent judgment of 2004 in which it held that article II(3) NYC not necessarily refers to the *lex contractus* and does not entail a determination of the applicable law, while Art V(1)(a) and V(2)(a) refer to the *lex fori*.[208] It went on to state that a court may decide the arbitrability of a dispute according to the *lex fori*, especially when Belgian public policy may be violated

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[203] *Cf. Hanotiau,* ArbInt 12 (1996) 391 (396).
[204] *Hanotiau,* ArbInt 12 (1996) 391 (401) with further references; *Company M. v. M.S.A.,* Cour d.appel Brussels (Judgememt 4 October 1985) YBCA 14 (1989) 618 (620).
[205] *Redfern/Hunter,* The Law and Practice of International Commercial Arbitration[4] (2004) 148.
[206] *Zeiler,* Schiedsverfahren § 581 no 125.
[207] Brussels Court of Appeal (Judgement 4 October 1985) YBCA 14 (1989) 618 (620).
[208] *Verbist,* JIA 22 (2005) 427 (430) with reference to the decision of the Belgian Supreme Court of 15 October 2004, Niwue Juridisch Weekblad 2005, 643 (644).

otherwise, which could be the case if the arbitral tribunal would be to apply foreign law.[209]

b) Substantive Law approach

The above approaches following the conflict of laws methods offer solutions to the problem of identifying the law governing the question of arbitrability but also suffer some inadequacies.

Some legal systems in Continental Europe have adopted an approach that offers substantive rules defining which subject matters are arbitrable. These rules are applicable to any matter before the court, with no regard to any foreign law.

This approach was initiated by Switzerland with the adoption of the Private International Law Act of 1988.[210] article 177 *leg. cit*. declares all disputes on proprietary claims ("*vermögensrechtlicher Anspruch*") arbitrable. The question of arbitrability is to be decided by Swiss law by both tribunals with their seat in Switzerland and Swiss courts even if other laws, such as that of the *lex contractus* or that of the enforcement jurisdiction, are stricter.[211]

This approach was also incorporated in the German (s.1030 German CCP) and Austrian (s.582 Austrian CCP) arbitration laws, which declare all proprietary claims arbitrable. According to both pieces of legislation, arbitrability is determined by the *lex fori / lex arbitri* to the exclusion of any other law.

Perhaps one step further was taken by the U.S. District court for the Eastern District of New York. In 1992, it decided the question of arbitrability solely based on an "international scale, with reference to the laws of the countries party to the

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[209] *Verbist,* JIA 22 (2005) 427 (430).
[210] For an English translation: International Business Law Journal 6 (1989) 805.
[211] Swiss Supreme Court (Judgement 28 April 1992) YBCA 18 (1993) 143 (146); *Poudret/Besson,* Comparative Law of International Arbitration² 284.

Convention".[212] Also this approach applies a substantive rule to decide the issue of arbitrability, however, while the states mentioned above applied certain national rules, the U.S. district court applied an international rule of substantive law.[213] In practice, however, it is doubtful whether the rule as formulated by the U.S. Court is precise enough to enable the parties to foresee whether their dispute is arbitral or not.

2. The impact of mandatory rules on the question of arbitrability

a) Mandatory rules of the forum

Above it has been argued that courts should apply – in specific circumstances – mandatory rules to the merits of a case and below it will be submitted that arbitrators should do so also. However, there is no guarantee for a national legislator that the mandatory rules it issues will in fact be applied by bodies not under its direct supervision such as foreign courts or tribunals with their seats abroad. It can therefore correctly be deduced that the only guarantee for the application of mandatory rules is the combination of mandatory rules with the exclusive jurisdiction of national courts to the exclusion of arbitration which will apply the mandatory rules of the forum.[214] Only then will a national court be in a position to hear cases brought before it despite the existence of an arbitration agreement and will be able to enforce the forum's mandatory rule.

National laws often provide for the exclusive jurisdiction of a specific national court for categories of disputes, such as the exclusive jurisdiction of the court in the area of competence of which real estate is situated for disputes regarding property rights. When faced with a rule granting a certain national court exclusive jurisdiction, it is necessary to establish whether the national legislator also wanted to also exclude the possibility of

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[212] *Meadows Indemnity v. Baccala & Shoop Insurance Services,* 760 F Supp. 1036-1045, YBCA 17 (1992) 686 (691).
[213] *Hanotiau,* ArbInt 12 (1996) 391 (402).
[214] *Vischer* in *Giuffrè,* Collisio Legum 577 (578).

arbitration. Art 22 of Council Regulation 44/2001 and Art 16 of the Lugano Convention both grant exclusive jurisdiction to a specific court with a relationship to the types of disputes listed there. According to Art 23(5) of Council Regulation 44/2001 and Art 17(3) of the Lugano Convention explicitly exclude the possibility of concluding forum selection clauses granting jurisdiction to another national court. However, these provisions do not exclude the possibility of concluding arbitration agreements on the disputes listed.[215] Also provisions found in Austrian and German regarding jurisdiction in domestic matters, do not exclude the conclusion of arbitration agreements.[216] Provisions in national laws, therefore, should carefully be examined as to whether the exclusive jurisdiction of courts also excludes arbitration.

The uncertainty about the application of mandatory rules has lead courts to declare disputes inarbitrable if they sensed the danger that arbitral tribunals with their seat outside their area of influence would not apply their mandatory rules.

The Belgian Supreme Court had held in 1979 and 1988 that with regard to a Belgian law that granted every distributor in a distribution agreement the right to sue for compensation before Belgian courts in the case of termination by the licensor, a dispute is not arbitrable and an award thus not enforceable in Belgium if the arbitrators did not apply Belgian law to the dispute.[217] This shows that courts are reluctant to grant arbitrability when they are unsure whether or not their law will be applied to a dispute. As the non-application of such rules may not always amount to a violation of public policy it may seem securer not to grant arbitrability in the first place.

Also the German Supreme Court held in early – and in the meantime altered jurisprudence – that arbitration agreements in contracts for futures trading to which a private investor was party and which did not guarantee the application of German law

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[215] *Kropholler,* Internationales Zivilverfahrensrecht[7] Art 1 EuGVVO, no 41; *Geimer/Schütze,* Internationales Zivilverfahrensrecht[3] Art 1 EuGVÜ, no 98.
[216] *Fasching,* Schiedsgericht und Schiedsverfahren 19; *Schlosser,* Schiedsgerichtsbarkeit[2] (1989) 225; *contra Samtleben,* RabelsZ 46 (1982) 716 (720).
[217] *Verbist,* JIA 22 (2005) 427 with reference to the decision of the Belgian Supreme Court of the 28 June 1979, YBCA 5 (1980) 257 and of the 22 December 1988.

due the combination of the place of arbitration and the choice of foreign law were not "to be recognized", which effectively meant that the German Supreme Court declared disputes in this constellation inarbitrable.[218] The reason for this decision was that the Supreme Court feared the inherent danger that arbitral tribunals would not apply German mandatory rules on trading in futures. [219] It also held that the second look doctrine would not suffice for the granting of arbitrability as the German mandatory rule would not be sufficiently enforced even if the award would not be enforced in Germany.[220]

This approach was also taken from the Upper Regional Court of Munich (OLG München) in its decision of 17 May 2006.[221] In this decision the court held that the combination of arbitration abroad and the choice of foreign law would lead to the inarbitrability of the dispute if there is a risk that the arbitral tribunal may not apply German mandatory law on the compensation of agents.

As can be seen from the above decisions, courts are unreserved when declaring disputes inarbitral in order to protect the forum's mandatory rules. The reason for this is the lack of trust in arbitral tribunals abroad which function outside their legal system and cannot be controlled by their courts. However, the approach of the German courts lacks a dogmatic basis and is not compatible with German arbitration law. German arbitration law before its reform made the arbitrability of a dispute dependant on whether it could be settled by the parties. The new German arbitration law, as described above, declares all proprietary claims arbitrable. Both the securities claims and the claim of the agent were therefore arbitrable at the time the dispute arose according to the relevant sections of the arbitration law.[222] German statutory law did not provide for the exclusive jurisdiction of German courts. The decisions of the Supreme Court and of the Munich

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[218] Judgement of the BGH, 6 June 1991, NJW 44 (1991-II) 2215; Judgement of the BGH, 15 June 1987, 40 NJW 3193 (1987-II).
[219] Judgement of the BGH, 6 June 1991, NJW 44 (1991-II) 2215; Judgement of the BGH, 15 June 1987, NJW 40 (1987-II) 3193.
[220] Judgement of the BGH, 15 June 1987, NJW 50 (1987-II) 3193 (3195).
[221] WM 2006, 1556.
[222] For the old law see, *Thorn,* IPRax 1997, 98 (102); for the new law see, *Quinke,* SchiedsVZ 2007, 246 (247).

Upper Regional Court therefore fail to provide a reasoning why the disputes were inarbitrable. With regard to the jurisprudence on futures trading, the German Supreme Court has in the meanwhile accepted the arbitrability of disputes in this area.[223]

The more stringent approach is to limit the supervision of the court to the setting aside or exequatur situation and to deny recognition and enforcement of the subsequent award if the arbitrators have failed to apply German mandatory law and the recognition of the award would therefore result in the violation of the German *ordre public*.[224] This approach, of course, entails the risk that the tribunal fails to apply German mandatory rules to the dispute but that the award has to be enforced nevertheless as the mere non-application of mandatory rules does not automatically amount to a violation of the *ordre public* or is enforced outside Germany.

This is the approach taken in the well known and commented case of Mitsubishi Motors Corp. v. Soler Chrysler Plymouth Inc. decided by the Supreme Court in 1985.[225] In that case the Supreme Court gave up its resentments against the arbitration of antitrust matters stated in *American Safety Equipment Corp*. v. *J. P. Maguire & Co*.[226] in which it held that antitrust matters were not capable of resolution by arbitration as arbitrators – especially those from (foreign) business communities – are not capable of comprehending U.S. antitrust law and that antitrust law is *per se* too sensitive a matter to be placed in the hands of private judges.[227] The Supreme Court was confident that arbitrators would apply U.S. antitrust law and found the possibility of refusing recognition of the award was sufficient at least in international cases.[228] This approach found both approval and criticism. It influenced the subsequent jurisprudence of the

[223] Decision of the BGH, 21 September 1993, XI ZR 52/92.
[224] *Quinke,* SchiedsVZ 2007, 246 (247).
[225] *Mitsubishi Motors Corp. v. Soler Chrysler Plymouth Inc* 473 US 614, 105 S Ct 3346 (1985); for a critical view: *Ovington,* JIA 1985, 53; *Carbonneau,* ArbInt 2 (1986) 116; *Sopata,* North Western J Int L. & Bus. 7 (1986) 595; *Smit,* JIA 4 (1987) 7; *Werner,* JIA 3 (1986) 81; for an approving comment: *Lowenfeld,* ArbInt (1986) 178.
[226] *American Safety Equipment Corp. v. J. P. Maguire & Co.,* 391 F.2d 821 (1968).
[227] *Mitsubishi Motors Corp. v. Soler Chrysler Plymouth Inc* 473 US 614, 105 S Ct (1985) 3346 (3357).
[228] *Mitsubishi Motors Corp. v. Soler Chrysler Plymouth Inc* 473 US 614, 105 S Ct (1985) 3346 (3359), n.19.

United States[229] and triggered the discussion of arbitrability of competition law disputes in other jurisdictions. The possible flaws of this approach are evident: The extent of review under the NYC is very limited and does not allow for a review of the merits of the case.[230] Therefore, under the New York Convention, courts cannot ascertain to a full extent whether U.S. antitrust laws have been applied correctly. Also the "second look" doctrine is flawed when U.S. antitrust law is not applied or not applied correctly by the tribunal and enforcement of the award is not sought in the United States. Lastly, it can be doubted that arbitrators are competent to award treble damages as foreseen by U.S. antitrust law.[231] The U.S. Supreme Court, however, showed an increase in trust in the capability of arbitrators to handle antitrust matters and to arbitration as a suitable tool for the resolution of disputes including antitrust matters.

Also the ECJ implicitly declared antitrust claims arbitrable in *Eco Swiss China Time Ltd.* v. *Benetton International NV*.[232] In that case the ECJ found that article 81 EC Treaty *in toto* constitutes rules of public policy[233] and that therefore national courts are precluded from enforcing arbitral awards which are contrary to EC competition law.[234] According to the ECJ, community public policy is integrated into the notion of national public policy of every member state.[235] Due to their mandatory character each member state is to take these rules into account. It is thus evident that the ECJ considers EC competition law (at least Arts. 81(1) and 81(2)) as capable of settlement by arbitration.

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229 *cf. McLaughlin,* Alb.LR 59 (1996) 905 (938) citing recent cases such as *Coors Brewing Co. v. Molson Breweries* 51 F.3d 1511(10th Cir. 1995) and *Nghiem v. NEC Electronic., Inc.,* 25 F.3d 1437 (9th Cir.), cert. denied, 115 S. Ct. 638 (1994) in which the 9th Circuit held that also domestic antitrust claims are arbitrable.

230 *Carbonneau,* ArbInt 2 (1986) 116 (127).

231 *Lowenfeld,* ArbInt 2 (1986) 178 (189).

232 ECJ, C-126/97 *Eco Swiss China Time Ltd. v. Benetton International NV* (Judgement 1 June 1999) repr. in Int.Arb.Rep. 14 (1999) B-1.

233 Which has been criticized, *Liebscher,* Am. Rev. Int. Arb. 10 (1999) 81 (85), arguing that article 81 may well be a mandatory rule, but does not necessarily form a part of public policy.

234 Komninos, Case Law, *Eco Swiss China Time Ltd. v. Benetton International NV*, CMLR 37 (2000) 459 (468).

235 *cf.* also the jurisprudence of some memberstates, Judgement of the BGH, 27 February 1969, CMLR 7 (1970) 96, Judgement of the OGH, 23 February 1998, 3 Ob 115/95, 40 ZfRV 1999, 24).

However, according to the ECJ, the fact that competition law issues may be arbitrated bears the inherent danger of misinterpretation of the law by arbitrators who are barred from requesting preliminary decisions from the ECJ[236] so that it is the obligation of the member states to ensure the uniform application of EC law.

b) Mandatory rules of third states

Disputes may not only be declared inarbitrable by a rule of the *lex fori* / *lex arbitri.* Also rules from states other than the one in which the arbitral tribunal has its seat may seek to limit the arbitrability of the dispute. In this situation the question arises whether the arbitrator or the judge faced with a challenge of an award or an application for the recognition of an award must respect a foreign mandatory rule restricting the arbitrability of the dispute.

At least for Switzerland there has been a ruling on this point by the Swiss Supreme Court which held in *Fincantieri* v. *Cantieri Navali Italiani SpA*[237] that foreign mandatory rules do not prevent a dispute from being arbitrable even if these rules would declare the contract null and void. The Supreme Court would only deny arbitrability of a dispute due to a foreign mandatory rule, if this rule requires a dispute to be heard exclusively by the courts of that state and this rule would have to be taken into consideration for reasons of public policy.[238] Swiss literature supports the approach taken by the Swiss Supreme Court, though there is some disagreement on whether

[236] Case 102/81 *Nordsee Deutsche Hochseefischerei GmbH v. Reederei Mond Hochseefischerei Nordstern AG & Co. KG and Reederei Friedrich Busse Hochseefischerei Nordstern AG & Co. KG*, ECR 1982, 1095.
[237] *Fincantieri v. Cantieri Navali Italiani SpA and Oto Melara S.p.A. v. M*, ATF 118 II 353, Revue de l'Arbitrage 1993, 691.
[238] Which is view which was approved of by Swiss doctrine: *Blessing,* Introduction to Arbitration – Swiss and International Perspectives 264; see also *Baron/Liniger,* ArbInt 19 (2003) 27 (35); *Voser,* ArbInt 15 (1999) 237 (241); this approach has also found its way into arbitral practice: ICC Case 7673, ICC Bulletin 6 (1995) 57 (58), in which a tribunal in Switzerland declared EU antitrust issues arbitrable due to 177 Swiss PIL.

arbitrability should only be denied if it violates the Swiss *ordre public*[239], the international *ordre public*[240] or also if it violates the foreign *ordre public*.[241]

The limitations of the arbitrability of disputes based on the violation of the Swiss (international) public policy can be based on article 190(2)(e) Swiss PILA. However, *Bucher* and *Wenger* suggest to base the limitation of arbitrability based on foreign *ordre public* not on article 190(2)(e) Swiss PILA, but on an Art 19 Swiss PILA, which similar to Art 7(1) Rome Convention allows for the application of foreign mandatory rules.[242] Also *Naón* argues that arbitrators cannot be indifferent to foreign mandatory rules restricting arbitrability and has suggested taking foreign mandatory rules restricting arbitrability into consideration if (1) they have a close connection to the dispute, (2) the mandatory rules have a clear and strong interest in application, (3) the application does not violate international public policy and (4) the assertion of jurisdiction of a state reflected in the relevant mandatory rule is not excessive under public international law.[243] Also *Mayer* agrees that foreign mandatory rules granting a foreign court exclusive jurisdiction over a dispute are inarbitrable.[244]

Also arbitral tribunals have taken this approach. In ICC case no 6379, the tribunal was faced with a dispute between an Italian principal and a Belgian distributor arising out of a distribution agreement which the claimant (principal) had terminated prematurely.[245] The defendant argued that the arbitration clause was invalid due to Belgian mandatory legislation which allowed every commercial agent active in Belgium to bring claims before Belgian courts which would then have to apply Belgian law. Defendant claimed

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[239] *Briner,* Basler Kommentar IPR, Art 177 no 18.
[240] *Lalive/Poudret/Reymond,* Le droit de l'arbitrage interne et international en Suisse 308.
[241] *Bucher,* Schiedsgerichtsbarkeit 44.
[242] *Bucher,* Schiedsgerichtsbarkeit 44; *Wenger,* Basler Juristische Mitteilungen 1989, 337 (342).
[243] *Naón,* RdC 289 (2001) 9 (86).
[244] *Mayer,* ArbInt (1986) 274 (290), who argues that if mandatory rules are applicable to the merits of the case and the parties cannot opt-out of their application, the same holds true if the mandatory rule prevents parties from opting-out of a specific courts jurisdiction.
[245] ICC Case number 6379, YBCA 17 (1992) 212.

that this piece of Belgian legislation was applicable due to article 7 of the Rome Convention and that the arbitration clause was therefore invalid.[246] The arbitrator found the Rome Convention inapplicable as it was not in force at the time and, secondly, as arbitration agreements were specifically exempted from its scope of application.[247] He then went on to find that there was no rule of Italian law (as the law applicable to the arbitral clause) that could be found to connect the Belgian mandatory rule to the present case. He concluded that the Belgian rule was actually not internationally mandatory (in the sense that it demanded extraterritorial application). What is left is that the arbitrators sought to apply the Belgian legislation by a conflict of laws rule, perhaps analogous to article 7 (1) of the Rome Convention, but could not find one in Italian law.

