ARBITRATORS AND ILLEGALITY: THE CHALLENGE OF DETERMINING THE PROPER APPLICABLE LAW

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In the face of suspected illegality of a contract in relation to which it is meant to adjudicate a dispute, how can, should or must an arbitral tribunal conduct itself? Given suspected or manifest illegality, which standards of law should apply as to whether and how to proceed respecting jurisdiction, separability, arbitrability and the merits of the dispute? Principles of competence-competence, arbitrability, separability and public policy must be applied and counterbalanced according to the relevant body or rules of law. But which one(s)?

Lex contractus as manifestation of party autonomy

If the parties to the contract submitted to arbitration agreed, by way of a customary choice-of-law clause, to apply the laws of Germany to their contract, must any alleged or manifest illegality be proven under that law? Would it suffice to establish illegality under some other, 'connected' body or rules of law (such as the substantive law of the seat)? Does the illegality under that other law, which is different from the one stipulated in the choice-of-law clause, mandatorily result in the illegality of the contract even under the stipulated governing law?

The substantive rights and duties of the parties (as opposed to the rights and duties of the arbitral tribunal) are governed first and foremost by the substantive law agreed, or otherwise determined, to be applicable to the contract. Invariably, the separable agreement to arbitration in that contract is likewise considered to be construed and interpreted against the background of that same agreed body of law. Accordingly, the first, and perhaps only required, step in assessing an allegation or suspicion of illegality of the main contract, and the consequences for the parties' rights and duties, will normally be that applicable substantive law.

The agreed law, the curial law and the place of performance

Let us suppose that the tribunal concludes that the main contract promoting importation of counterfeit compact discs offends public morals under the agreed German law. Let us also suppose that such contract does not—for the sake of argument—offend public morals under the substantive law reigning at either the non-German seat of arbitration or the non-German place of counterfeiting or importation, or both.

That fact would not prevent the tribunal from making any and all rulings flowing from its finding of illegality under the applicable German law. The rulings available to the tribunal might include an order or award denying or upholding its jurisdiction and an award granting or denying relief requested on one or both sides.

Any incompatibility of those rulings under German law with a diverging law at the seat or the place of "performance" would be irrelevant unless and to the extent that the rulings violated a mandatory norm. More specifically, in the case of the seat of arbitration that mandatory norm would need to be such as to justify nullification of the award. In the case of the place of performance, that mandatory norm should be wholly irrelevant unless enforcement of the award were sought there, and the norm justified denial of enforcement under Article V of the New York Convention or such other basis as might apply.

The connection with the law of the place of performance

Would it suffice to establish illegality under some other, 'connected' body or rules of law? In our prior example, there is no identity or overlap between the state of the applicable substantive law, the state in which the seat is located and the state in which the performance occurs. One could assume, however, a not unusual scenario in international arbitration: namely, that both the agreed substantive law and the agreed seat have nothing to do with the place of characteristic performance of the illegality—other than that the parties agreed to them.

Say, for example that non-German and non-Swiss parties agreed to German substantive law and a Swiss seat in connection with an "intermediary contract" whose nexus is in neither Germany nor in Switzerland, but in third country X. Indeed the contract has everything to do with X, and nothing to do with Germany or Switzerland other than the 'mere' party agreement. The tribunal also suspects that the parties intentionally agreed to German law and a Swiss seat so as to distance the contract as much as possible from the reach of the law of X and X's prohibition against such contracts.

This scenario is in fact a realistic modification of various elements of many of the awards and court decisions discussed already above. Where the intermediary or brokerage contract is not illegal under German law or Swiss law, what happens if it is manifestly illegal under the law of Third Country X? To the extent X is closely connected to the contract, should its public policy be followed by the tribunal deciding under German substantive law in Switzerland?

The proper result appears to be that unless the illegality under X's law rises to the level of a violation of notions of international public policy which likewise offend notions of international public policy in German and/or Swiss law, the illegality at X need not concern the tribunal, and cannot bind it. This is not to say that the illegality of conduct in another country cannot easily render a contract immoral under the law of the seat or the law governing the contract. At the same time, the immorality resulting from the application of the foreign law should be of an egregious nature in order to supersede the agreed substantive law and contrary mandatory norms at the seat.

The fact that the law of X is, factually, closely connected to the contract—and that the laws of Germany and Switzerland respectively are not at all except for the contract terms—is, by itself, of no consequence. Even where such issues of connectivity might place a role in the national courts, such consideration has no binding effect in the arbitral sphere. Conflict of law rules which might bind the national courts will not bind the arbitral tribunal, eg, at our Swiss seat. Such issues are then governed by specific legislation on international arbitration (in this case, Article 187(1) of the Swiss Private International Law Act 1987Act), which supersedes any other conflicts principles.

Thus the illegality at X does not mandatorily result in the illegality of the contract under the stipulated governing law or under the curial law—unless it fits into an egregious violation of public policy. Indeed notably in a country such as France which distinguishes between local public policy and international public policy offences, even a violation of local public policy at the seat as a result of the prohibition in country X should not mandate a finding of illegality where the parties and subject-matter call for application of international, and not domestic, public policy standards.

Violation of universal public policy versus local public policy.

Only a fundamental violation of transcending international public policy 'in the German sense' under the substantive law and 'in the Swiss sense' under the curial law would call for a finding of illegality based

merely on the close connection to X and X's own mandatory norms: "If regard is to be had to mandatory provisions ... of a law other than that of the forum or that chosen by the parties, then such provisions can only prevent the chosen law from being applied if there is a close link between the contract and the country of that law and if they further such aims as are generally accepted by the international community." (Article 9 of the 1991 Resolution of the Institute of International Law concerning the autonomy of the parties in international contracts between private persons or entities, reprinted in *Institut de droit international*, Tableau des résolutions adoptées (1957-91) at 408, 413 (1992), 1992 Rev. Crit. DIP 198.)