This approach, however, entails an irregular application of conflict of laws provisions. Art 7(1) Rome Convention and Art 19 Swiss PILA are provisions which allow for the application of foreign mandatory rules. However, they both provide for the application of foreign substantive rules only. The Rome Convention is a convention on the law applicable to contractual obligations. Art 19 Swiss PILA is part of the section on the applicable substantive law. Both provisions therefore were not intended for the application of rules of foreign procedural law, such as the exclusive jurisdiction of courts and are no basis for the application or even consideration of the exclusive jurisdiction of foreign courts. Regard for such foreign rules could only be had if there was a rule in the *lex fori* / *lex arbitri* allowing for this.[248] Clearly, neither Art 177 Swiss PILA nor any other of the examined legal orders entail such a provision.[249] Until such a rule exists, any discussion on the application of foreign mandatory rules providing for the inarbitrability of a dispute is moot (except for the case that the *ordre public* of the forum orders the application of the foreign rule).[250] Therefore, it is also of no further relevance that – as has been pointed out - Art 19 Swiss PILA is not (directly) applicable

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[246] ICC Case number 6379, YBCA 17 (1992) 212 (*217).*
[247] Article 1 (2)(d).
[248] *Schnyder* in FS Heini (1995) 365 (368).
[249] Section1030 German ZPO; section 582 Austria ZPO.
[250] *Briner,* Basler Kommentar IPR, Art 177 no 18; following his approach ICC Case No 8420, *Collection of ICC Arbitral Awards 1996 – 2000* 389, 393 with an analysis of Swiss scholarly opinions on this matter.

to procedures before arbitrators but only before national courts.[251] Even if it were, it would be of no avail to render foreign mandatory rules granting foreign courts exclusive jurisdiction applicable.

[251] *Lalive/Poudret/Reymond,* Le droit de l'arbitrage interne et international en Suisse 305–308.

VI. THE INFLUENCE OF MANDATORY RULES ON THE CHOICE OF LAW BY THE ARBITRATORS

In an arbitration, it will often be one of the first tasks of an arbitrator to select the system of rules according to which he is going to resolve the dispute before him. Before determining the applicable law, the arbitrator must determine the rule or set of rules which will guide him to the applicable law. Once this has been determined, the arbitrator can decide which law to apply. He must then also decide whether and on which basis to apply mandatory rules of the various legal systems connected to the arbitration.

In the following, the applicable conflict of laws systems for arbitrators and the consequently applicable legal system will be analysed. Then it will be analyzed whether these underlying conflict of laws systems can serve as a basis for the application of mandatory rules.

A. THE CONFLICT OF LAWS SYSTEM DETERMINING THE SUBSTANTIVE APPLICABLE LAW

1. The denationalized approach

The autonomy of the parties to determine the applicable procedure and the law applicable to their dispute is a fundamental pillar of international commercial arbitration. Some authors consider that the autonomy of the parties and their contract is sufficient to establish and maintain the entire system of international commercial arbitration. The tenor of their arguments is that the arbitral tribunal draws its competences not from a national set of laws, but from the contract of the parties which

established the arbitral tribunal.[252] Thus, the will of the parties manifested in the contract as the origin of the tribunals existence and competence is decisive for the applicable law and does not require the award of legal force by a national state.[253] Some scholars even go a step further and argue that the fact that party autonomy is recognized by all legal orders transcends the national order forming a sphere of "transnational conflict of laws rule" completely detached from any national legal order.[254]

This approach has a dogmatic *lacuna* as it remains unclear how a contract can have any legal force if it is not founded in any legal order, but is floating detached from any legal order somewhere in the legal ether. Only a legal order can make the piece of paper to a legally binding contract. Thus the choice of law of the parties needs more than a "transnational conflict of laws rule" namely some conflict of law rule to become effective.

2. The traditional approach

Mann has argued that the system the arbitrator derives his competences from the *lex arbitri* of the state of the seat of the tribunal.[255] Thus, an arbitrator is bound to the conflict of laws system of the *lex arbitri* and must determine the applicable law following its rules. Only if the conflict of law system of the *lex arbitri* allows a choice of law by the parties, is an arbitrator to respect it and the legal force of the choice of the parties is derived from the *lex arbitri*. [256]

As *Mann* stressed, all powers of the arbitrator are inexorably conferred by or derived from a system of municipal law, namely the *lex fori*.[257] Accordingly, the arbitrator is

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[252] *Paulsson,* ICLQ 30 (1981) 358 (360).
[253] *Fouchard,* L'Arbitrage Commercial International 356-357.
[254] *Lew,* Applicable Law in International Commercial Arbitration 81-82.
[255] *Mann,* Lex facit arbitrum 157; coming to the same conclusion *Sauser-Hall,* Annuaire de l'institut de droit international (1957-II) 394.
[256] *Mann,* Lex facit arbitrum 157; coming to the same conclusion *Sauser-Hall,* Annuaire de l'institut de droit international (1957-II) 394.
[257] *Mann,* Lex facit arbitrum 159, 160.

only a substitute for the national judge when resolving the dispute, especially as there is no reason to exempt arbitrators from the system of national law.[258]

This approach was also adopted by the *Institut de Droit International* in 1957 in article 11 of its Resolution on 'Arbitration and Private International Law', which stated that conflict of laws rules of the forum were decisive for the arbitrator and only within these rules was he allowed to choose a foreign law or to give heed to the choice of law of the parties.[259]

Also the 1955 ICC Rules stated that in absence of a choice of law by the parties, the arbitrator was to apply the law of the place of arbitration.

The dogmatic basis for this approach is the analogy of the arbitrator with the state judge.[260] It is true that the arbitrator is bound by the procedural rules of the *lex arbitri*. A violation of these rules may lead to the successful challenge of an award. However, it is not convincing to extend the binding force of the *lex arbitri* to the conflict of laws system of the forum. The arbitrator is a product of a contractual bond between two parties, as their arbitration agreement excludes the jurisdiction of a national court and establishes the arbitral tribunal. Only if a state enacts conflict of laws rules that are mandatory for arbitrators in that state, the arbitrator is obliged to adhere to such rules.[261]

Further practical arguments have also been invoked against the binding force of the conflict of laws rules of the *lex fori* for the arbitrator. One main argument is that the parties may have chosen the place of arbitration for reasons of neutrality or it may have

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[258] *Wortmann*, Choice of Law, ArbInt 1999, 97 (106); *Craig/Park/Paulsson,* ICC Arbitration 324; *Heiskanen,* FinnishYIL 4 (1993) 98 (100).
[259] L'arbitrage en droit international privé, 47 II Annuaire de Institut de Droit International (1957) 491, 496 also available at http://www.idi-iil.org/idiF/resolutionsF/1957_amst_03_fr.pdf.
[260] *Voit,* JZ 52 (1997) 120.
[261] *Bucher* in FS Moser 214 (*Bucher,* Schiedsgerichtsbarkeit 88; *cf. Lew,* Applicable Law in International Commercial Arbitration 253.

been chosen by an arbitral institution for them. If this is the case, it may be totally unforeseeable for them which law will be applied to their contract.[262]

It has also been shown that the application of the conflicts of law rules of the seat may vary strongly from the legitimate expectations of the parties, as the conflict of laws rules they expected to be applied may point towards a completely different law to the conflict of laws rules at the seat of the arbitration.[263]

Also international instruments on international arbitration reject the notion of the binding force of the conflict of laws system of the *lex fori*.[264]

3. The modern approach

a) Party autonomy

Party autonomy is widely regarded as one of the pillars of international commercial arbitration. Most modern arbitration laws respect a choice of law by the parties and oblige the arbitrator to honour this choice. Only in the absence of a choice of law of the parties the arbitrator must determine the applicable law.

b) Choice of a conflict of laws rule

Both Art VII(2) European Convention on International Commercial Arbitration and Art28(2) UNCITRAL Model Law depart from the idea of the binding force of the

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[262] *Böckstiegel* in FS Beitzke 443, 447; *Croff,* International Lawyer 1982, 613 (625).
[263] *Sandrock,* RIW 38 (1992) 785 (788, 789); *Croff,* International Lawyer 1982, 613 (626); both with practical examples; see also *Böckstiegel*, FS Beitzke, 443ss, *Berger*, Internationale Wirtschaftsschiedsgerichtsbarkeit 340 and *Martiny*, FS Schütze 529 (539) all rejecting the traditional approach.
[264] Article VII (1) of the European Convention on International Commercial Arbitration 1961; Art 28 (2) of the UNCITRAL Model Law on International Commercial Arbitration.

conflict of laws systems of the forum. According to these instruments, which have also found reflection in national laws, such as the 1996 Arbitration Act in the UK, the arbitrator is to apply the conflict of laws rule, which he considers appropriate.[265] The drafting history of the Model Law shows that at the time the widespread view was that an arbitrator was not bound by the conflict of laws rule of the seat but must either choose a conflict of laws rule he considers appropriate or must directly choose the law he considers applicable to the substance.[266] In the end, the less progressive approach was opted for.[267]

The arbitrator is therefore not to directly determine the applicable law, but (at least in the first step) to determine the applicable conflict of laws rule. While the arbitrator is therefore freed from the constraints of the domestic conflict of laws system, he is bound by a specific conflict of laws rule designed for arbitration requiring him to determine a choice of law rule.[268]. This conflict of conflict of laws systems which is referred to a as a *conflit au deuxième degré*[269] has been solved in various ways in practice and doctrine. Accordingly, either the conflict of laws rules of the forum can be applied or a general principle of private international law or any conflict of laws rule which seems appropriate or the conflict of laws rule which has the closest connection with the case.[270]

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[265] which has found wide acceptance in doctrine, see *Böckstiegel*, FS Beitzke 443ss; *Berger*, Internationale Wirtschaftsschiedsgerichtsbarkeit 340ss; *Martiny*, FS Schütze, 539ss.
[266] *Holtzmann/Neuhaus,* A Guide to the UNCITRAL Model Law on International Commercial Arbitration (1989) 769-770; *Broches,* Commentary on the UNCITRAL Model Law on International Commercial Arbitration 147.
[267] *Broches,* Commentary on the UNCITRAL Model Law on International Commercial Arbitration 147.
[268] *Sandrock,* RIW 38 (1992) 785 (791).
[269] *Lalive*, Revue De l'Arbitrage 3 (1976) 155 (156); see also *Kegel/Schurig,* Internationales Privatrecht[9] 50.
[270] *Poudret/Besson,* Comparative Law of International Arbitration² 583ss examining various approaches taken in practice; see also ICC Award 4237 YBCA 10 (1985) 52 in which the criterion of the closest connection was used to determine the conflict of laws system applicable.

UK law adopted this approach in s 46(3) of the Arbitration Act 1996. According to this provision, the tribunal is to determine the applicable law by applying the conflict of laws rule it considers applicable in the absence of a choice of law by the parties. It is clear that arbitrators sitting in England are therefore free to apply any conflict of laws rule they deem appropriate and are not bound by English conflict of laws rules.[271]

c) A specific conflict of laws rule for arbitrators

Another alternative to release the arbitrators from the conflict of laws system of the forum is not to grant the arbitrator total freedom to decide which conflict of laws rule to apply, but to include in the *lex arbitri* a rather rudimentary conflict of laws rule applicable specifically to arbitrations within the scope of application of the *lex arbitri*.

This is the approach made by section 1051 of the German CCP which was introduced in 1998. There has been much discussion in connection with this provision. Section 1051 (2) provides that, in the absence of a choice of law by the parties, an arbitrator is to apply the law of the state with the closest connection to the subject of the dispute. This rule applies to all arbitrations taking place on German territory.[272] The German legislator considered that section 1051 (2) German CCP would establish a binding (even if indirect) effect for arbitral tribunals of Arts 3ss Rome Convention.[273] The German legislator obviously wanted to provide a legal basis for the traditional approach of the binding force of (at least a part) of the conflict of laws rules of the forum. A consequence would be that Art 3ss of the Rome Convention and their interpretation by German courts would have to be respected by arbitrators seated in Germany when deciding on which legal order had the closest connection to the case at hand. Neither the wording of section 1051 (2) German CCP nor the overwhelming opinion in literature support this restrictive interpretation of the provision. German scholars tend to the approach that the arbitrator has to interpret the element of the "close connection"

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[271] *Merkin,* The Arbitration Act 1996[4] (2008) 118.
[272] § 1025 dZPO; *Reithmann/Martiny,* Internationales Vertragsrecht[5] no 3511.
[273] Regierungsentwurf zu § 1051 ZPO reprinted in *Berger,* Das neue Recht der Internationalen Schiedsgerichtsbarkeit The New German Arbitration Law (1998) 260.

autonomously and is not restricted to the provisions of the Rome Convention or German jurisprudence.[274] However, this also means that an arbitrator cannot simply reason his choice of a law by reference to the rules enshrined in the Rome Convention but must detail why a legal relationship has the closest connection to a specific country though he may use the German rules as guidance.[275] Thus section 1051 (2) German CCP establishes a specific conflict of laws rule for arbitrators (a "Sonderkollisionsrecht") which by and for itself is the only conflict of laws rule the arbitrators are to apply to determine the applicable substantive law.

Also article 187 of the Swiss PILA provides that, in absence of a choice of law of the parties, an arbitrator is to apply the law with the closest connection with the case. Also this provision creates a specific conflict of laws rule for arbitrators (a "Sonderkollisionsrecht") and does not oblige the arbitrator to have reference to the provisions of the other chapters of the Swiss PILA containing the conflict of laws rules for national courts.[276]

d) *Voie Directe*

The direct choice of the applicable law without necessitating a conflict of laws analysis is reflected by various national legislations such as s 603 (2) Austrian CCP.[277] However, this does not mean that the arbitrator in practice does not apply a conflict of laws analysis. It is doubtful that the arbitrator will apply substantive rules at random. To the contrary, he will choose some legal system and in arriving at his choice he will also

[274] *Martiny* in FS Schütze 529 (540); *Kronke,* RIW 44 (1998) 257 (262); *Schlosser,* RIW 40 (1994) 723 (727); *Blase,* Die Grundregeln des Europäischen Vertragsrechts als Recht grenzüberschreitender Verträge 161ss; *Junke* in FS Sandrock 443; *Solomon*, RIW 1997 981ss; *contra*: *Sandrock,* RIW 46 (2000) 321 (323); *Junker*, RIW 1998 741 (745)

[275] *Kronke,* RIW 44 (1998) 257 (263); *Martiny* in FS Schütze 529 (541).

[276] *Bucher,* Schiedsgerichtsbarkeit 90; *Karrer* in International Arbitration in Switzerland, Art 187 no 5; *Heini* in ZürchKomm IPRG² Art 187 no 2.

[277] See also the similar approach taken in France, article 1496 of the French *Nouveau Code de Procédure Civile* and the Netherlands article 1054 (2) of the Dutch Code on Civil Procedure.

carry out some sort of conflict of laws analysis.[278] The main difference to the above approaches is that he is under no obligation to do so and need not necessarily reason (though in practice he mostly will) why he applied a specific legal system.

This approach allows an arbitrator to take into account values that may not be respected by conflict of laws rules.[279] Thus, the arbitrator will be able to choose a law that may suit the dispute better, *e.g.* if it is more modern or has a specific provision relevant to the dispute. In this case, he may not be guided by hard and fast conflict of laws principles but may only be applying the more suitable law. This is the true measure of liberty granted by this approach.

e) The cumulative application of several conflict of laws systems.

One way to minimize the disappointment of the parties' expectations of the law applicable to their contract is to apply not one rule of a specific conflict of laws system, but to apply cumulatively the relevant rules of all "interested" conflict of laws systems.[280] Accordingly, this method serves the interest of the parties effectively.[281] It is based on the presumption that the conflict of laws rules of all "interested" systems should point towards the same law.[282] This approach could be taken in legal systems which provide for the application of a conflict of laws rule which the arbitrator considers appropriate or in situations in which the arbitrator is free to apply such rules of law he considers appropriate. It seems not to have found explicit reception in national legal system.

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[278] See also *Sandrock,* RIW 38 (1992) 785 (789 Fn 34), arguing that a direct choice cannot exist, as implicitly an arbitrator will always use some conflict of law rule to determine the applicable law; *Gaillard,* ICSID Rev 2 (1987) 424 (433).
[279] *Fouchard,* L'Arbitrage Commercial International 876; *Croff,* International Lawyer 1982, 613 (632).
[280] *Derains,* Revue Arb. 1972, 99.
[281] *Derains,* Revue Arb. 1972, 121; Fouchard/Gaillard/Goldmann on International Arbitration (Gaillard/Savage eds., 1999) 872.
[282] *Croff,* International Lawyer 1982, 613 (630); *Fouchard,* L'Arbitrage Commercial International 872.

Undoubtedly this method has its merits and has been applied in many cases.[283] It may especially serve as a good reasoning for the application of a specific set of national law when the arbitrator is free to determine the applicable law. However it will be flawed in cases in which the conflict of laws rules do not point towards the same law.[284] It also must be noted, that the question which conflict of laws rule is "interested" in the case will not always be easily solved. As there is no "meta conflict of laws rule"[285] that will help the arbitrator to find out, which rules are interested, this approach may fail in cases in which exactly this point is subject to a dispute. As an substitute it has been suggested to take into account "the choice of law rules of legal systems which had a connection with the case at a time when the parties were required to act in a certain way, under the contract or otherwise",[286] which seems to be the only logical approach to take.

f) The Application of general principles of private international law

This approach is similar to the one above, which also compares various conflict of laws systems. In this case, however, the connection between the case and the laws analyzed will be more distant or even not existent.[287] This method bears strong resemblance to the method of searching for general principles of substantive law, such as the *lex mercatoria*.[288]

283 See the numerous decisions cited by *Fouchard,* L'Arbitrage Commercial International 872 Fn 35.
284 *De Ly,* NorthwesternJILandBusiness 12 (1991) 48 (63).
285 *cf. Schlosser,* Schiedsgerichtsbarkeit² 726.
286 *Fouchard,* L'Arbitrage Commercial International 872.
287 *Craig/Park/Paulsson,* ICC Arbitration 327.
288 *Fouchard,* L'Arbitrage Commercial International 873.

B. The Application of Mandatory Rules By Arbitrators

1. Interests involved in the application of mandatory rules

a) The Interests of the Parties

The national legal systems examined in this thesis show a large margin of autonomy for the parties of an international arbitration to design the proceedings and the method for the resolution of their disputes. It is the parties that appoint the arbitrator and grant him the power to render a binding decision on their dispute. The arbitrator must therefore adhere to the instructions given to him by the parties to a far larger extent than a national judge. The arbitration agreement is the source from which the arbitrator derives his powers. With this arbitration agreement the parties can also oblige the arbitrator to decide their dispute in accordance with a specific set of rules. Consequently, they can also instruct the arbitrator not to apply specific rules. As the arbitrator unlike a judge owes no allegiance to a specific state and the mandate of the parties is his primary source of obligations and powers, he generally must follow the instructions given to him. For the application of mandatory rules this means that the parties may have an interest in being able to have their dispute decided without the application of mandatory rules solely in accordance with a specific set of rules determined by them. This may even be a reason for opting for arbitration in the first place. Whether or not the arbitrator must adhere to this will in all situations will depend on the nature of the mandatory rule (see below c)).

However, the parties (or at least one party) will in most cases have an interest in the application of a mandatory rule. One party may be obliged to follow a mandatory rule by an enacting state that can factually enforce this rule. Further, the foremost will of the

parties is to have an award that will end their dispute once and for all. In order to obtain such an award, the arbitrator will have to apply at least those mandatory rules, the non-application of which would be sanctioned by the setting aside of the award or the non-enforcement.[289]

b) Interests of national legislators

As stated above, states enact mandatory rules to protect values they consider vital for the political, social or economic order of the state. They consider the protection of these values to rank higher than the autonomy of the parties and therefore oblige their judges to apply these rules regardless of the law chosen by the parties.

Nevertheless, states and national courts have decided to confer the competence to apply these mandatory rules and therefore to contribute to the safeguarding to the protection of their interests to private arbitrators and no longer insist on the inarbitrability of disputes involving mandatory rules. States have invited arbitrators to support them in adjudicating commercial matters with transborder aspects, as they have recognized the positive aspects of arbitration. They have done so by declaring subject matters arbitrable that pertain to very sensitive areas of their public policy (*supra* V.A.2).[290] In doing so they relied on the capability and willingness of arbitrators not to disregard the tasks and the trust given to them.[291] They have however not abandoned their interests in the application of the mandatory rules they enacted. It has been recognized that arbitrators thus owe a responsibility not only to the parties, but in some cases also to the international (commercial) community as a whole.[292]

[289] *Naón,* RdC 289 (2001) 9 (71); *Lazareff,* ArbInt 11 (1995) 137 (140), who correctly states that the application of mandatory rules of the *lex arbitri* and the place of enforcement is only a pragmatic, but no dogmatic approach.
[290] *Naón,* RdC 289 (2001) 9 (94).
[291] *Jarvin*, JIA 2/3 (1985) 69 (80); *Mayer,* ArbInt (1986) 274 (285).
[292] *Lando* in FS Zweigert 157 (172).

c) The application of mandatory rules *ex officio*?

Above, the criteria for the application of mandatory rules have been set out. The problem that may arise in practice is that the arbitrator may consider a mandatory rule applicable, even when this issue has not been raised by a party.
What is an arbitrator to do in such a situation?

Article 7 (1) Rome Convention and § 187 (2) (b) of the Restatement do not by their wording require the invocation of a mandatory rule by a party for a judge to consider it. Far more, he has the discretion do so from his own motion. It has been held that arbitrators too in fact have the capacity to apply mandatory rules due to their own motion.[293] This capacity has however been limited by some authors to mandatory rules, the application of which was foreseeable for the parties,[294] while others doubt that parties in fact cannot foresee the application of mandatory rules closely connected to their contract.[295]

If none of the parties invokes the mandatory rule, they will probably be doing so because they simply do not want the mandatory rule to influence (and perhaps invalidate) their contract.

Does the arbitrator in such a case have the power or the duty to apply the mandatory rule? An arbitrator is on the one hand obliged by the mandate given to him by the parties. On the other, however, he is bound also to the state he draws his authority from and the international legal and commercial community as a whole. The arbitrator is thus in a dilemma as, if he observes the mandatory rule, he is not serving the parties according to his mandate and his award may be set aside as it may be *ultra petita.* But this may also happen if he does not observe a mandatory rule which forms part of public

[293] *Brulard/Quintin,* JIA 18 (2001) 533 (535) with further references.
[294] *Derains* in International Commercial Arbitration ICCA Congress Series No. 2 (1984) 169 (190).
[295] *Naón,* Choice-of-Law Problems 68.

policy (see *infra* section VII).[296] In such a case, it has been suggested that the arbitrators raise the question of the application of the mandatory rules and deliberate with the parties.[297] If the parties then still refuse to deliberate on the question, it has been suggested that the arbitrator should either apply it if he considers it applicable or declare himself incompetent.[298] The reason for this is that the parties should not be able to evade the application of mandatory rules by resorting to arbitration. If the arbitrator considers that the rules are legitimately applicable he need not be complicit in the parties' attempt to evade applicable rules. Therefore, parties could, e.g., not resort to arbitration to decide a dispute within a pricing cartel.

Courts both in Europe and in the U.S. seem to consider the application of mandatory rule – be it their own or those of third states – to be an arbitrators' duty.

The ECJ held in the well-reported Eco-Swiss case that the mandatory rules of European competition law were to be applied by the arbitrator *ex officio*.[299] It must however be noted that this judgment is only partially decisive for the *ex officio* application of mandatory rules. Firstly, the ECJ held that article 81 of the EC Treaty is *in toto* European Community public policy, which has been criticized.[300] Secondly, in that case, Dutch law was applicable to the contract so that the mandatory rule in fact formed part of the *lex contractus* (as according to European doctrine European law forms part of the national laws). It can be inferred from that case that the ECJ requires the application *ex officio* of mandatory rules forming part of the *ordre public*.[301] Whether or not the ECJ would have rendered the same decision had, for example Swiss law been applicable to the contract and the mandatory rule thus not been part of the *lex contractus*, remains open. It however seems likely that the judgment would have been

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[296] *v.Mehren,* ArbInt 19 (2003) 465 (468).
[297] *Blessing,* EG / U.S. Kartellrecht in internationalen Schiedsverfahren – 77 aktuelle Fragen aus der Praxis 46; *v.Mehren,* ArbInt 19 (2003) 465 (469); *de Groot,* JIA 20 (2003) 365 (372).
[298] *Blessing,* EG / U.S. Kartellrecht in internationalen Schiedsverfahren – 77 aktuelle Fragen aus der Praxis 46; *Mayer,* ArbInt (1986) 274 (280ss).
[299] *Brulard/Quintin,* JIA 18 (2001) 533 (536).
[300] *Liebscher,* Am. Rev. Int. Arb. 10 (1999) 81 (85, 86).
[301] *Zobel,* wbl 2001, 300 (301).

the same as the ECJ did not specifically state the applicability of European competition law as it was part of the *lex contractus*.

The *ex officio* application of EC competition law was also subject to scrutiny of the Swiss Supreme Court. The Swiss Supreme Court decided on a case concerning a complaint against an award rendered in a dispute between a Belgian and an Italian company.[302] During the course of the arbitral proceedings, matters of EC competition law had been raised and the arbitrator had declared that he had no jurisdiction to examine the validity of the contract according to EC competition law and assumed its validity. The Supreme Court in a setting-aside procedure commenced by both parties, held that the arbitrator had incorrectly denied his jurisdiction to examine the matter, which constitutes a ground for setting aside under Swiss law (article 190 para 2 lit. b SLPIL).[303]

The U.S. Supreme Court in the Mitsubishi[304] judgment did not explicitly state the duty of arbitrators to apply U.S. antitrust law. It did however mention that an award would not be enforced in the U.S. if it was not in compliance with the U.S. law. It has been deduced from this, that the U.S. Supreme Court implicitly wanted the arbitrators to apply U.S. law.[305]

From the above-mentioned, two conclusions can be drawn. Firstly, an arbitrator cannot disregard mandatory rules that reflect a notion of international public policy, either of the *lex contractus* or of a third state, merely because they have not been invoked by one of the parties. An arbitrator may not be the servant of some states public policy; he may however not disregard legitimate regulations of states. If he does so, the detriment to national economies may seriously jeopardize the whole system of international commercial arbitration, as it may not become a safe haven for contracts breaching public policy.

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[302] Judgement BGE, 28 April 1992, 118 II 193.
[303] *Schnyder,* IPRax 1994, 465 (466).
[304] *Schnyder,* IPRax 1994, 465 (466)
[305] *Brulard/Quintin,* JIA 18 (2001) 533 (535).

Secondly, if he may not disregard such mandatory rules, the question arises whether or not he is under an obligation to apply such rules *ex officio*. His position in the system of dispute resolution, especially his obligations towards the parties, distinguishes him from a national judge. He is thus under no obligation to apply such rules. In such a situation, he can declare himself incompetent especially is the parties explicitly request the mandatory rule not to be applied. The only thing he may not do is disregard mandatory rules reflecting public policy, as thereby he neither serves the parties as the award may be set aside or be unenforceable, nor the states which are deprived from enforcing the values they seek to protect.

This may be different for rules that do not pertain to public policy. In these cases, the danger of setting aside or of unenforceability will be limited (see *infra* section VII.). In such cases, an arbitrator is not violating the most fundamental interests of a state. In such a case, his obligations to the parties may override the interests of a state and the non-application may be acceptable.

2. Mandatory Rules of the *lex causae*

a) In the case, the applicable law has been chosen by the parties

As examined above, an arbitrator first and foremost owes allegiance to the parties will when determining the applicable law. If the parties have chosen the applicable law in their contract, they will in nearly all cases refer to a national law using language such as "… this contract shall be governed by Swiss law." The question that arises from this language is: Did the parties, when choosing a specific national law to govern their contract also chose its mandatory rules?

Clearly, if the parties have explicitly chosen also the (or certain) mandatory rules of the *lex causae*, these mandatory rules are applicable *prima facie*. Nevertheless, the facts of the case must fulfil the prerequisites set out in the mandatory rules for their application.

If, *e.g.* the parties to a contract with no connection to Germany subject their contract to German currency export law, it does not necessarily follow that these rules apply. Only if the prerequisites formulated by the German legislator are fulfilled, can these laws be applied.

If the parties have not expressly opted for the application of the mandatory rules of the *lex causae*, which will mostly be the case, a far spread opinion in arbitral literature nevertheless considers them applicable. Several notable authors consider it to be a matter of course that the mandatory rules of the *lex voluntatis* apply.[306] The reason put forward to support this is that the arbitrator is bound to apply the law chosen by the parties, which, obviously is considered to entail also the application of its mandatory rules. Consequently, however, the parties must also have the possibility to exclude the applicability of certain mandatory rules of the *lex voluntatis*, though this must be done explicitly.[307] Also arbitral awards reflect this opinion.[308]

This approach has found reception in the jurisprudence of the Swiss Supreme Court, which has stated that the mandatory rules of the law the parties have chosen are included in the choice-of-law of the parties.[309] The Swiss Supreme Court seems to follow the "Schuldsstatutstheorie" elaborated on above, when it comes to the

[306] *Derains,* ICCA Congress Series No. 3 (1987) 227 (244); *Lazareff,* ArbInt 11 (1995) 137 (138); *Lörcher,* BB 1993, IV 12, 4; *Juenger*, FS Rittner, 242.
[307] *Derains,* ICCA Congress Series No. 3 (1987) 227 (244); *Mayer,* ArbInt 1986, 274 (280).
[308] ICC Case No. 7047, reprinted in Collection of ICC Arbitral Awards 1996 – 2000, 32,41 (*Arnaldez* et al eds., 2003) in which the arbitral tribunal held that the law chosen by the parties (which was Swiss law) was the only law applicable to the contract and that article 19 of the Swiss Law on Private International Law was not applicable to the case if the parties had contractually agreed on a specific law (for an examination of this case see *infra* section VI.B.3.a); ICC Case No. 8385, *Collection IV*, 474, 483, in which the arbitral tribunal held that the an American mandatory rule (in that case the RICO Act) could be applicable only due to the choice of New York Law by the Parties. It considered however that the choice of law of the parties did not include the mandatory rules of New York law.
[309] Judgement of the BGE 118 II 193.

application of mandatory rules of the *lex voluntatis* by arbitrators.[310] Several Swiss scholars share the opinion of the Supreme Court.[311]

It is submitted that in the case the parties have not expressly included the mandatory rules of the *lex voluntatis* in their choice of law the arbitrators must interpret the contract and determine whether or not the parties could have intended to include the mandatory rules and must not apply them automatically.[312] The arbitrators will have to examine carefully, whether the parties actually had any intent to include the mandatory rules of the *lex causae* or even had any knowledge of them.[313] In doubt, it is submitted that the parties will usually not have wanted to include the mandatory rules of the *lex causae* in their choice of law. Mandatory rules intervene in the contractual relationship of the parties; they may modify the parties' obligations or may even render the contract void. Therefore it will hardly have been the intent of the parties to include these rules in their choice of law. It can hardly be expected that the parties would have subjected their contract to a legal order under which it is not valid or not valid as concluded.[314] To the contrary, the parties to international contracts will invariably have chosen a law applicable to their contract for reasons of neutrality that has no connection with their contract at all. There is no legitimate reason to apply the mandatory rules of a legal order that is only applicable because it has no connection to the case. Firstly, the parties will hardly have conceived that these rules would apply. Secondly, the mandatory rules of the *lex voluntatis* will by their legislative intent hardly apply to a case which has no connection to the case. The enacting state will regularly have no interest in their application.

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[310] *Schnyder,* RabelsZ 59 (1995) 292 (298); *Karrer* in Kommentar zum SchwPrivatrecht, Art 187 no 135.
[311] *Rüede/Hadenfeldt*, 277; *Blessing*, Das neue internationale Schiedsgerichtsrecht in der Schweiz 13, 61 who argues for application of mandatory rules of the lex voluntatis and of such that one party has invoked, but states that the application of third states mandatory rules ex officio is „questionable".
[312] *Beulker,* Eingriffsnormenproblematik 231ss; *Aden*, RIW 1984, 936.
[313] *Aden*, RIW 1984, 936.
[314] *Beulker,* Eingriffsnormenproblematik 232ss.

The reason for the application of mandatory rules of the *lex causae* is therefore not respect for the autonomy of the parties. It is also not respect for the interests of the states enacting the mandatory rules.

b) In the case the *lex causae* is determined by the arbitrator

If the parties leave the determination of the applicable law to the arbitrators, the basis for the application of the mandatory rules of the *lex causae* cannot be found in the will of the parties. Therefore, even if one would agree that the choice of a specific legal system includes its mandatory rules, the *lex causae* determined by an arbitral tribunal cannot include these rules. [315]

The reason for this is, as detailed above, that the conflict of laws rules, be it those applicable before a national court or rudimentary rules applicable before arbitral tribunals (such as s.1051(2) German CCP) designed for the determination of the *lex contractus* are inadequate for determining the applicability of mandatory rules. These rules fall outside the law designated by the classic conflict of laws rules and therefore are not included in the law to which they point.

It is submitted that in the case the parties have not chosen the applicable law, the mandatory rules of the *lex contractus* do not take priority over mandatory rules of any other legal order and are not automatically applicable. Regarding the mandatory rules of the *lex causae*, the arbitrators must follow the same approach (detailed below) that is taken to the application of third states mandatory rules. [316]

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[315] *Derains,* ICCA Congress Series No. 3 (1987) 227 (245); *Beulker*, Eingriffsnormenproblematik 241; *Juenger*, FS Rittner 233 (242).

[316] *Derains,* ICCA Congress Series No. 3 (1987) 227 (246); *cf.* also *Heini* in ZürchKomm IPRG² Art 187 no 19, who states that there should generally be no difference between the application of mandatory rules of the *lex causae* and those of third states; *Beulker*, Eingriffsnormenproblematik 242; *Kreuzer*, Ausländisches Wirtschaftsrecht 85..

3. The mandatory rules of third states

a) The Relevance of Party Autonomy

It has been shown above that the application of mandatory rules of the *lex causae* is justified by some authors by reference to the autonomy of the parties and the alleged choice of these rules by the parties. The application of the mandatory rules of third states cannot be based on the choice of law of the parties. Following this approach several tribunals have refused to apply mandatory rules not belonging to the *lex causae* (see below section VI.B.4.g). In some cases this argument has been augmented by reference to the public character of the rule and its territorial limitation.

The party autonomy referred to in these awards is a very important aspect. In fact many parties may have opted for arbitration for the very reason that their autonomy will be given higher esteem by an arbitral tribunal than by a national court. By opting out of the framework of national courts, the parties have also lost a measure of legal certainty. Therefore, the arbitral tribunal must firstly and foremost adhere to the will of the parties. As has been stated above, an arbitrator who is explicitly instructed by the parties not to apply certain mandatory rules should therefore adhere to their will. However, as he should also not further the circumvention of (perhaps very legitimate) interests of states by agreement of the parties, he should consider refusing to arbitrate their dispute if he considers that the agreement of the parties would lead to the enforcement of a contract which violates mandatory rules which he considers legitimately applicable.

ICC Award No. 1512[317] and 1664[318]

Both cases arose out of Pakistani emergency legislation that had been enacted due to the outbreak of armed hostilities between the Pakistan and India, which prohibited payments to made from Pakistani to Indian parties.

In the first case the arbitrator sitting in Switzerland refused to apply a Pakistani law, which prohibited any payment from any Pakistani party to an Indian party for reasons of hostilities. The arbitrator reasoned that as Indian law applied to the contract, the Pakistani legislation could not be considered and release the Pakistani debtor from his debts. The arbitrator reasoned with a conflict of laws analysis, namely that the law of the contract governed the question, whether or not the contract was invalid and that the *lex loci solutionis* rule was controversial. He thus held that the Pakistani rule could not be applied to the case.

In the second the arbitrator the arbitrator examined the emergency legislation itself and made an assessment whether in the case in front of him the terms "enemy" and "illegality" which had been used in the legislation were fulfilled. He held that such legislation could not bind him as an arbitrator in a foreign and neutral country but could only bind the courts of the country that had enacted it. Further the parties had chosen Indian law so only Indian law could be applied to the contract and the Pakistani rule would not be applied.

ICC Award 1803[319]

The award rendered to solve this dispute shows how arbitrators have disregarded mandatory rules of states that seek to intervene into a treaty for political reasons. In this case, a state-owned company in East Pakistan had concluded a contract for the construction of a pipeline for the transport of gas in the Eastern part of Pakistan. The contract was to be governed by Pakistani law and provided for arbitration under the ICC Rules in Geneva. After East Pakistan became Bangladesh on March 26, 1971, the new

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[317] Collection of ICC Arbitral Awards 1975-1985 (Jarvin ed.) 3.
[318] Reported by *Lew*, Applicable Law 545ss.
[319] YBCA 5 (1980) 177.

Bangladeshi government established a state owned Bangladeshi company, which was the legal successor of the Pakistani company. The Bangladeshi government however also enacted two decrees which exonerated the new Bangladeshi company from all liabilities of its legal predecessor.

After determining his jurisdiction over the new company and the Bangladeshi government due to a rule of succession taken from Swiss law, the arbitrator went on to examine the Bangladeshi decrees. He held that they were in clear violation of Swiss *ordre public* and also international *ordre public* and in any case were not applicable as they did not form part of the *lex contractus, i.e*. Pakistani law.[320]

This award was subsequently set aside by the Swiss courts for a number of reasons.[321] Firstly, it held that the arbitrator had had no jurisdiction over the Bangladeshi government. Secondly, the Swiss Supreme Court reasoned, Swiss *ordre public* could not be affected by the Bangladeshi decrees, as the case had no territorial connection to Switzerland and the Swiss Supreme Court did not acknowledge any notion as international *ordre public*. In any event, the legal status of an entity is governed by the law of the State in which it has its seat. The expropriation of foreigners abroad, which had taken place in this case, could not be judged by Swiss courts, which had to recognize the seizure of goods abroad.

ICC Case 7047[322]

Two parties entered into a contract in which the claimant undertook to assist the defendant in promoting and selling military products in state X. For this assistance a fee was to be paid. State X agreed to a contract with the defendant, however not without first issuing a writ in which it declared to the defendant that all the costs for all deliveries must be calculated without fees for agents or intermediaries. The defendant subsequently sought to terminate the contract with the claimant and declared that their

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[320] YBCA 5 (1980) 177 (181-182).

[321] BGE, 5 May 1971, YBCA 5 (1980) 217.

[322] reprinted in Collection of ICC Arbitral Awards 1996 – 2000, 32,41 (*Arnaldez* et al eds., 2003).

services were no longer needed. The claimant initiated arbitration in Switzerland applying Swiss law. The defendant contended that the contract with the claimant was void, as the circular was an expression of mandatory law of state X. The tribunal crushed this argument, holding that this writ was merely a contractual provision between the defendant and state X.

The defendant then invoked a provision of law of state X which prohibited the activity of commercial agents in state X who were not nationals of state X.

The tribunal held that it was "disputed in arbitration whether article 19, belonging to Chap. 1 of the LDIP [Swiss Law on Private International Law], is applicable if the parties have contractually agreed on a specific law". It then went on to hold that, if the parties have not chosen a law to apply to their contract, the arbitral tribunal is bound by this choice unless the rule in question forms part of the *ordre public* international.

In this case the arbitrators specifically held that only provisions of the law that has been chosen by the parties can be applied by the arbitrators. The reasoning follows the approach strictly following the parties choice of law. However, an exception is to be made in the merits of the rule. If it reflects *ordre public* international it is applicable, obviously without any further prerequisites.