Indeed, the quite recent case of the Swiss Federal Tribunal, *Beverly Overseas SA v Privredna Banka Zagreb*, Swiss Fed Trib, Mar 28, 2001, Bull ASA 2001 807 f, confirms this approach: if the facts which need to be analysed to determine the enforceability of the Swiss-based international award have no or only few links to Switzerland, then universal public policy considerations must be taken into account in addition to Swiss public policy.

Whether the Swiss award would have any prospect of successful enforcement in X is, of course, an entirely different matter. To what extent the tribunal should be concerned with that problem relates, again, to the discussion of, eg, Article 35 of the ICC Rules and the question of a duty to render an award which is "enforceable at law".

The tribunal's award respecting suspected or manifest illegality cannot make legal what would otherwise be illegal. At the same time, the arbitrator should not disregard the governing substantive law in favour of some other connected national law respecting illegality unless the application of the governing law (in disregard of the other connected law) would result in a violation of international public policy. This is no different from saying that the arbitrator need not apply the agreed or determined governing law if to do so would cause the arbitrator to violate international public policy. In such extreme cases, party autonomy is trumped by the 'higher good' of international public policy.

In our scenario, the tribunal may disregard the mandatory public policy at X in favour of the agreed German law, even if German law has vastly less connection to the disputed contract than does X's law, unless such disregard would offend international public policy. And where disregard of the mandatory public policy at X would itself offend international public policy, the arbitrator has a right to apply the law of X over and above the agreed German law so as to avoid offending that transcending public policy: "[T]he parties are entitled to submit their legal relations to whatever law they choose, and to exclude national laws which would apply in the absence of a choice. Consequently, the provisions of the law thus excluded can only prevail over the chosen law insofar as they are matters of public policy." (*Westacre Investments Inc v Jugoimport—SPDR Holding Co Ltd & Others*, Award in ICC Case No. 7047 (1994), 1995 Bull ASA 301, 330-32, upheld by Swiss Fed Trib, Dec 30, 1994, 1995 Bull ASA 217).

Once again, to the extent the arbitrator has a duty to render an award enforceable at law, it is submitted that he or she would then have a duty to apply the law of X in such case. Where the provisions of foreign law are not considered to rise to the level of a transnational *loi de police*, then there should be no obligation by the arbitrator to apply them in lieu of the agreed substantive law. Likewise, where the provisions of the foreign law are considered to be valid inasmuch as the parties agreed to them at arm's length, they may nevertheless not be applied by the enforcing court if the court considers that the mandate of party autonomy must yield to the mandate of forestalling absurd results which offend public policy.

In the enforcement context, that public policy may in fact be local public policy, and not necessarily transnational public policy. See, eg, *Soleimany v Soleimany*, 1998] 3 WLR 811, 13 Int'l Arb Rep A1 (Mar 1998) (CA 1998), where the Court of Appeal refused to enforce an award at the London seat under Jewish law in a dispute between two Iranian refugees where the award gave effect to a contract which violated Iranian customs regulations.

Ascertaining consensus surrounding transnational public policy.

All of the foregoing does not change the challenge confronting the arbitrator as to whether a *loi de police* or other prohibition should be regarded as local or transnational. Nor does it alter the challenge of ascertaining whether in fact particular kinds of illegality which are not necessarily uniformly condemned still give rise to a transnational norm justifying or requiring respect by the arbitrator.

In cases where bribery or corruption are generally condemned throughout the world, what importance if any should the arbitrator attach to the fact that a particular corrupt practice is indeed widely practised and widely accepted in a single country, and it is that country which has the closest connection to the performance of the contract in dispute?

In cases where the illegal act relates to disrespect of a United Nations-sanctioned embargo against one or only a few states, what importance, if any, should be attached to the fact that respect of the embargo constitutes a crime in the target country, and that target country has the closest connection to the performance?

In the case of a generally condemned corrupt practice which is nevertheless widely—perhaps even officially or statutorily—condoned in a single country, the arbitrator's task need not be complicated. The agreed substantive law should be applied except to the extent it violates generally accepted international norms. Alternatively, the tribunal may be entitled to conclude that even if the agreed substantive law is the law of that single country, it will disregard that governing law if applying it would contravene international public policy.

In such situations, the tribunal cannot possibly be the servant to several different masters: it must observe generally accepted international norms, even if it is thereby likely that the award will have little prospect of cross-border enforcement in that single country. Inasmuch as Article V(2)(b) of the New York Convention should be seen as a mandatory guideline for the arbitrator, he must attempt to determine whether the broad consensus internationally is embodied in the application of the agreed substantive law or not.

The same would apply to alleged illegality relating to embargo measures, where arguments could be made that the measures reflect the will of only a handful of states, and not necessarily global policy: "[i]n no case shall an arbitrator violate principles of international public policy as to which a broad consensus has emerged in the international community." (Article 2 of the Resolution on Arbitration between States, State Enterprises or State Entities, and Foreign Enterprises, adopted by the Institute of International Law on 12 September 1989, XVI YB Com Arb 236, 238 (1991)).

Ultimately, the existence of transnational conventions, resolutions and the like condemning a particular practice does not necessarily translate into a broad consensus which might be used by the arbitrator as justification for ascertaining the existence and violation of a principle of 'international public policy'. Furthermore, query how extensive and transparent such broad consensus in the international community really is on some of the issues of illegality which typically affect an international commercial arbitration proceeding. At the same time, even in such cases the arbitrator will have had, and should have made use of, his or her various tools and arsenal to firmly address any issues of illegality. The opportunities to do so within the context of competence-competence and separability are largely there for the taking.