ICC Award 2977,2978,3033[323]

In a case between a Swedish shipyard Götaverken and the Libyan General Maritime Transport Organization a dispute arose as to the payment of the agreed price as Götaverken had accordingly used Israeli parts in violation of Libyan boycott legislation and not met all technical specifications required by the contract. The arbitrators held that Swedish law was applicable and thus the Libyan boycott legislation could only be

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[323] YBCA 6 (1981) 133.

respected as far as it had been made part of the contract but not due to the legislative will of the law.[324]

b) The Relevance of the Choice of Law and the *Ordre Public*

It has been laid down above that provisions such as Art 7(1) Rome Convention or Art 19 Swiss PILA are not applicable in arbitration. Therefore, the arbitrator cannot apply these provisions (directly) to justify the application of foreign mandatory rules of mandatory rules of a legal order not chosen by the parties. If the parties have chosen the applicable law, the wording of the *lex arbitri* of the examined legal orders (with the exception of the USA and the FAA which contains no provision on the applicable law) indicates that the dispute is governed solely by this law.

However, it has been demonstrated above that mandatory rules can be applied regardless of the choice of law of the parties. Their application lies not in the discretion of the parties.[325] Therefore, the choice of law does not render internationally mandatory rules inapplicable. If the parties' choice of law does not have an influence on the application of mandatory rules, the question remains what the legal basis for the application of mandatory rules in the absence of an explicit provision to this effect in the *lex arbitri* could be.

The first basis that may serve to render mandatory rules applicable is the *ordre public*. The term *ordre public* used here refers to the standard of *ordre public* used by national courts when deciding on the setting aside of an award. The *ordre public* forms the limits within which states have granted private parties the right and the freedom to have their dispute decided by arbitrators. A violation of the *ordre public* will justify the setting aside of an award (see below section VII.) and will bar its enforceability. Therefore there is an obligation of arbitrators to consider mandatory rules if their non-application

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[324] *ibid*. 135.

[325] *v.Hoffmann*, Internationally Mandatory Rules of Law Before Arbitral Tribunals 11; *Schnyder,* RabelsZ 1995 292 (303); see also *La Spada* 127; who list the mandatory rules as a factor limiting the choice of law of the parties; *Lachmann*, no 1673.

would result in a violation of the *ordre public*. The obligation to consider the application of these rules derives from the fact that arbitration may not be abused as a method to violate the *ordre public* of a state without sanctions. States in their national legislations have made it clear that such an abuse of arbitration would not be tolerated. By taking an increasingly liberal attitude towards the arbitrability of disputes involving rules which form the *ordre public*, states have transferred the obligation to respect the *ordre public* into arbitration. [326]

In such a situation, therefore, the arbitrator is entitled and in fact obliged to ignore the choice of law of the parties. Often, it is then argued from this premise and also follows logically that arbitrators are entitled to apply or take into consideration such mandatory rules that pertain to public policy and the non-application of which would endanger the sustainability of the award. The wording of the *lex arbitri* of the examined legal orders (with the exception of the United States), however, indicates that the arbitrator is to follow the choice of law of the parties and in the absence of such a choice is to either apply a conflict of laws rule, a legal system the arbitrator considers appropriate or the law with the closest connection to the case. It does not mention that the arbitrator is to disregard a choice of law the effect of which violates the *ordre public*. It must be supposed and it is submitted that in the case the choice of law of the parties would lead to a result contrary to the *ordre public*, the choice of law is irrelevant for the arbitrator[327] and the provisions of the *lex arbitri* designed for the case that no choice of law has been made are triggered. There are no other provisions relevant for the arbitrator to decide on the applicable law in the absence of a valid choice of law. It is therefore under these provisions that the arbitrator must decide which mandatory rules to apply. If he has the freedom to choose a conflict of laws rule or to apply a *voie directe*, he will be able to reason the application of a mandatory rule according to the methodology laid out below (section VI.B.4.) and can therefore render an award which is consistent with the *ordre public*. If the *lex arbitri* provides for the application of the law with the closest connection to the case, the arbitration could either adopt a reasoning similar to that of the Austrian Supreme Court, which states that the legislative

[326] *Schiffer*, Handelsschiedsverfahren, 168; *Drobnig*, FS Kegel 113.
[327] *Zeiler,* Schiedsverfahren, § 603 no 11; *Lachmann*, no 1673.

intent of a rule creates the closest connection to a case (*supra* section IV.D.(2)(c)).[328] Otherwise, the *lex arbitri* must be considered to have a gap which is to be filled by arbitrators ("*schiedsrichterliche Rechtsfortbildung*") (similar to the gap created by the reservation made to Art 7(1) Rome Convention by Germany).[329] This gap is evident as s.1051 German CCP does not explicitly allow the arbitrator to apply any law other than that chosen by the parties or with the closest connection but the award may be set aside if the arbitrator fails to apply the rule and thereby renders an award incompatible with the *ordre public*. Therefore, the arbitrator must be able to fill this gap by applying the mandatory rule despite the (incomplete) wording of the law.

c) Mandatory Rules that Do Not Reflect the *Ordre Public*

A number of mandatory rules may not reflect the *ordre public* of a state or even the *transnational ordre public*. Nevertheless, the state may consider their application important. Art 7 (1) Rome Convention, Art 9 (3) Regulation 593/2008 or Art 19 Swiss PILA grant judges the power to consider the application of such rules even if the parties have chosen a specific law to govern their contract. They, however, do not apply before arbitral tribunals.[330] Does this then mean that arbitrators are prevented from applying them? As stated above, numerous authors generally subscribe to the idea that mandatory rules other than those of the *lex causae* can be applied to the dispute.[331]

It is submitted that mandatory rules that do not reflect the *ordre public* of the enacting state may under limited circumstances by applied. The reason for this is that – as stated above – mandatory rules generally are considered to apply regardless of a choice of law of the parties or the otherwise applicable law. Therefore, even if the parties have chosen a specific legal system to govern their dispute, the potential application of mandatory rules is not prevented by this. The arbitrator can therefore also in this case refer to the

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[328] *Karrer* in BaslerKomm IPRG², Art 187 No 240.
[329] *Schiffer*, IPrax 1991 84.
[330] *Bucher,* Schiedsgerichtsbarkeit 97; Fouchard/Gaillard/Goldmann on International Arbitration, 850 (*Gaillard/Savage* eds., 1999).
[331] *Heini* in ZürchKomm IPRG² Art 187 no 18ff; *Voser,* The Amercian Rev. Int. Arb. 1996, 319 (342); Berger, ZvglRWiss 1997 316 (330ss); *Blessing*, JIA 1997 23ss.

lex arbitri which allows him to determine the applicable law in the absence of a choice of law. In this case there is an absence of a choice of law of the parties, as they simply cannot make a valid choice of law regarding the non-applicability of mandatory rules.[332] To the extent the *lex arbitri* allows him to choose a conflict of laws rule or to apply the law he deems applicable, the application of mandatory rules can be justified by reference to these provisions. The arbitrator may reason that he considered a conflict of laws rule such as the one described below (section VI.B.4.) to be applicable or - in the case of the *voie directe* – explain why he considers a mandatory rule to be applicable.[333] If the *lex arbitri* obliges the arbitrator to apply the law with the closest connection, he can adopt the same reasoning as suggested immediately above (*supra* b)).

4. The Methodology for the Application of Mandatory Rules

It has been established immediately above that arbitrators may, under specific circumstances, consider the application of mandatory rules. This, however, does not indicate under which circumstances arbitrators may apply mandatory rules. In the following it will therefore be attempted to establish a methodology for the application of mandatory rules by arbitral tribunals. For the methodology to have a basis as broad as possible and therefore to be as internationalizable as possible, it will include common elements from all examined national legal orders. As arbitrators enjoy a margin of remoteness from national courts and national law, the methodology will however not be a mere copy of the theories developed for the application of mandatory rules before national courts. It will be attempted to take the specific circumstances of arbitration and the imperative of party autonomy into account.

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[332] *v.Hoffmann*, Internationally Mandatory Rules of Law Before Arbitral Tribunals 3, 11; *Schnyder,* RabelsZ 59 (1995) 292 (303).
[333] *Voser,* The Amercian Rev. Int. Arb. 1996, 319 (342).

a) The extraterritorial intent of the mandatory rule.

The legislative intent of the mandatory rule to be applied to a specific case is one of the most relevant criteria for the application of foreign mandatory rules before national courts. The essential function of this criterion is to ensure that only such mandatory rules can be applied that actually want to govern the situation. This criterion is relevant both in continental and in U.S. theories.[334]

This criterion can be used as a starting point of the examination of whether or not to apply a mandatory rule to a case in arbitration too. It is an inevitable element if the arbitrator is to avoid considering the application of mandatory rules that do not even attempt to govern a case. If the legislative intent cannot be determined, the enacting state has no interest in the application of its rule and therefore there is no reason to apply it to a case.

Most authors who are in favour of the application of mandatory rules by arbitral tribunals agree that only rules which have the legislative intent to be applied can be considered.[335]

b) The Element of a “close connection”

The Sonderanknüpfungstheorie requires a “close connection” between the facts of the case and the enacting state. As stated above, there is no general test to determine whether a case has a connection close enough to an enacting state. Regulation 593/2008 limits the application of mandatory rules to the mandatory rules of the *lex loci solutionis*. This regulation, however, is not applicable in arbitration. Therefore, there is no legal duty of the arbitrator to limit the scope of the possibly applicable rules to the *lex loci solutionis*. This regulation does not meet modern doctrinal standards. Further,

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[334] See above section VI.B.1.b;

[335] *Schiffer*, Normen ausländischen »öffentlichen« Rechts 186; *Lando*, The Law Applicable to the Merits 159; Chukwumerije, *Mandatory Rules*, 573; *Bucher,* Schiedsgerichtsbarkeit 97; *Berger*, ZvglRWiss 1997 316 (330ss).

national courts have accepted to a certain extent that mandatory rules of legal orders other than the *lex loci solutionis* can be applied or respected. Therefore, it is submitted that arbitrators need not limit the application of mandatory rules to the rules of the *lex loci solutionis*.

This can further be underlined by reference to the U.S. approaches. As has been detailed above, the influential Restatement (Second) of the Conflict of Laws in section187(2)(b) entitles the judge to apply rules reflecting a policy of another state with an materially greater interest in the application of its rule. The interest of the enacting state is justified and becomes more relevant the closer the contacts are between the case and the enacting state.[336] Therefore, also the U.S. approach requires a close connection between the facts of the case and the enacting state. The U.S. approach, however, does not limit the potentially applicable rules to those of the *lex loci solutionis*.

English law requires no close connection between the enacting state and the facts of the case. Apart from the mandatory rules of the *lex loci solutionis*, no other rules will be applied. Also the rules of the *lex loci solutionis* will only be applied if the proper law of the contract is English law. Further, possibly the violation of foreign mandatory rules also constitutes a violation of the English *ordre public*, though this does not depend on the close connection between the case and the state which enacted the rule. It is, however, submitted that English law and its unwillingness to apply foreign mandatory rules does not reflect an internationalizable standard on this point.

Also scholars agree that the application of mandatory rules requires a close connection between the facts of the case and the enacting state.[337] Nevertheless, few of these authors explicitly state which standard of a close connection – if at all – they consider appropriate. There seem to be two approaches to this issue, which, however, do not differ as much as it may seem. The first requires that the mandatory rule in question has

[336] Restatement (Second) on the Conflict of Laws, 564ss.
[337] *Voser,* The Amercian Rev. Int. Arb. 1996, 319 (345); *Bucher,* Schiedsgerichtsbarkeit 97; *Berger*, ZvglRWiss 1997 316 (330ss); *Blessing*, JIA 1997 23 (32) *Schnyder*, RabelsZ (1995) 293 (306); *Drobnig*, FS Kegel 95 (116ss); *Berger*; Wirtschaftsschiedsgerichtsbarkeit 487..

been enacted by the state in accordance with international law. The second approach demands that a close connection must be established in the individual case, without, however, limiting this to rules which are in conformity with international law.

Schiffer opines that the arbitrator is supposed to examine a close connection and not merely to examine whether a state has excessively claimed jurisdiction, as the limits set out by public international law are too vague and unnecessary if the arbitrator can determine a close connection.[338] Further authors agree that the facts of the case must have a close connection with the enacting state[339] or merely state that arbitrators can apply Art 7 Rome Convention in analogy.[340]

Voser also suggests that a close connection must exist, but that this close connection exists even when it is the connection legitimizing the jurisdiction under public international law, e.g. when the anticompetitive effect of an agreement is felt in a state.[341] It has been suggested to use of the limits set out by public international law as criterion when applying mandatory rules also before national courts.[342]

Clearly even if the enacting state is make use of its jurisdiction to prescribe legitimately under public international law, it is still the prerogative of the forum state to enact legislation requiring a closer link than the one established by public international law and to define this close link as it likes for the foreign rule to be applicable.[343] The question arises whether an arbitrator must search for a close connection under other criteria than those set out by public international law or whether the points of contact international law requires are sufficient.

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[338] *Schiffer*, Normen ausländischen »öffentlichen« Rechts 188.
[339] *Berger*, ZvglRWiss 1997 316 (330ss); *Blessing*, JIA 1997 23 (32); *Schnyder*, RabelsZ (1995) 293 (306); *Drobnig*, FS Kegel 95 (116ss).
[340] *Heini* in ZürchKomm IPRG² Art 187 no 19; *Bucher,* Schiedsgerichtsbarkeit 97.
[341] *Voser,* The Amercian Rev. Int. Arb. 1996, 319 (346).
[342] *Kreuzer,* Ausländisches Wirtschaftsrecht 91; *Lorenz*, Vetragsabschluß 167 with a reference to *Kleinwort Sons & Co. v. Ungarische Baumwolle Industrie AG*, Jugment, Court of Appeals, [1939] 2 K.B. 678.
[343] *Basedow*, RabelsZ 1983 141 (147 – 149).

To answer, however, whether the limits set out by public international law are at all useful to determine whether a rule can be applied or not it is purposeful to set out the limits of a state's jurisdiction to prescribe.

c) The limits of jurisdiction set out by public international law

Public international law sets out limits of the right of each state to prescribe its laws to the conduct which takes place outside its territory.[344] International law imposes limits on each state when to demand from other states to apply its laws. International law also requires a connection between the facts of the case and the forum state.[345] This connection may be vaguer than the connection that states may require before they are willing to apply foreign mandatory rules, but it is still a pre-requisite. In international doctrine, these connections are often termed as principles, which allow the extraterritorial prescription of national law. Under international law the following principles have been established:[346]

The territoriality principle, the nationality principle, the protection principle and the effects doctrine.[347]

The territoriality principle gives each state the right to prescribe law applying to conduct on its territory. This approach is generally accepted, but may be difficult to apply in

[344] American Law Institute, Restatement of the Law, Third, Foreign Relations Law of the United States 235 (1987); the author is of the opinion that the judgement rendered by the Permanent Court of International Justice in the *Lotus Case*, which granted every state to exercise extraterritorial jurisdiction freely, except in cases in which international law specifically prohibited it, is going too far and must be reversed so as to mean, that a state may exercise extraterritorial jurisdiction only when international law allows for it to do so; Lowe, AJIL 1981 257 (263-264).
[345] *Meng,* Extraterritoriale Jurisdiktion, 541ss.
[346] American Law Institute, Restatement of the Law, Third, Foreign Relations Law of the United States 235 (1987); *Meng,* Extraterritoriale Jurisdiktion, 498ss.
[347] for all these principles see: European Communities: Comments on the U.S. Regulations Concerning Trade with the U.S.S.R., 21 ILM 891, 893-897 (1982).

certain cases due to the vagueness of the extent to which the conduct must take place on the territory to of a state to justify the application of its laws.[348] In *Branch v. Federal Trade Commission*,[349] a U.S. Court applied the Federal Trade Commission Act (FTC) applied to a U.S. citizen, who sold correspondence study courses without having the authority or the education to do so according to U.S. laws, by mail to students in Latin America. Though the deceived students were all located in Latin America and thus the detrimental impact was only felt there, the U.S. Court held that territorial jurisdiction could be applied as Branch was sending the coursebooks and correcting the tests in Chicago, Illinois.[350]

The nationality principle grants states the right to prescribe laws for their nationals even when these are abroad. This principle can gain practical usage for subsidiaries of foreign companies.[351] The ECJ has taken a very extensive approach to this issue and has applied the so-called "economic entity doctrine" on parents of subsidies who had taken part in illegal price fixing outside the EC.[352] Only because they had subsidiaries in the EC and formed an economic entity, did the ECJ hold that EC competition law was applicable to the parent companies.[353] If a subsidiary has a sufficient amount of control over itself, without only being the long arm of its parent, the territoriality principle will override and the subsidiary will be subject to the territorial jurisdiction of the state in which it is located.[354]

The protective principle allows for the prescription of laws which regulate conduct abroad that endangers the safety of a state. This principle has found acceptance in

[348] *Erne*, 82.
[349] 141 F.2.d 31 (7th Circuit. 1944).
[350] *Atabaki*, International Lawyer 2000 564 (566).
[351] to the conflicts arising out of the application of the control theory (which defines the nationality of a subsidiary according to the control exercised over it from a parent) for the application of the principle of nationality see *Meng*, ZaöRVR (1997) 269 (294ff).
[352] ICI v. Commission (Case 48/69) CMLR 557, para 130ss (1972)
[353] *Ibid*.
[354] *Lowe,* GYIL 1984 54 (60-62).

international criminal law,[355] but could arguably also be used for economic issues. If a state deems it necessary to enact export control laws which are to be applied by third countries, as in the pipeline case described above (*supra* section IV.D.(2)(b)), one could discuss the justification of such measures with this principle. It has been argued that extraterritorial cartels have a detrimental impact on the national economy and that therefore the protective principle can be applied to justify the prescription of extraterritorial legislation.[356] The principle was however not accepted by the Arrondismentrechtsbank Den Haag, which argued that it is permissible for a State to invoke the protective principle to prevent the jeopardy of its security or creditworthiness, but that the foreign policy interests set forth by the U.S. do not justify the applicability of the embargo before Dutch courts.[357]

Of interest specifically here is the so-called effects doctrine. This doctrine is the most heavily-debated basis for jurisdiction. It was established by U.S. court practice and has lead to some controversies with European states. The Restatement declares the grasp for jurisdiction of U.S. law, especially of competition law to be legitimate, when the conduct takes place outside the U.S. but has substantial effects in the U.S.[358]

The first notable decision endorsing this principle was rendered in 1945 in the case of *United States v. Aluminium Co. of America* (ALCOA) in which the Sherman Act was declared to apply extraterritorially as “any state may impose liabilities, even upon persons not within its allegiance for conduct outside its borders which the state reprehends”.[359] This approach provoked the feeling in other states that their sovereignty was infringed by the grasp of jurisdiction over conduct taking place on their soil to such

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[355] American Law Institute, Restatement (Third) of the Law on International Relations, Comment f to § 402.
[356] Haymann, 312; Stern, AFDI (1986) 7 (35); *contra* Seidl-Hohenveldern, AWD 1963 73, who argues that the protective principle can only be invoked to protect the most fundamental and vital interests of a state; so also *Meng*, Extraterritoriale Jurisdiktion, 517.
[357] *Sensor Case* discussed *supra* in section IV.D.(2)(b).
[358] American Law Institute, Restatement (Third) to the Law of Foreign Relations, comment (d) to § 402.
[359] 148 F.2d 416 (2nd Cir. 1945).

an extent. In the 1970s, American courts acknowledged the resentments of the international community and developed a more sophisticated approach to the matter.[360] In the cases of *Timberlane Lumber Co. v. Bank of America*[361] and *Mannington Mills Inc. v. Congoleum Corp.*[362], two U.S. Courts had the opportunity of reconsidering the ALCOA judgment. They held that U.S. Antitrust law does apply extraterritorially, but they limited the unconditional approach taken in ALCOA. They introduced the test of reasonableness which is now included in § 403 of the Restatement, Third.[363] This test introduced a catalogue of factors which a court is to follow when considering whether a law is to be applied to an international case.[364] These factors include: the link of the activity to the territory of the regulating state, connections such as nationality, residence or economic activity between the regulating state and the person principally responsible for the activity to be regulated, the extent to which another state may have an interest in regulating the activity and the likelihood of conflict with regulation by another state.[365] Section § 403 of the Restatement, Third therefore combines a list of connecting factors which establish the jurisdiction of a state to prescribe with a balancing test.[366] The stronger the connecting factors link a case to a specific state the stronger the interest of that state is in the application of its law which should then be the law to be applied. The application of the rule of the state in favour of which the balancing test turns out, is not based on comity but is based on international law. According to the Restatement, this test of reasonableness is a rule of customary international law.[367] This test was, however, reconsidered in *Hartford Fire Insurance Co. v. California*[368] in which the U.S. Supreme Court took a very extensive approach to its jurisdiction turning back on the

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[360] *Demetriou/Robertson*, ECLR 1995 461 (462).
[361] 549 F.2d 597 (9th Cir. 1977).
[362] 595 F.2d 1287 (1979).
[363] for this test of reasonableness see: *Lowenfeld*, RdC (1994-I) 9 (46, 75); *Meng*, ZaöRVR (1981) 469 (483).
[364] it is not its own comity that the court is exercising, but it is interpreting the legislative comity that the legislator had introduced when enacting the law, see Justice Scalia's separate opinion in *Hartford Fire Insurance Co. v. California,* 509 US 764*,* 20
[365] For the complete catalogue of factors, see § 403 of the Restatement;
[366] *Meng,* Extraterritoriale Jurisdiktion*,* 546.
[367] American Law Institute, Restatement of the Law (Third) of Foreign Relations Law 231 (1987);
[368] 509 US 764.

road from *Mannington Mills* and *Timberlane Lumber* to its approach in ALCOA.[369] The court in *Laker Airways* v. *Sabena* also refused to apply the balancing test.[370] It is therefore doubtful whether the approach taken by the Restatement Third actually reflects international law.[371]

Other approaches limit the grasp of states to regulate the extraterritorial conduct by utilizing the prohibition of abuse of rights or the principle of non-intervention.[372]

From the above it is clear that international law requires a case to have a link to a state for that state to be able to justify its enactment of a rule that by its terms seeks to apply to the case. This link has been coined in a number of ways, e.g. "as a genuine link"[373], "a substantial and bona fide connection"[374], "a sufficiently close connection"[375], a "relevant and reasonable connection".[376] Essentially, therefore the same question is asked both from the conflicts of law perspective and from the public international law perspective. As Mann eloquently formulated:

> *If one realises the history of and the inter-relation between the conflict of laws and public international law in respect of the problem of the reach of legislation, i.e., of international jurisdiction, it becomes plausible, perhaps even obvious that today both continue to give rise to the same fundamental question: does there exist a sufficiently close connection between a given set of facts and, on the one hand, a particular legal system called upon to govern it or, on the other hand, a particular legislator qualified to*

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369 *Hay*, RabelsZ 1996 303 (316); *Durack*, 479 (480).
370 Laker Airways v. Sabena, 731 F 2d. 909, 948ss (D.C. Cir 1984).
371 *Meesen*, Conflicts of Jurisdiction, 47, 62ss.
372 *Rehbinder,* GWB, section 130(2) nos 21ss.
373 *O'Connell*, 2 International Law 603.
374 *Brownlie*, Principles, 311.
375 *Mann*, RdC (1964-I) 1 (49).
376 *Mann*, RdC (1984-III) 9 (28); citations taken from *Meng,* Extraterritoriale Jurisdiktion 543.

> *regulate it? The former question belongs to private, the latter to public international law.*[377]

That an arbitrator is to establish a close connection between the facts of the case and the enacting state, can therefore be seen as an imperative either of conflicts of law or public international law. The requirement of a close connection formulated in approaches such as the "Sonderanknüpfungstheorie" essentially justifies the application of a foreign mandatory rule also under public international law even though it is a conflict of laws requirements. Of course every legislator and every court can require an even closer connection than the one required under public international law in its conflict of laws rules. It is, however, submitted that in a case that an arbitrator can determine a close connection between the facts of the case and the enacting state that justifies the application of the mandatory rule from a conflict of laws perspective, the requirements under public international law will be fulfilled also. Whether this holds true when reversed may be doubted. The reason for this is, as correctly observed by *Schiffer*,[378]that international law has yet to determine the borders of interntional jurisdiction and to offer more than general *formulae*.[379] There also is no dogmatic reason to deviate from the element of close connection as required under national conflict of laws rules to the realm of public international law.

An arbitrator must therefore establish a close connection between the facts of the case and the enacting state. It is not sufficient to merely refer to a principle of public international law which in most cases is ill-defined to justify the application of a mandatory rule.

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[377] *Mann*, RdC (1984-III) 9 (28).
[378] *Schiffer*, Normen ausländischen »öffentlichen« Rechts 188.
[379] *Mann*, RdC (1984-III) 9 (28); *Meng,* Extraterritoriale Jurisdiktion*,* 544.

d) The substance of the rule in question.

According to the Sonderanknüpfungstheorie proposed above national continental European judges do not merely determine the spatial reach of a mandatory rule, but also examine its contents. Numerous approaches to this examination have been suggested, reaching from the conformity with the public policy of the forum state, over a shared value approach to the criterion of the furtherance of an interest of the forum state, were put forward. It was submitted above that the mandatory rule must be compatible with the interests of the forum state. Also the American approach analyses the contents of a rule when deciding on the policy behind the rule, though there is no requirement that is fosters the interests of the forum state.
In the constellation of the application of a mandatory rule by a national court, it is clear that the judge has to assess the compatibility of the substance of the mandatory rule against the values of the *lex fori*. U.S. doctrine also requires the judge to decide whether a rule of foreign legal system must be applied due to the policy reflected in that rule. The question that arises in the international arena, specifically before an international arbitrator is: which body of rules form the yardstick by which the arbitrator is to assess the substance of the foreign rules in absence of a *lex fori*?

A number of scholars opine that the arbitrator – in the absence of a forum – cannot and should not refer to any national notion of *ordre public* but must measure the substance of the rules against the "transnational *ordre public*".[380] The use of the transnational *ordre public* can be either positive or negative. The negative approach uses the transnational *ordre public* to deny only such rules application that violate these must fundamental values of the international community.[381] The positive approach requires that mandatory rules protect vital interests of the international community as a whole.[382]

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[380] *Naón,* RdC 289 (2001) 9 (79); *Blessing*, *Impact* 64; *Chukwumerije*, African journal of international and comparative law 1993 561 (576); *Berger*, ZvglRWiss 1997 316 (331ss); *Beulker*, Eingriffsnormenproblematik 307; *Schlosser*, Schiedsgerichtsbarkeit² 741..

[381] *Schnyder,* RabelsZ 59 (1995) 292 (306).

[382] *Berger*, ZvglRWiss 1997 316 (331ss); *Naón,* Choice-of-Law Problems 289s arguing that especially vital interests of developing countries must be respected .

It is true that the substance of mandatory rules must be assessed before they are applied. The notion of the transnational *ordre public* is at first glance a rather obvious choice as this yardstick. It is the lowest common denominator amongst states. The international character of arbitration and the requirements of practice prevent the national conceptions of *ordre public* to be a useful tool in this respect. The negative approach described above, however, seems to be overly broad. It is undoubtedly true that rules which violate the transnational *ordre public* may not be applied. However, this leaves a very broad margin of potentially applicable rules. It would have the consequence that in international arbitration mandatory rules could be more readily applied than before national courts. However, arbitration is constructed on the autonomy of the parties which therefore have a greater importance in arbitration than in proceedings before national courts. As mandatory rules limit the autonomy of the parties, they must be applied with greater restraint in arbitration. Therefore, the mere negative application of the transnational *ordre public* seems to be an insufficient criterion when deciding on the application of a mandatory rule.

The positive approach is more limited. To be applied a mandatory rule must secure some vital interest that is common to the international community. By applying the notion of the transnational *ordre public* an international tribunal is free from any national concepts of *ordre public*. A reference to the *ordre public* of any of the legal orders connected to the arbitration, such as that of the *lex causae* or the seat of the arbitration may be arbitrary as they will often have been chosen for reasons of neutrality. Therefore is seems very appropriate to refer to the transnational *ordre public* as a yardstick against which to assess the substance of the mandatory rule. However, the difficulty with this approach lies in the definition of the transnational *ordre public*. If the transnational *ordre public* is to comprise the values protected by all legal systems of the world, one may wonder whether the intersection of all these legal systems will be large enough to provide a viable basis for a decision of an arbitrator. Certain values will undoubtedly be counted to the transnational *ordre public*, such as the prohibition of the sale of drugs, trafficking in human beings, the human rights reflected in the Universal

Declaration of Human Rights, embargos enacted by the United Nations or the like.[383] However, it is doubtful whether an arbitrator in practice will be able to use these very general notions to determine whether a rule is part of the transnational *ordre public* or not. Apart from the mentioned very basic elements, it is difficult to see a broad acceptance of values relevant in the commercial arena which are accepted by all legal orders of the world.[384] One example for this is the *Hilmarton* v. *OTV* arbitration in which the arbitrator considered a contract to be invalid due to a mandatory rule of Algerian law prohibiting the use of intermediaries for the procurement of state contracts stating that the values of the rule would be shared by the principle European legislators.[385] This award was set aside by Swiss courts for the reason that the Algerian rule did not reflect fundamental interests of Switzerland or the international community.[386] It must be acknowledged that the development of the concept of the transnational *ordre public* is by no means finished and the notion is therefore not finally determinable.[387]

The solution submitted to this problem here is to limit – if possible – the scope used to define the transnational *ordre public*. There seems to be no cogent necessity for an arbitrator to examine all or most of the legal orders of the world and then to determine a rule pertaining to the transnational *ordre public* to establish a yardstick against which to assess the substance of a mandatory rule. If he can do so, such as in the cases mentioned above, the arbitrator will face no problem in assessing the substance of the mandatory rule. However, states often enact rules which reflect legitimate and strong policies but are generally not considered to pertain to the transnational *ordre public*. One example of this is rules of competition law. As rules of competition law are customized to the economic realities in various states, it is not possible to count the conservation of

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[383] *Lalive*, ICCA Congress series no 3 (1987) 258 (285ss); *Beulker*, Eingriffsnormenproblematik 293ss.

[384] *Sandrock*, Am.Rev.Int.Arb 1992 30 (55); *Karrer* in BaslerKomm IPRG² Article 187 nos 270ss; *Böckstiegel*, ICCA congress series no.3 (1987), 177 (180) criticizing that the values reflected in the notion of the transnational *ordre public* are subject to constant change.

[385] Award of 19 August 1988, ASA Bulletin 1993, 247.

[386] Decision of the BGE, 17 April 1990, YBCA 19 (1994) 214 (221).

[387] *Zhilsov*, NILR 1995 81 (99); *Böckstiegel,* Public Policy and Arbitrability 177 (180).

competitive markets to the transnational *ordre public*.[388] However, the correct conclusion cannot be that - as mandatory rules pertaining to competition law do not reflect the transnational *ordre public* - they are not applicable in arbitration. In this case, a solution could be to determine the substantive yardstick against which to measure the rule not by reference to the transnational *ordre public* but to the legal orders of all concerned states. Such concerned states and legal orders are those of the seat or the parties, of the place of performance, of the place the effects of a contract are felt, of the place where goods are located and the like. The arbitrator needs to compare the common interests protected in these states and by their legal orders and attempt to determine a common denominator among them. This approach serves the interests of the parties, as the values against which a mandatory rule is measured was foreseeable for them and will derive from legal orders with a connection to them or their transaction. Also, doctrine recognizes the substance of the transnational *ordre public* can be derived from a comparative approach to the legal orders of the states connected to the case.[389] Therefore, if the arbitrator can determine that a mandatory rule of a closely connected legal order reflects a value also protected by the legal orders of the states which are connected to the case, this – it is submitted – would be sufficient to show that the substance of the mandatory rule reflects not only the interests of one single state but of at least a part of the international community and would ensure that mandatory rules that only serve the selfish interests of one state, e.g. bilateral embargos, are not applied.

e) Rules that do not meet the above criteria

Some mandatory rules may not meet the above criteria but may nevertheless have an impact on the relationship of the parties by effectively preventing or influencing performance of one of the parties. An example for this would be the case of a bilateral embargo of a state against another. If the goods to be delivered under a contract are on

[388] *Karrer* in BaslerKomm IPRG² Art 187 no 287 with reference to the jurisprudence of the Swiss Supreme Court; *Voser,* The Amercian Rev. Int. Arb. 1996, 319 (342).
[389] *Beulker*, Eingriffsnormenproblematik 294.

the territory of the state imposing the embargo, a seller may effectively be prevented from delivering. Nevertheless, if the embargo has been imposed for some interests which are not shared or are even disapproved of by the international community, the arbitrator should not apply the rule as he should not abet the interests of one state which are not shared by others. In this case, the arbitrator must accept that the seller is in no position to perform under the contract. The only solution if the arbitrator does not want to render an unjust decision is to recognize the factual effects of the mandatory rule on the contractual relationship and to take them into account as facts. This has been proposed for the same situation under national law[390] and there is no good reason why not to transfer this approach into arbitration.

f) Summary

It thus seems accepted by literature that mandatory rules of third states need not be left unconsidered in the realm of international commercial arbitration.

In order to be applicable a mandatory rule in question must fulfil certain prerequisites:

(1) It must have a legislative "will" to be applied to a contract, regardless of the otherwise applicable law
(2) The facts of the case must have a sufficiently close connection to the enacting state
(3) The contents of the rule must be in conformity with the notion of transnational ordre public. If no rule of transnational ordre public can be established, the arbitrator can limit himself to determining a common interest of all concerned states
(4) If the rule does not meet one of the above criteria, the arbitrator must consider whether it effectively prevents performance by a party or influences it and handle it as a fact of the case

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[390] *Radtke,* ZVglRWiss 84 (1985) 325 (340); *Martiny* in MünchKomm BGB X[4] § 34 no 68.

Some authors have concluded that these elements could constitute a general principle of private international law.[391] With view to the numerous schools of thought and methods in this field, one may legitimately doubt that there exist rules that are so hard and fast as to make this a general principle. It is however submitted, with the authoritative backing of a great part of literature, that the elements set out above are a practical tool and constitute a legitimate and workable method of applying foreign mandatory rules.

g) The Relevance of the criteria set out in the case law of arbitral tribunals.

The above criteria for determining the applicability were extracted from national legal orders of various legal systems and not from arbitral case law. The approaches of national case law were partially adapted so as not to copy the approach valid before national courts to arbitration. In the following it will be examined whether the method is reflected in arbitral jurisprudence. A number of awards will be scrutinized for the approaches taken for the application of mandatory rules and compared to the criteria set out.

ICC Award No. 6320[392]

The dispute arose out of a construction contract for a power plant which contained an arbitration clause for arbitration in Paris and the application of Brazilian law. A dispute arose in which claimant, owner of the plant to be constructed (a Brazilian party), asserted that the contractor (a U.S. power plant equipment manufacturer) had violated the U.S. Racketeering Influenced and Corrupt Organizations Act[393] [hereinafter RICO Act] and claimed treble damages.

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[391] *Naón,* RdC 289 (2001) 9 (75, 76); Lando, RdC (1984-VI), 225 (400-401).
[392] YBCA (1995) 62.
[393] 18 U.S.C. (1961).

The tribunal started by holding that in some cases the autonomy of the parties to choose a system of law must be subjugated to overriding interests reflected in mandatory rules. Accordingly, the RICO Act was such a mandatory provision. For its application the tribunal required two criteria: firstly, the enacting state must have strong and legitimate interest in the application of its law and, secondly, there must be a connecting factor between the case at hand and the enacting state. The tribunal scrutinized the provisions of the act and the policies furthered by it. It concluded that the RICO Act had been enacted to protect the U.S. economy and reflected U.S. public policy. It further held that there was an international consensus on the struggle against the practices prohibited by the RICO Act. However, there was no international consensus on the means in which these practices had to be combated. It held that the treble damages provision which had been invoked was not a universally accepted method in these practices. The aim accordingly was universally accepted, not however the means (i.e. the treble damages provision). Thus, the tribunal found that the interest of the U.S. law was not given in the present case.

The tribunal also held that the connection between the facts of the case and the U.S. was too distant to command the application of U.S. law, as the alleged fraud took place outside the U.S. and the "centre of the relations" between the two parties was outside the U.S.

This approach bears strong resemblance to the criteria set out above. The tribunal first dealt with the interest of the U.S. that was reflected in that RICO Act and sought to determine whether the rule had the legislative intent to be applied beyond the territory of the U.S. It held that to be applied in international arbitration, the rule would have to reflect an interest shared by the "international marketplace" and not only by the U.S. The tribunal therefore combined the examination of the legislative intent with the policy protected by the rule. It denied that the application of the rule outside the U.S. was justified as it did not protect the international marketplace by means accepted by other legal orders it compared the U.S. approach to.

Secondly, the tribunal searched for a close connection between the facts of the case and the enacting state. It took the place where the alleged fraud had taken place and the "centre of the relations" of the parties into consideration and found the connection of the facts of the case to the U.S. to be too remote to command the application of the rule.

ICC Case No. 8528[394]

The case concerned a joint venture contract between a Turkish construction company and a U.S. construction company for a construction project tendered by a Turkish public works authority. The U.S. construction company was to provide the financing for the project, while the Turkish company was appointed as the "Leader of the Joint Venture" and was to represent it to the Turkish tax authorities.

The Turkish tax authorities granted the joint venture two "Export Incentive Certificates" that exempted it from a number of duties, taxes and customs. The dispute arose over the benefits granted by these exemptions. While the Turkish company asserted that only it was entitled to the benefits, the U.S. company claimed payment of half of the benefit. The Turkish company contended that a mandatory provision of Turkish law prohibited the sharing of benefits granted to the Turkish company, as the "Export Incentive" privileges, which should promote Turkish exports, could only be granted to Turkish companies. The contract included an ICC arbitration clause. A tribunal seated in Geneva, Switzerland, had to assess whether to apply the provisions of the Turkish law, even though Swiss law was applicable to the joint venture agreement.

The tribunal acknowledged that even though Swiss law was applicable, foreign mandatory rules might claim application. It started by examining article 19 SLPIL. It seems that the tribunal did not actually consider article 19 SLPIL directly applicable. Far more, it mentioned the "principle set out in article 19 SLPIL".[395] It then went on to examine other legal instruments with similar provisions, such as article 7 (1) Rome Convention or article 16 (2) of the Hague Convention on the Law Applicable to Trusts and on their Recognition. It came to the conclusion that all those provisions envisage

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[394] YBCA (2000) 341.
[395] YBCA (2000) 346.

the same concept. After citing a number of commentators and court decisions, the tribunal regarded itself entitled to apply the Turkish law if the preconditions set out by "the principle expressed in article 19" were fulfilled.

The tribunal held that the Turkish provisions were mandatory in nature. Then the tribunal concluded that a close connection between the contract and the legal system of law from which the mandatory rule emanated existed.

Finally the tribunal examined the legitimate interests of the parties, as set out by article 19 SLPIL. It held that the defendant had a preponderant interest in the application of the Turkish provisions, as he would be burdened by severe penalties if he were be ordered by the award of the tribunal to share the tax benefits with the claimant. The tribunal therefore sought to interpret the Turkish legislation and tried to find a "reasonable solution". It differentiated between tax benefits, which were granted to the Turkish company and could not be shared with the claimant, and tax savings which were profits and accordingly could be shared according to the joint venture contract without infringing Turkish law.

In this award the tribunal applied the principle expressed article 19 SLPIL which reflects the theory of "Sonderanknüpfung". It thus analyzed the criteria mentioned above when deciding on the applicability of the mandatory rule. The respect for the parties interests were stipulated by article 19 SLPIL, which in that point differs from article 7 (1) Rome Convention.

ICC Case 8404[396]

In ICC Case 8404, a tribunal had to decide whether or not to apply European Antitrust law to a contract otherwise governed by Swiss law. It considered article 19 SLPIL and article 7 (1) of the Rome Convention. Thereafter it followed that a tribunal could apply mandatory rules of a legal order other than that of the *lex causae*, if three prerequisites were met. Namely, the rule must pertain to a category of rules, which wish to be applied

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[396] unpublished, the author refers to the analysis of this case by *Naón,* Choice-of-Law Problems 326.

irrespective of the otherwise applicable law. Secondly, there must be a close connection between the facts of the case and the enacting state. Lastly, it held that the application of the rule must be justified after balancing with the interests of the parties. It then stated that the more the values are universally protected, the more likely that an arbitrator will have to apply them. Here again, the tribunal used the criteria set out above but added the criteria of the parties interests.[397]

It remains however, that the tribunal used the "Sonderanknüpfungstheorie" as guidance when considering foreign mandatory rules.

ICC Award 9333[398]

In this case, a dispute arose out of a contract in which claimant, a Moroccan Broker, undertook to provide services to respondent, a French building company to obtain and perform a contract. After respondent had paid 40% of the commission on to a Swiss bank account, he refused to pay more. It had become part of a U.S. group and this group's policy prohibited it from paying in a country other than that where the agent was located or the services rendered, as any other payment would be considered bribery. This policy was in conformity with the U.S. Foreign Corrupt Practices Act [hereinafter FCPA].

The parties had stipulated that Swiss law be applicable and the place of arbitration was Geneva, Switzerland.

The sole arbitrator was thus faced with the applicability of the FCPA to the contract, as the payments were legal under Swiss law. The arbitrator used article19 SLPIL to judge on the applicability of the FCPA.

He started by analysing the reach of the FCPA by its legislative intent. He found that the only respondent in this case was the French subsidiary and not the U.S. group. He analysed the policy of the FCPA and the values it sought to protect and found that the

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[397] *ibid*. 328.
[398] ICC Bulletin 102 (1999).

FCPA did not - by its will - apply to foreign subsidiaries of U.S. companies. Further, the only territorial connection with U.S. law was the fact that the French company had become a subsidiary of the U.S. group. The arbitrator did not stop to analyse the interests of the parties.

It is not quite clear why the arbitrator felt bound by article 19 SLPIL. Perhaps he deemed it appropriate to use this provision as he was seated in Switzerland. From the theory constructed above, it does not however matter whether he applied article 19 directly or would have used the criteria set out in this provision as these criteria are a consensus that seems to hold true also for arbitral practice.

ICC Case 9298[399]

This case concerned a contract for the sale of shares. Respondent argued that the contract was invalid, as it violated foreign exchange provisions of the *lex causae*. The arbitral tribunal held that the choice of law of the parties did not include public law matters, but only contractual matters. It applied article 187 SLPIL to establish whether the foreign exchange regulations, which had been invoked, had a sufficiently close connection to the case.

What is to be noted from this case is that it is a clear rejection of the "Schuldstatutstheorie". The mandatory rule invoked was one of the *lex causae*. Still the tribunal did not blindly apply the rule, but stopped to consider whether or not the rule had the legislative will to be applied. This approach is laudable as it shows that also mandatory rules of the *lex causae* do not enjoy preference, but must be analyzed just like any other mandatory rules.

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[399] unpublished, the author refers to the analysis of this case by *Naón,* Choice-of-Law Problems 311.

h) Conclusion

The analysis of the case law underlines that arbitral tribunal – where they are willing to apply mandatory rules of third states – use the criteria set out above. Often they base their analysis on the methodology of provisions such as Art 19 Swiss PILA or Art 7 (1) Rome Convention. In several cases, the tribunals analysed the interests protected by the mandatory rules and have examined whether they are shared by the international community or at least a large number of states. The tribunals also determined the spatial reach of the rules by interpretation and assessed whether they actually were intended to be applied to the case and whether the case had a connection with the enacting state close enough to justify the application.

5. The Relevance of mandatory rules of the seat of the arbitration

The arbitrator is not an organ of the state where he happens to have his seat. The place of arbitration will in many cases have been chosen only for reasons of neutrality and because it has no connection for to the facts of the case. Therefore, according to the above proposed theory of application of mandatory rules, an application of the mandatory rules of the mandatory rules of the state in which the arbitrator has his seat will fail for lack of a close connection. [400]

Mandatory rules of the seat of the tribunal may however become relevant not for dogmatic reasons but merely for practical ones. The courts of the seat of arbitration are entitled to set aside an award rendered on their territory. An arbitrator must therefore consider the risk of his award being set aside, if he disregards rules of the state in which he has his seat as he has the obligation to render an enforceable award and may become liable to the parties if he fails to do so.[401] Therefore, an arbitrator should at least

[400] *Drobnig* in FS Kegel 95 (106); *Reiner,* ICC Schiedsgerichtsbarkeit 244 (1989); *Mayer,* ArbInt 1986 274 (283); *Voser,* The Amercian Rev. Int. Arb. 1996, 319 (338); *Schnyder,* RabelsZ 1995 292 (301); *cf. Schiffer*, Handelsschiedsverfahren 182..
[401] *e.g.* article 25 ICC Rules 1998.

consider the mandatory rules of the state in which he has his seat if only to ensure that their non-application would lead to the setting aside of the award.[402]

6. Relevance of the mandatory rules of the place of enforcement

The same considerations valid for the application of the mandatory rules of the state in which the arbitrator has his seat are valid for the application of the mandatory rules of the place of enforcement.

The place of enforcement (if known at the time of the decision of the arbitrator) may have a close connection to the facts of the case. This will be true if one of the parties has its seat in the place of enforcement. However, the potential enforcement of an award does not for itself establish a close connection to the case.[403] As detailed above, the close connection must be determined between the facts of a case and the enacting state. The winning party may seek enforcement in any country were the losing party has assets. The mere location of assets of a party, however, does not for itself constitute a close connection to the facts of a case. A multinational corporation with possesses assets in numerous countries would otherwise be subject to the mandatory rules of all those countries, even if the assets have no connection to the case.[404] The only reason to consider the rules of the place of enforcement could be to ensure that the winning party can enforce the award. This, however, is a consideration which is not sufficient to justify the application of mandatory rules.[405] The application of mandatory rules of the seat of arbitration may be justified in situations in which the non-application could lead

[402] *Lazareff*, ArbInt 1995 137 (140), who however does explicitly state that this approach is merely a pragmatic one; *Samuel*, Jurisdictional Problems, 235.
[403] *Schwab/Walter*, Schiedsgerichtsbarkeit, Chp 55 no 9.
[404] Of course, if the enacting state in which a party has assets can and will enforce its rule against these assets, the arbitral tribunal may take this into account as a fact.
[405] *contra* Beulker, Eingriffsnormenproblematik, 286ss arguing that if an award may likely be enforced in a state, this place can be considered the place of performance which justifies the existence of a close connection. However, this approach seems inappropriate. The close connection must exist between the facts of the case and the enacting state. The potential later enforcement of an award is no real connection. Such connection, if any, would only come into existence after the arbitration in concluded by the rendering of the award.

to the setting aside of the award. This danger to the existence of the award, however, does not exist if mandatory rules of the place of enforcement are not applied.

VII. THE RELEVANCE OF MANDATORY RULES FOR SETTING ASIDE PROCEDURES.

A. INTRODUCTION

After the award has been rendered, the underlying party may challenge the award before the courts of the seat or may seek to prevent its enforcement.[406] For the scope of this thesis it is relevant in which circumstances the application or non-application of mandatory rules by the arbitrators can have an influence on the decision of the court.

B. THE INFLUENCE OF MANDATORY RULES ON SETTING ASIDE AND ENFORCEMENT PROCEDURES

In the following first the legal framework for the setting aside and enforcement procedures in Austria, Germany and Switzerland will be outlined. As the framework is very similar in all three jurisdictions, the influence on mandatory rules on these procedures which is subject to doctrinal debate rather than jurisprudence will be discussed for all three jurisdictions subsequently. Thereafter, the situation in the U.K. and the U.S will be examined.

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[406] This is the position of most national arbitration laws, the New York Convention and the Model Law; see s.1059 German CCP; s.611 Austrian CCP; s.190 Swiss PILA; s.67ss U.K. Arbitration Act; s.10 Federal Arbitration Act; Judgement of the OGH, 22 October 2001, 1 Ob 236/01i, in which the OGH denied international jurisdiction ("internationale Zuständigkeit") for setting aside an award rendered in China. It held that under the system of the New York Convention only the courts of the seat of arbitration have jurisdiction to set aside an award unless the parties had agreed otherwise.

1. The Situation in Austria

a) Setting aside an award due to a violation of the *ordre public*

According to s.611(2)(8) Austrian CCP, an award can be set aside if it violates the Austrian *ordre public*.

The old Austrian arbitration law allowed for setting aside an award for a violation of either the Austrian *ordre public* or of a rule which the parties cannot derogate by a choice of law. This distinction provoked a doctrinal discussion on the relationship between the notion of *ordre public* and the rules from which the parties cannot derogate by choice of law. As the old Austrian arbitration law only applies to proceedings initiated before 1 July 2006, it is of no longer of particular relevance. It suffices for the scope of this thesis to summarize that the dispute was essentially about whether mandatory rules in the sense used in this thesis (therefore excluding rules of consumer protection, labour law and the like) were included in the rules from which a party cannot derogate from.[407] Consequently, it was disputed whether a violation of mandatory rules that did not form part of the *ordre public* could lead to the setting aside of an award or whether the rules the parties could not derogate from only referred to rules of private law or rules which enforced a contractual equilibrium against commercial reality (such as in the case of labour law or consumer protection law).

As this distinction is no longer made in the new Austrian arbitration law, a challenge of an award for the violation of a mandatory rule must allege the violation of the *ordre public*. The discussion on the meaning of the term "rules from which the parties cannot derogate by choice of law" used in the old Austrian arbitration law is therefore now moot. Of course the term *ordre public* used in section 611 Austrian CCP is not clearly defined. However, the often cited equation between the notion of *ordre public* relevant for setting aside procedures and the one used in s.6 of the Austrian Private International

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[407] *Gamauf* ZfRV 2000, 41 (52); Liebscher, wbl 1999 493 (496); Melis, FS Bülow 129 (138).

Law Act has rightly been criticized.[408] The notion of *ordre public* in s.611 Austrian CCP determines to what extent the Austrian legal order will tolerate erroneous awards. It will also sanction the failure of an arbitrator to apply rules forming part of the *ordre public* which the court considers must have been applied. The notion of *ordre public* in section 611 Austrian CCP therefore functions in a broader way than the *ordre public* referred to in section6 of the Austrian Private International Law Act, which will only prevent the application of foreign rules.

Unlike other jurisdictions, Austrian courts do not distinguish between the international *ordre public* and the "domestic" *ordre public*.[409] Semantically this makes no difference, as what is generally considered to be the *international ordre public* is part of the Austrian *ordre public*.[410] However, the remoter the connection of the case is to Austria, the more intolerable the result must be the arbitrator reached for it to violate the Austrian *ordre public* as it is established (at least in doctrine) that the functioning of the *ordre public* requires a certain connection between the facts of the case and the forum.[411] Therefore, if two foreign parties chose Austria as a place of arbitration merely for reasons of neutrality to decide a case with no connection to Austria, the award should not be set aside for parochial notions of the *ordre public*, but only if the award violates more generalisable rules.[412] The result would be the same as Swiss courts reach when applying the international *ordre public*.

The Austrian Supreme Court has as of yet seldom discussed the possibility of setting aside an award due to the violation of the *ordre public* and the relationship of this term to mandatory rules. In some instances, the Austrian Supreme Court has defined certain

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[408] *Liebscher*, wbl 1999, 493 (496).
[409] Judgement of the OGH, 11 May 1983, 3 Ob 30/83 and the critical comment to this decision from *Seidl-Hohenveldern*, ArbInt 1983, 322.
[410] *Seidl-Hohenveldern*, ArbInt 1983 322 (326).
[411] Kropholler*, Internationales Privatrecht*[5] 344; *Kegel/Schurig*, Internationales Privatrecht[9] 521.
[412] *Cf. Seidl-Hohenveldern*, Austrian Public Policy and the Enforcement of Foreign Arbitral Awards ArbInt 1983, 322 (327) who states that only if a case has nothing to do with foreign law, the domestic ordre public applied, but that a balance must be struck if a case is embedded in foreign law between that foreign law and rules of the forum.

mandatory rules as belonging to the Austrian *ordre public*. These include specifically Art 81 and 82 EC Treaty[413], the prohibition of so called "Differenzgeschäfte", i.e. a contract foreseeing the payment of the difference in price for a product between two dates, that has characteristics of a bet,[414] and specific rules of the Austrian currency export laws.[415]

In a rather recent decision on this matter, the Austrian Supreme Court showed doctrinal inconsistencies. The Supreme Court had to decide on the validity of an award rendered by an arbitral tribunal seated in Austria concerning a dispute arising out of a construction contract of terraced houses.[416] Due to delay in the building process, the owner refused to pay the full amount according to the contract. The arbitral tribunal awarded the full amount out of the contract including interest. Further – and this was the point were the case becomes relevant for the scope of this work – the tribunal awarded 20 % VAT for the interest. The ECJ had however held that interest is to be considered as damage and thus not subject to VAT.[417]

According to the Austrian Supreme Court, awards can only be set aside if they violate the most fundamental notions of the Austrian legal order. This number of fundamental notions is smaller than the number of mandatory rules. The Austrian Supreme Court held that the judgment of the ECJ was binding for it. It went on to hold that rules of tax law do not only deal with the relationship between the parties but serve interests of the whole society. Thus, tax laws are mandatory in nature. According to this decision of the Austrian Supreme Court, this circumstance was sufficient to set the award aside partially.

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413 Judgement of the OGH, 23 February 1998, 3 Ob 115/95.
414 Judgement of the OGH, 11 May 1998, 3 Ob 30/83; 26.11.1996 1 Ob 639/95.
415 Judgement of the OGH, 22 February 1989, 3 Ob 148/88.
416 Judgement OGH, 5 May 1998, 3 Ob 2372/96m, EvBl 1998/179.
417 BAZ Bausysteme AG v. Finanzamt München für Körperschaften, Case 222/81, Judgement 1. July 1982, ECR 1982-VII, 2527, 2541.

The judgment obviously contradicts itself as it at first correctly states that the *ordre public* does not consist of all mandatory rules and then goes on to state that only because the award violated a mandatory rule was its setting aside justified.[418]

It is important to note, as the Austrian Supreme Court did itself and has also been noted by the majority of scholars, that mandatory rules and *ordre public* are two separate matters. According to Austrian law, an award cannot be set aside merely because it violates mandatory rules. In this case the Austrian Supreme Court did not stop to consider whether or not the judgment of the ECJ constituted a rule forming part of the *ordre public*, which arguably it did not.[419] It merely judged its mandatory character. This approach is inconsistent with the words of the law and scholarship.[420]

Regarding the extent of review, Austrian jurisprudence and literature do not provide such an extensive discussion as German scholars and courts do. It is established that a court is not entitled to review the tribunal's solution of questions of law or of fact *ab initio*.[421] However, it has correctly been noted that such a limited measure of review would effectively prevent any effective possibility for the court to examine the accordance of an award with the *ordre public*.[422] The Supreme Court has therefore adopted a *prima facie* approach to the extent of review holding that a violation of the *ordre public* must be obvious.[423] Accordingly, this does not mean that the award will be reviewed as to the factual holdings or the legal evaluation. The Supreme Court will merely review an award to the extent necessary to decide whether or not the Austrian *ordre public* has been violated.[424] Some authors, however, recommend that for a court to be able to examine the accordance with the *ordre public*, a court may not be bound

[418] *Oberhammer*, RdW 1999, 62 (67).
[419] *Achatz/Burgstaller*, JBl 1999, 403 (404).
[420] *Liebscher*, ArbInt (2000) 357 (359s); Gamauf, ZfRV 2000, 41 (45).
[421] *Hausmaninger* in Fasching, section 611 no 205; *Zeiler,* Schiedsverfahren, section 611 no. 34 both with further references.
[422] *Reiner*, IPrax (2000) 323 (326).
[423] Judgements of the OGH, 23 February 1983, 3 Ob 185/82; 30 October 1985, 3 Ob 89/85; 15 November 1989, 3 Ob79/89; 25 April 2001, 3 Ob 84/01a; 23 October 2002, 3 Ob 251/02m; 20 October 2004, 3 Ob 73/04p; *Liebscher*, ArbInt 2000, 357 (363).
[424] OGH, 26 January 2005, 3 Ob 221/04b.

either to the factual findings of the tribunal nor to its legal arguments and may even admit new evidence.[425] This is essentially the position of the German Supreme Court and may be the more realistic approach if the compatibility with the *ordre public* should really be examined.

2. The Situation in Germany

a) Setting aside of an award due to a violation of the *ordre public*

According to § 1059 of the German CCP, an award can be set aside for a number of reasons. Relevant in the context of this examination is § 1059 (2)(2)(b) which allows a court to set aside an award for the violation of *ordre public*.

Also under German law the violation of a mandatory rule can be sanctioned by a challenge or refusal of enforcement if this violation also amounts to a violation of the *ordre public*. The standard of *ordre public* for the setting aside procedures and the recognition procedures is the same. Therefore, the influence of mandatory rules on both an application to have an award set aside and on the enforcement procedures will be addressed in one.

Under German law, only the result of the award is decisive for a possible violation of the *ordre public*, not the factual or legal findings of the tribunal. It is therefore not relevant whether the law was applied incorrectly but only whether a wrong application of the law led to a result that violates the *ordre public*. Also regarding the application of mandatory rules this means that not every non-application or wrong application of a mandatory rule will lead to the setting aside of an award. Scholars who have argued that, at least for domestic awards, every violation of mandatory rules must lead to the setting aside of the award have stayed the minority.[426] Also, German law does not apply

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[425] *Reiner*, IPrax (2000) 323 (326).
[426] Metzger, NJW 1970 368 (369); *Münch* in MünchKomm ZPO, section 1051 no 23.

different standards of *ordre public* when setting aside domestic and international awards.[427]

b) The extent of review

To establish whether the result of an award violates the *ordre public*, the court will have to review the award. However, the extent of review is limited and has been subject of various judgements of the German Supreme Court.

Regarding the extent of review of the factual holdings of the tribunal, the German Supreme Court has repeatedly held that it is not bound by the factual or legal holdings of the arbitral tribunal, when deciding whether or not an award is in conformity with the German *ordre public*.[428] In following decisions the German Supreme Court broadened its extent of review, holding that it was entitled not only to review the legal evaluation of the arbitral tribunal but also the factual holdings and to determine additional facts where the tribunal had failed to do so.[429] This practice may be appropriate only if the court could not decide whether or not a violation of the *ordre public* has occurred otherwise.[430] In other cases, the court is not bound by the legal evaluation of the facts but by the factual determination of the tribunal. [431]

Regarding the legal evaluation of the arbitral tribunal, the German Supreme Court in a noteworthy decision of 1966 seemed to consider itself to be a second instance that was entitled to review the legal evaluation and set aside an award rendered after the tribunal had decided (after an evaluation) not to apply a German mandatory rule.[432] It held that even though the legal opinion of the tribunal was tenable, the award could be set aside as the German Supreme Court had a different legal opinion. It has been criticized as

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[427] *Schlosser* in Stein/Jonas, Anhang § 1061 no 134.
[428] Judgement of the BGH, 12 May 1958, BGHZ 27, 949.
[429] Judgement of the BGH, 23 April 1959, BGHZ 30, 89; Judgement of the BGH, 31 May 1972, NJW (1972) 2180; Judgement of the BGH, 26 October 1972, NJW (1973) 98.
[430] *Trappe*, BB (2000) 7 (9); *Kornblum*, NJW 1969, 1793 (1794).
[431] *Trappe*, BB (2000) 7 (9); *Kornblum*, NJW 1969, 1793 (1794).
[432] Judgement of the BGH, 25 October 1966, NJW (1967) 1178,1179.

German law only allows the German courts to review whether or not the recognition of the award as a result would violate the German *ordre public*; it does not set up German courts as courts of appeal.[433] This criticism seems partially unfounded now as the German Supreme Court has explicitly stated that, even if a mandatory rule has been applied incorrectly, the award will only be set aside if the award based on this error violates German *ordre public*. The mere misapplication for itself is no ground for setting aside the award.[434] Here the solution of *Schlosser* may also be of help.[435] He proposes that the terms of a rule that pertains to the *ordre public* have a clearly defined core ("Begriffskern") and a less clearly defined border area ("Begriffshof"), which is subject to debate.[436] Accordingly only the core of rule can be part of the *ordre public*. If an award however has only been rendered that is based on a different approach to the border area, this cannot be a violation of public policy.

3. The Situation in Switzerland

The relevant section for setting aside awards under the Swiss PILA is s.190. According to s.194, the recognition and enforcement of awards in governed by the New York Convention. Both s.190(2)(e) and article V(2)(b) of the NYC provide for recourse against awards which violate public policy.

The notion of ordre public used in these two provisions is, however, not the same. Art 190(2)(e) does not refer to Swiss ordre public. It is therefore disputes whether this terms refers to Swiss international ordre public,[437] transnational ordre public or also may include foreign notions of ordre public.[438]

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[433] *v.Brunn*, NJW 1969, 823 (827); *Wolf*, RabelsZ 1993, 643 (652f).
[434] Judgement of the BGH, 27.2.1969, NJW 978, 979 (1969).
[435] *Schlosser* in Stein/Jonas, Anhang § 1061 no 141.
[436] critically, *Reiner*, IPrax 2000, 323 (326).
[437] *Poudret/Besson*, Comparative Law of International Arbitration² 765.
[438] *Bucher, Schiedsgerichtsbarkeit* 131ss.

The Swiss Supreme in a recent judgement confirmed that the notion of ordre public in Art 190(2)(e) Swiss PILA refers to the Swiss international ordre public and does not include notions of ordre public of third states.[439]

a) The extent of review

The Swiss Supreme Court has stated that it will examine the award freely to establish whether or not a ground for setting aside an award exists. It will not, however, review the factual holdings of the arbitral tribunal.[440]

The correct application of foreign law and thus also of foreign mandatory rules is a disputed subject in Swiss literature. *Heini*[441] argues that the Swiss Supreme Court cannot review the application of foreign law as this would run counter to the concept of Swiss law to limit the possibility of review of awards as far as possible. Only if the foreign ordre public which was violated also forms part of the "universal" ordre public which accordingly is part of the Swiss ordre public, could the Swiss Supreme Court set the award aside.

Both *Bucher*[442] and *Blessing*[443] consider that the Swiss Supreme Court has a broader powers of review and can also examine the application of foreign law to the merits of the case. This approach is consistent which their opinion on the possibility of reviewing the correct application of rules pertaining to a foreign ordre public. The Swiss Supreme Court has, however, rejected this approach.

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[439] Judgement of the BG, 8 March 2006, BGE 132 III 389.
[440] Judgement of the BG, 2 September 1993, BGE 119 II 383; *Heini* in ZürchKomm IPRG² Art 191 no 14.
[441] *Heini* in ZürchKomm IPRG² Art 191 no 151.
[442] *Bucher,* Schiedsgerichtsbarkeit 137.
[443] *Blessing*, Das neue Internationale Schiedsgerichtsrecht 81.

4. The influence of mandatory rules of third states in setting aside and enforcement procedures

Above the approaches of Austria, Germany and Switzerland regarding the setting aside and enforcement procedures and the *ordre public* was outlined. It was established that if an award violates a mandatory rule which forms part of the domestic *ordre public* of any of these states, it will either be set aside or denied enforcement. The violation of other mandatory rules of the forum state will not have this effect.

There is, however, far less scholarly writing and no jurisprudence on the question of whether and under which circumstances an award can be challenged or set aside if it violates not a mandatory rule of the forum but of a third state. Several authors support the idea that the violation of a mandatory rule not part of the law of the forum may under specific circumstances violate the *ordre public* of the forum. The idea seems to have been first formulated by *Remiros Brotóns* who argued that international obligations of states are part of the *ordre public* of any state.[444] Accordingly, there is a duty of cooperation between states, which also obliges states to respect the mandatory rules of other states. Therefore, the non-application of a mandatory rule of a third state by an international tribunal may amount to a violation of the *ordre public* of the forum. *Schlosser* argues that arbitrators are obliged to apply mandatory rules. States can legitimately expect their mandatory rules to be applied by them as they increasingly consider more types of disputes to be arbitrable. The *ordre public* of also protects the framework of international trade. Therefore, the non-application of a mandatory rule of a third state which is part of this framework, may violate the German *ordre public*.[445] The same approach has also been taken by Swiss authors, who argue that Swiss law protects the "bonnes mœurs" of international commercial relationships, which may also be protected by mandatory rules of third states.[446] *Bucher* argues that the notion of ordre public used in Art 190(2)(e) Swiss PILA also includes the ordre public of third states

[444] *Remiro Brotóns*, RdC (1984-I) 169 (247).
[445] *Schlosser* in Stein/Jonas, Anhang § 1061 no 145; *Schlosser*, Schiedsgerichtsbarkeit² 634ss.
[446] *Jermini*, Die Anfechtung von Schiedssprüchen im internationalen Privatrecht, nos 580ss,

and therefore also the mandatory rules of these states which reflect their ordre public.[447] Which rules are part of the "framework of international trade" is unclear. Certainly, rules prohibiting corruption, trade in drugs and the like are part of this framework.[448] Violations of competition law seem not to be part this framework.[449] A slightly different approach compares the values protected by the foreign mandatory rule to those protected under the laws of the forum.[450] If both legal orders consider a rule to be part of the *ordre public*, the award can be challenged.

The respect for foreign mandatory rules in the framework of the *ordre public* may be a necessity to ensure that arbitration is not abused as a tool to circumvent mandatory rules by designating a place outside the jurisdiction of the state enacting a mandatory rule and thereby bereaving the enacting state of any possibility of influence on the award, especially if it can be enforced in a third state.[451] States consider ever broadening categories of disputes arbitrable. However, this concession to the autonomy of the parties should not lead to the disregard of rules which a state can legitimately expect an arbitrator to apply.

From a dogmatic point of view the setting aside of an award due to the violation of a third states mandatory rule is difficult to argue. An award is set aside due to a violation of the (international) *ordre public* of the forum. Only if one agrees that the undefined notion of the "framework of international trade" is part of the *ordre public* or if there are international treaty obligations obliging a state to apply foreign mandatory rules (such as article VIII(2)(b) of the Bretton Woods Agreement), can the *ordre public* of the forum be violated by the non-application or incorrect application of third states' mandatory rules. Outside these two categories, the violation of third states' mandatory rules can only be relevant if this violation at the same time constitutes a violation of the

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[447] *Bucher,* Schiedsgerichtsbarkeit 132.
[448] *Jermini*, Die Anfechtung von Schiedssprüchen im internationalen Privatrecht, nos 580ss.
[449] Judgement of the BG, 8 March 2006, BGE 132 III 389, E.3.
[450] Lörcher, BB Beilage 17 1993, 3 (7) who requires that the forum has enacted a similar rule; *Berger*, ZvglRWiss 1997 316 (327ss); *Bucher,* Schiedsgerichtsbarkeit 131; with a similar approach Broggini, in FS Siehr 95 (110).
[451] *Schlosser* in Stein/Jonas, Anhang § 1061 no145.

notion of *ordre public* used by the forum. [452] This will presumably not be the case for the majority of mandatory rules. The *ordre public* can therefore only be violated if it includes values which are the same as those protected by the foreign mandatory rule, though this need not necessarily be expressed in a mandatory rule of the forum.[453] This approach, however, is not entirely reconcilable with the traditional function of the *ordre public*.[454] The concept that the *ordre public* of the forum can be violated by the non-application of a mandatory rule of a third state requires the forum judge to apply certain values protected by a foreign legal order. The prerequisite for this is that they are compatible with the values protected by the *ordre public* of the forum. This is, however, not the negative function of the *ordre public* but the application of foreign values protected by foreign mandatory rules based on the compatibility with the values of the *ordre public* of the forum. This use of the *ordre public* of the forum includes a conflict of laws analysis based on a compatibility of interests. Nevertheless, the necessity to give a judge a possibility to set aside an award which grossly violates mandatory rules of third states which - from the perspective of the forum judge - legitimately protect values of the foreign state, may guide a court to apply this concept of *ordre public*.

Further, the review of awards should not serve as a basis for the control of the correct application of the law by the arbitral tribunal. The supervising court should therefore not review whether a mandatory rule was applied correctly or not.[455] Only if the non-application or misapplication of the rule leads to a result which is obviously incompatible with the standard of *ordre public* used by the court, can an award be set aside. The supervising judge may therefore not step into the shoes of the arbitrator and review whether or not he should have applied a mandatory rule or applied it differently. He must, however, be aware of the foreign mandatory rule and sanction obviously and absolutely wrong results reached by an arbitrator.

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[452] *Berti/Schnyder* in BaslerKomm IPRG² Art 190 no 80; *Heini* in ZürchKomm IPRG² Art 190 no 48.
[453] *Berger*, ZvglRWiss 1997 316 (327).
[454] *Michaels*, ZfRV 1999, 5 (6).
[455] *Berti/Schnyder* in BaslerKomm IPRG² Art 190 no 80.

5. The Situation in the United Kingdom

a) The setting aside of an award

Unlike many other arbitration laws, U.K law does not provide for a challenge of an award for a violation of public policy. Under section 68 of the Arbitration Act 1996, public policy is only relevant regarding the procurement of the award but not its merits. However, under s.69 of the Arbitration Act, a party can raise an appeal on a point of law. The courts will then review the legal evaluation of the arbitrator. Under this provision, English courts will review whether arbitrators seated in England applied English law correctly. As English courts consider questions of foreign law to be factual questions, s.69 is only applicable when the arbitrators applied English law deciding the dispute.

As was laid out above, U.K. law will to a limited extent respect foreign mandatory rules under the English notion of *ordre public*. As a challenge cannot be based on this notion, an English court would have to be applying English law for an appeal on a point of law based on a violation of the *ordre public* to be successful. Essentially the same holds true for appeals based on illegality under the *lex loci solutionis*. As this rule is a rule of contract law, its application could only be appealed if English law were applicable.

If this is the case and the parties so agree or the court grants leave (s.69(2) Arbitration Act), the court can then review the award. Under s.69 the court, however, can not only confirm or set the award aside, but can also remit the award back to the tribunal for reconsideration or may even vary the award. Therefore, under this provision, English courts can scrutinize under very limited circumstances whether the correct approach to mandatory rules under English law was taken. There is, as far as could be ascertained, no jurisprudence on the appeal against an award based on the violation of the *lex loci solutionis* or the violation of the English *ordre public* due to the misapplication or a foreign rule.

b) The recognition and enforcement of awards

The recognition and enforcement of arbitral awards in England can be applied for under various instruments, such as by an action on the award, summary enforcement under section 66 of the Arbitration Act, under the Administration of Justice Act 1920, the Foreign Judgments (Reciprocal Enforcement) Act 1933 and the New York Convention which has been implemented in s.100 to 104 of the Arbitration Act. The enforcement under the New York Convention is by far the most efficient under English law and is usually chosen.[456]

Under s.103(3) recognition and enforcement of an award can be denied if the enforcement of the award would violate public policy. This provision has also been invoked to prevent the enforcement of awards which violate foreign mandatory rules, though this term was not used by the English courts.

In *Soleimany* v. *Soleimany*,[457] the Court of Appeal refused to enforce an award that had been rendered by the Beth Din, the Court of the Chief Rabbi. In that case, a dispute had arisen out of contract between to Iranian jews, a father and his son, to smuggle carpets out of the Iran and sell them in the West in violation of Iranian export law. The Beth Din had acknowledged that the contract violated Iranian law, but held that Jewish law, which it was applying, did not prevent it from arbitrating the matter or rendering an award in the favour of the plaintiff. Subsequently, the plaintiff tried to enforce the award in England.

The Court of Appeal held, first, that the illegality of the contract did not affect the validity of the arbitration clause. It then went on to hold that an illegal contract would not be enforced in England and that the inclusion of an arbitration clause and the resulting award does not strip the contract of its illegality.[458] Consequently, the Court

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[456] *Tweeddale/Tweeddale*, Arbitration of Commercial Disputes, no 30.44.
[457] Court of Appeal, QB (1999) 785.
[458] *Ibid.*, 800; see also the discussion on this point in *Westacre Investments (Panama)* v. *Jugoimport-SDPR Holdings and others*, All ER (1999) 570, in which Colman J, holds

of Appeal held that – just as it did in cases involving the enforcement of illegal contracts – it could not enforce awards which enforced contracts that violated the laws of a foreign and friendly state.[459] It emphasized that it did so because the award found as a fact that the contract had been entered into with the intent to violate Iranian law but nevertheless enforced the contract in disrespect of its illegality. It stated that it may have come to another result had the tribunal found that there was no violation or simply made no such findings.[460]

Also in *Westacre* the illegality of the underlying contract was invoked; the result, however, was different.[461] The Commercial Court enforced an award which settled a dispute over a contract for the lobbying and alleged bribing of Kuwaiti officials by the plaintiff in order for the defendant to obtain contracts for the delivery of weapons. The tribunal applying Swiss law had held that it could not determine the allegations of bribery and the contract did not violate the international *ordre public*. A subsequent challenge to the Swiss Supreme Court had failed. Enforcement of the award was sought in England where the defendants came up with new evidence on the illegality.

Colman J, first established that the arbitral tribunal had jurisdiction to decide on the matter of illegality and held that this was due to the fact that there was an English policy in the favour of sustaining arbitral agreements that overrides the policy against the enforcement of corruption and that international arbitrators of great esteem can be relied upon to find the correct facts and base their decision on them.[462]

He went on to hold that the enforcement of the illegal contract must be distinguished from the enforcement of the subsequent award. The latter depended on the public policy

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that and award could only free the contract from illegality if the arbitration mechanism displaced this illegality, which under English law it does not; *Sheppard*, IntArbLR, 1999, 78 (79).

[459] Soleimany v. Soleinmany, Court of Appeal, QB 1999, 785 (803).

[460] *Ibid*. (797)

[461] *Westacre Investments (Panama)* v. *Jugoimport-SDPR Holdings and others*, All ER (1999) 570.

[462] *Westacre Investments (Panama)* v. *Jugoimport-SDPR Holdings and others*, All ER (1999) 570.

of England while the former depended on Kuwaiti public policy. In applying the rule established in Lemenda Trading Colman J. held that only if the contract violated both Kuwaiti and English public policy could the defence against the enforcement of the award be successful. In the present case, the contract did not violate English public policy as outright bribery could not be established and the use of personal influence was not contrary to English public policy. Consequently, the defendant could not invoke a violation of English public policy based on the England's obligation of comity with Kuwait. The application for the refusal of the leave to enforcement was therefore dismissed.

On appeal, Waller L.J., who had also delivered the judgment for the court in Soleimany, confirmed the argument of Colman J. on Lemenda and held that as long as the tribunal did not find the enforcement of a contract contrary to the public policy of both England and the place of performance, an award based on the contract would be enforceable in England.[463] If, however, the contract was subject not to English law but to the law of another country and was not contrary to the public policy of either the *lex arbitri* or the *lex causae*, it could validly render an award enforcing the contract, which would then be enforced in England unless it was contrary to a "fundamental rule" of English public policy.

Also, in OTV. v. Hilmarton[464] Walker J. held that the alleged illegality of a contract, in that case based on the violation of a rule of Algerian law, did not necessarily influence the enforcement of the award. He held that he was deciding on the enforcement of the award and not on the validity of the contract and that other courts or tribunals may legitimately come to other conclusions on the point of illegality than an English court would have come to. The mere fact that English courts may have decided differently, does not render an award unenforceable. The enforcement would only be denied, if it would violate fundamental rules of English public policy. Accordingly, there is a rule of English public policy to uphold awards, unless they violate fundamental rules of

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[463] Judgement, 12 May 1999, 3 All ER (1999) 864.

[464] Omnium de Traitement et de Valorisation S.A v. Hilmarton, QB (Commercial Court) XXIVa YBCA (1999) 777.

English public policy. Again discussing the Lemenda case, Walker J. held that there are fundamental rules of English public policy which would render the award unenforceable whatever the otherwise applicable law and the law of the place of performance of the contract. Other rules of (foreign) domestic public policy will only be a valid basis for the refusal of enforcement of an award if they at the same time are considered to be shared by English public policy. As outright bribery had not been established and contracts for the purchase of personal influence do not violate a rule of English public policy to justify the enforcement of the award, the court granted leave for the enforcement.

From the above cases the following considerations can be deduced. In *Westacre* the contract was legal under the *lex causae* and the *lex arbitri* and illegal in the place of performance (Kuwait) while in Soleimany the illegality of the contract had been taken into account under the *lex causae*, which however did not foresee its unenforceability as a consequence.[465] Thus the legality under either the *lex causae* or the *lex arbitri* is relevant for setting aside the award if the underlying contract is illegal in the place of performance.[466]

Secondly, as Colman J stated in *Westacre*, there seems to be a scale of illegality. As stated in the cases above, there are "fundamental" rules of English public policy which will render an award unenforceable regardless of the applicable law or the law of the place of performance. A contract for drug trafficking, prostitution or the like would more likely lead to unenforceability of a subsequent award than the sale of influence. Perhaps one must also set smuggling on the list. Offences that do not amount to such crimes such as the use of influence short of bribery and corruption will not lead to the unenforceability of the award. Thirdly, if a contract is violates the *ordre public* of the law of the place of performance and at the same time also violates English ordre public, enforcement can be denied.

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[465] See also *Tweeddale/Tweeddale*, Arbitration of Commercial Disputes, 302.
[466] See generally *Wade*, IntALR 1999, 97 (101).

English law has taken up a clear stance on the violation of fundamental rules of English public policy (which obviously correspond to the notion of the international ordre public).[467] Awards violating these basic notions will never be enforced. Awards violating rules of a foreign state that form part of that state's public policy and at the same time also violate English public policy, will also not be enforced. This rule, however, does not apply if the contract is valid under the *lex arbitri* and/or the *lex causae*.

c) The extent of review.

Just as in Continental Europe, a court will have to decide to what extent it wishes - if at all - to re-open the case which was before the arbitral tribunal. This problem arouse in the *Westacre* case. In that case the defendant had brought up new evidence in the enforcement proceedings which allegedly showed the illegality of the contract. Colman J, held that the re-opening of the facts of the case pleaded by the defendants could only be admitted if the policy against corruption (which was the alleged illegality) outweighed the policy in the finality of the award.[468] This balancing would have to include factors such as the extent to which the tribunal dealt with alleged illegality and the nature of the illegality.[469] The defendant was not allowed to adduce further evidence. On appeal, Waller J, held that courts could not turn such a blind eye on corruption, at least if there is prima facie evidence of illegality. Accordingly, new evidence must have 'sufficient cogency and weight to be likely to have materially influenced the arbitrators' conclusion had it been advanced at the hearing' and the party adducing the new evidence was unable to present it either to the arbitral tribunal or to the court with supervisory jurisdiction. After thus establishing that a court could re-open the facts of the case, he held that the court must balance between the finality of the award and the illegality. In this case accordingly, the illegality was very serious and justified the re-opening of the facts. However, Mantell L.J. disagreed stating that he could not see how such the re-opening of the facts based on prima facie evidence should

[467] *Brown*, IntALR 2000, 31 (34).
[468] All ER (1999) 570
[469] Wade, *Westacre v. Soleimany: What Policy? Which Public?* IntArbLR 96, 100 (1999).

function in practice. The third judge, Sir David Hirst agreed with Mantell L.J.. Therefore, the facts of the case were not to be reopened. The latter two judges therefore came to the conclusion that in the specific case the policy of the finality of awards preceded over the policy against corruption. This decision may have been different if the alleged violation of fundamental rules of English public policy had been at stake.

6. The Situation in the United States

a) Reasons for Setting Aside Awards

Under U.S. federal law a domestic award rendered in the U.S. can only be vacated for the reasons listed in s.10 FAA. This list does not include a provision allowing the courts to review the merits of the award and does not explicitly provide for the vacation of the award due to a violation of public policy.

Nevertheless, U.S. courts have introduced a test allowing them to review the merits of a case, even if only to a limited extent. The U.S. Supreme Court held in Wilko v. Swan that the interpretation of the law by arbitrators is not subject to review by courts, except in cases of "manifest disregard of law".[470] Further, the Supreme Court has also established that domestic arbitral awards can be challenged for violations of public policy.[471]

However, it is disputed whether "non-domestic awards" are subject to recourse under section 10 FAA or whether they can only be vacated for the reasons of Art V NYC.[472] The term non-domestic award has not been defined by U.S. courts, but is considered to include awards in disputes in which one of the parties is domiciled outside the U.S[473], in

[470] Judgemment, 7 December 1953, 346 U.S. 436ss.
[471] Judgement in Grace & Co. V. Local Union, 31 May 1983, W.R. 461 U.S. 757.
[472] For the discussion see *Born*, International Commercial Arbitration 727-729 with extensive references to U.S. jurisprudence.
[473] Judgement of the Court of Appeals, 11th Circuit in Industrial Risk Insurers v. M.A.N. Gutehoffnungshütte GmbH, 22 May 1998, 141 F.3d 1424.

which property located abroad is involved, in which performance abroad is envisaged or disputes which have some other reasonable relationship with one or more foreign states.[474]

While it is therefore clear that an award can be challenged under any of the reasons listed in Art V NYC, of which a challenge due to a violation of public policy is most relevant in this context, it is unclear whether the reasons under section 10 FAA and the manifest disregard of the law – test apply.[475] Therefore, only a possible violation of public policy by disregard for mandatory rules will be elaborated on in the following.

b) Violation of Public Policy

As U.S. law has not incorporated the distinction between mandatory rules and other rules of law, there is no express provision to sanction a violation of such ruled. Any challenge alleging such a violation must therefore be brought under Art V(2)(b) NYC. U.S. courts have yet to establish a clear notion of the term ordre public and to determine whether U.S. courts will accept the distinction between international ordre public and domestic ordre public. In Parsons & Whittemore Overseas Co Inc. v. Societe Generale de l'Industrie du Papier the Court of Appeals held that notion of ordre public in Art V(2)(b) NYC had a "supranational emphasis".[476] Another line of jurisprudence, however, indicates that courts interpret Art V(2)(b) to refer to domestic public policy.[477] A review of the judgments, however, reveals that most courts paid little attention to the distinction between the two notions of *ordre public*. The essence of the refusal of the

[474] *Born*, International Commercial Arbitration 725.
[475] *Born*, International Commercial Arbitration 809 citing extensive jurisprudence denying the applicability of the grounds ofsection10 FAA and the manifest disregard test to non-domestic awards.
[476] Judgement of the Court of Appeals, 23 December 1974, 508 F.2d 969 (2d Cir. 1974).
[477] Judgement of the District Court for the Norther District of Gerorgia of , Laminoirs-Trefileries-Cableries de Lens, SA v. Southwire Company, 484 F.Supp 1063(N.D.Ga.1980) in which the court held that an interest rate of 14,5% and 15,5% was penal and therefore violated national public policy; Judgement of the Court of Appeals for the 2nd Circuit in Waterside Ocean Nav. Co. v. International Nav., 18 June 1984, 737 F.2d 150, 152 referring to the "public policy of the United States".

court in Parsons & Whittemore to deny enforcement of the award seems to have been less an application of an international standard of *ordre public* and more a distinction between the U.S. international politics and U.S. *ordre public*. In that case the defendant had argued that the decision of the U.S. government to withdraw financial support for the contract between the litigants was evidence of a U.S. policy against the contract. The court held that U.S. foreign policies had to be distinguished from U.S. *ordre public*. Courts seem to handle on a case-by-case basis whether specific policies are applicable to international cases or not.[478]

c) Violation of Foreign Law as a Violation of U.S. Public Policy

U.S. courts have in very few cases decided on the influence of violations of foreign laws on the alleged violation of U.S. public policy. In Northrop Corp. v. Triad International Marketing SA the U.S. Court of Appeals[479] had to decide on the action to vacate an award which dealt with an agency agreement for the sale of military equipment from the U.S. to Saudi Arabia. Triad, the arms seller, refused to pay the full amount of the agreed commissions as Saudi Arabia had, five years after the contract had been concluded, issued a decree declaring the payment of commission payments for arms deals illegal. From this point in time onwards, Triad argued, it was illegal to make the commission payments. As the contract was subject to the laws of California, the arbitral tribunal ignored the Saudi decree and ordered payment by Triad. Triad sought to have the award vacated, arguing that the decree expressed a Saudi policy which essentially was also a policy of the U.S. Department of Defence. The court held that for an award to be set aside for a violation of public policy, this policy must be "well defined and dominant". Accordingly, the U.S. Department of Defence did share the policy prohibiting the payment of commissions for arms deals as this ultimately increased the costs for arms. However, the U.S. Department of Defence also had adopted a policy furthering the sale of U.S. manufactured arms to Saudi Arabia. Therefore, the court held, there was no well

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[478] *Born*, International Commercial Arbitration 827.

[479] Judgement of the Court of Appeal for the 9th Circuit, 29 March 1988, 842 F.2d 1154

defined and dominant U.S. policy on this point which would serve as a basis for the vacation of the award.

In Victrix S.S. Co. v. Salen Dry Cargo AB[480] the U.S. Court of appeals decided on the enforcement of an English award against assets of a company which was involved in Swedish insolvency proceedings. According to the Court U.S. courts have long recognized the need to extend comity to foreign bankruptcy proceedings in order to ensure the equitable distribution of the bankrupt's assets. Under U.S. bankruptcy laws, foreign bankrupts can file ancillary proceedings in U.S. courts to prevent piecemeal distribution of their assets. The Court of Appeals then relied on the general principle of comity and the rational of U.S. bankruptcy laws to establish that the enforcement of the award would violate the public policy to ensure the equitable distribution of the bankrupt's assets. The claimant, so the court concluded, would have to seek enforcement of his awards before the competent Swedish court.

Both awards show that U.S. courts are at least willing to respect foreign laws under the notion of public policy. In Northrop v. Triad the U.S. court, however, explicitly analyzed a "policy" of the U.S. Department of Defence. The Saudi law incorporating the Saudi policy was only relevant to the extent that the U.S. policy coincided. The policy of the U.S. Department of Defence as described in the judgment, however, seems not necessarily to be what is generally understood to be ordre public. The court analyzed a commercial policy of the U.S. government, namely that the government wanted to support arms deliveries to Saudi Arabia and at the same time disapproved of commission payments, but failed to explain why this policy was part of the ordre public. To this extent the judgment seems inconsistent with the decision in Parsons & Whittemore in which the court had explicitly stated that public policy "was not meant to enshrine the vagaries of international politics." It is hard to see why the policy of the U.S. Department of State could touch upon the most basic notions of morality and justice and this is also not elaborated on by the court. The notion of ordre public employed in this case is vague and seem loaded with national parochialism.

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[480] Judgment of the Court of Appeal for the 2nd Circuit, 5 August 1987, 825 F.2d 709 (1987).

The Court of Appeal in Victrix seems to have a clearer idea of the notion of ordre public and established by reference to statutes a clear U.S. policy against the piecemeal distribution of the bankrupt's assets. In this case it was of course not the contents of the award which violated U.S. policy but the potential enforcement. Nevertheless, the court included the Swedish proceedings and the possibility for Swedish courts to decide about the distribution of all the bankrupt's assets including his foreign assets in the U.S. policy by relying on the principle of comity. The Court of Appeal takes a broad approach to the ordre public in this decision. It includes foreign rules of law which reflect a policy of a foreign state, if this policy is compatible with U.S. policies. It is noteworthy that the Court did not only rely on a U.S. policy as in Northrop v. Triad but explicitly on a foreign policy which was identical with a U.S. policy. This judgment shows that U.S. courts may respect what is considered a mandatory rule in continental doctrine under their notion of public policy.

d) The standard of review

Whatever standard of ordre public may be applied, U.S. courts have stated that they will not second guess the application of law to the facts.[481] This does not, however, mean that U.S. court will not examine whether mandatory rules of U.S. law have at least been considered by the arbitrators. In *Mitusubishi Motors* the U.S. Supreme Court famously held that it would be able ensure that the legitimate interest in the enforcement of U.S. antitrust law would be addressed by the arbitrators and to review whether the arbitral tribunal took cognizance of the antitrust claims and actually decided them.[482] If the

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[481] Judgment of the District Court for the Southern District of NY in Brandeis Intsel Ltd. v. Calabrian Chemical Corp., 5 January 1987, XIII YBCA (1988) 543; Judgement of the Court of Appeals in Parsons & Whittemore Overseas Co Inc. v. Societe Generale de l'Industrie du Papier Wilkinson, 23 December 1974, 508 F.2d 969 (2d Cir. 1974); Note, Judicial Review of Foreign Arbitral Awards on Antitrust Matters After *Mitsubishi Motors*, 26 Colum. J. Transnat'l L. 407, 418 (1987-1988).

[482] Judgement of the Supreme Court in Mitsubishi Motors Corp. v. Soler Chrysler Plymouth Inc, 2 July 1985, 473 US 614, 638.

arbitral tribunal failed to do so, U.S. courts would have little hesitation in denying recognition and enforcement of the award.[483]

The Supreme Court did not elaborate in detail, which standard of review it would apply when reviewing an award dealing with statutory claims. It held that "review at the award-enforcement stage remain[s] minimal"[484], which obviously means that it will not in detail review whether the arbitrators have applied U.S. statutory law correctly but will limit itself to inspecting whether the antitrust law has been considered at all by the arbitrators.[485]

It seems likely, however, that whatever standard the court chooses to apply, it will take a close look at a violation of U.S. statutory law that claims application to a case.[486]

VIII. SUMMARY

A. THE DETERMINATION OF MANDATORY RULES

Doctrine in the examined legal orders in continental Europe has developed several criteria to determine whether a rule is mandatory. The only coherent criterion that can serve this purpose is the determination by the interests served by the rule in question. A judge or arbitrator must ascertain whether the rule serves over-individual interests or merely the interests of individuals. Only in the first case, can a rule be mandatory. In this context, a careful distinction must be drawn between rules which protect contractual *equilibria* in situations in which it has been distorted by commercial reality such as rules of consumer protection. The rules re-establishing the bargaining power of the weaker party which the legislator considers diminished, does not serve over-individual

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[483] *Ibid*. fn. 19 of the Judgement.
[484] *Ibid.* 473 US 614, 638.
[485] *Carbonneau*, Vand. J.T.L. 1986, 265 (285); Note, Judicial Review of Foreign Arbitral Awards on Antitrust Matters After *Mitsubishi Motors*, 26 Colum. J. Transnat'l L. 407, 413 (1987-1988).
[486] *Paulsson*, Journal of International Arbitration 1989, 101.

interests but only those of certain groups such as consumers. These groups are best protected by the rules of the *lex causae*. A legislative trend in this area seems to be the restriction of the choice of law when specific groups are concerned. This may further ensure that specific groups are not bereft of the protection they may need. However, such conflict of laws rules are irrelevant when an arbitrator or court is deciding of the characterization of such a rule of a foreign state.

Neither of the two common law jurisdictions, the United Kingdom and the United States, have yet established a comparable concept.

In England foreign mandatory rules will be – if at all – applied as a party of English public policy. This approach does therefore not require a definition of the concept of the mandatory rule.

The approach taken in the United States does not consider mandatory rules to be a concept of their own. The conflict of laws approaches in the United States examine the policies which are reflected in the individual rules and the intentions of the legislator. To this extent they bear a resemblance to the continental European approach. However, mandatory rules are not a category of their own in this system, all rules are treated equally.

B. THE APPLICATION OF MANDATORY RULES BY NATIONAL COURTS

Continental European scholarly writing has established a plethora of approaches for the application of foreign mandatory rules. Each of these approaches is disputed with regard to is details by its proposers. However, the only convincing theory that has been put forward in the last century is the so-called “Sonderanknüpfungstheorie”. According to this theory, a foreign mandatory rule may be applied if the legislative intent of the foreign legislator, that the rule be applied also by foreign courts, can be determined. Further, the facts of the case must show a close connection to the enacting state. Under which circumstances this criterion can be considered fulfilled will have to examined on a case-by-case basis as due to the possible constellations in which a transaction is

connected to a state make the establishment of general rules impossible. Lastly, the interests served by the foreign mandatory rule must be compatible with the values of the forum state. This last criterion is to be applied with care. The interest of the forum state need not have been set out in explicit provisions of the forum state's law. The judge must ascertain only whether the legal or social order of the forum state as such can be considered to share the protected interest.

As mentioned in the preceding sub-section, the conflict of laws system of the United Kingdom does not provide a coherent system for determining and applying foreign mandatory rules. Their application is dependent on whether they form party of the English *ordre public*. The only exception to this rule was established for rules of the *lex loci solutionis* which rendered the performance of a contractual obligation illegal. This approach has now been enshrined in Art 9(3) Regulation 583/2008. If the place of performance is considered to be a factor creating a close connection, the English approach and that of the European legislator resemble the Sonderanknüpfungstheorie even if only to a rather minor extent as the element of the close connection is pre-determined taking a rather random factor, the place of performance, into account.

The United States approach focuses on the interests of the enacting state. This interest is also the basis for the application of the rule. Such interest may be, at least according to the approach taken by the Restatement (Second) based on the contacts between the facts of the case and the enacting state. Such contacts, however, are used only to justify an interest and are not a connection factor for themselves.

C. The Relevance of Mandatory Rules for the Arbitrability of a Dispute

The impact of mandatory rules on the question of arbitrability has triggered controversial and contradicting decisions of national courts.

The protection of the mandatory rules of the forum state has, especially in German jurisprudence, induced national courts to declare disputes inarbitrable. The courts are

concerned that the arbitrators may not feel inclined to apply German mandatory rules in cases in which German law was not the *lex causae*. Especially in cases in which the seat of arbitration was not in Germany the loss of control over the arbitral award made judges believe it to be the safer option to deny the possibility of arbitration completely. The more stringent approach is of course to limit the supervision of the arbitral tribunal's work to examination of whether an award violates the national ordre public. This barrier exists both in setting aside proceedings as well as in proceedings for the recognition and enforcement of foreign awards. Though of course the control is limited compared to that over national courts, the denial of arbitrability of such disputes lacks any justification, especially as in German law there is no rule which would provide a basis for such denial. The U.S. Supreme Court in the notorious Mitsubishi decision confirmed its trust in the ability and willingness of arbitrators to pay the necessary attention to U.S. antitrust rules even if the place of arbitration in that case was in Japan. In the recent past, also German courts seem to be overcoming their concerns and are widening the scope of arbitrability of disputes governed by mandatory rules.

The impact of third states' mandatory rules declaring disputes inarbitrable has been subject only to very scarce jurisprudence which makes it difficult to determine finally their relevance, if any. The Swiss Supreme Court leaves only a very narrow margin of application for such rules. Accordingly, only foreign mandatory rules which declare a dispute inarbitrable and are to be applied for reasons of order public should be given effect at all. This approach will, in practice, obviously limit the number of foreign mandatory rules which will be applied by national courts. However, as there is no reason why arbitrators should be less inclined to apply foreign mandatory rules to merits of a dispute, there is also no reason to restrict the arbitrability of disputes. The ever widening scope of arbitral disputes, however, conversely should make arbitrators aware of their function when deciding on the application of mandatory rules and the fact that parties' instructions are the most relevant but by no means the sole maxim they should be acting by.

D. The Application of Mandatory Rules by Arbitral Tribunals

As arbitrators do not have a forum, all mandatory rules are “foreign”. Mandatory rules may therefore either derive from the *lex causae* of a third legal order. In both cases the arbitrator is to apply the same methodology for applying the rule. The rules of the *lex causae* take no precedent.

The conflict of laws approaches providing for the application of foreign mandatory rules before national courts do not apply to arbitrators. This does not, however, mean that arbitrators may not or cannot apply foreign mandatory rules. The conflict of laws rules of arbitrators found in modern arbitration laws and rules are rudimentary and leave arbitrators a wide margin of appreciation in deciding which law to apply.

As the theories providing for the application of foreign mandatory rules before national courts are not uniform, arbitrators will serve the parties’ expectations best, if they apply a theory incorporating the common elements of these approaches. Consequently, they should decide on the application of mandatory rules based on the legislative intent of the rule to be applied extraterritorially and the close connection of the facts of the case and the state enacting the rule in question. Arbitrators also need to ensure that the substance of the rule in question comply with the transnational ordre public, or, if this concept cannot be established in a case, the *ordre public* of all concerned states. These elements are also employed by arbitral tribunals, though not always completely and stringently.

E. The Relevance of Mandatory Rules for the Challenge of an Award

Awards will be set aside or denied recognition if they violate the *ordre public* of the forum. To the extent that mandatory rules of the forum reflect its ordre public, their non-application can lead to the setting aside of an award or the refusal of its recognition

and enforcement. This notion is also the only gate for taking the violation of foreign mandatory rules into account after the award has been rendered. It will, however, be necessary to establish that the violation of the foreign mandatory rule constitutes a violation of the *ordre public* of the forum. This will only be the case in a very limited number of cases.

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