

# Why Arbitration Needs Conflict of Laws Rules

## Kluwer Arbitration Blog

October 17, 2018

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Please refer to this post as: Giuditta Cordero-Moss, 'Why Arbitration Needs Conflict of Laws Rules', Kluwer Arbitration Blog, October 17 2018, <http://arbitrationblog.kluwerarbitration.com/2018/10/17/why-arbitration-needs-conflict-of-laws-rules/>

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It's been decades since arbitration has started its emancipation from conflict of laws rules (private international law). Many were of the opinion, and still are, that conflict of laws rules are an undesirable straitjacket forcing the arbitral tribunal to determine the applicable law according to rigid and complicated rules and thus hindering it from considering whatever rules it deems appropriate. The private international law method for determining applicable law, so goes the criticism, is unnecessary, complicated and leads to results that may come as a surprise to the parties. Underlying is the known philosophy according to which arbitration is international and not rooted in any specific national legal system. According to this philosophy, arbitration owes no obedience to national laws. It is delocalized. It owes obedience only to the parties. The logical consequence is that there is no need to apply conflict rules to determine the applicable law. Under most sources of arbitration law, the arbitral tribunal is obliged to apply the law chosen by the parties. Failing a choice by the parties, this philosophy requires that the tribunal determine the applicable law directly, without having to apply any conflict rules (the *voie directe*). The ICC was first out in introducing the *voie directe*, and many arbitral institutions followed suit. Other instruments of arbitration law are less radical, for example the UNCITRAL Model Law makes still reference to conflict rules – albeit not necessarily belonging to the law of the place where the tribunal has its seat.

There is no question that party autonomy is crucial in arbitration.

However, this does not necessarily mean that conflict rules have no function in arbitration.

*Firstly*, where the parties have not chosen a law, the result will be much more predictable if the applicable law is determined on the basis of objective criteria known in advance (i.e., applying conflict rules), than if it is the result of the tribunal's complete discretion.

*Secondly*, and perhaps more importantly, conflict rules may contribute to the efficiency of the specific proceedings and (*thirdly*) to the effectiveness of arbitration in general.

Let's discuss first the efficiency of the specific proceedings.

It is quite evident that a proceeding will not be efficient, if it results in an award that eventually is set aside as invalid or is refused enforcement. How can conflict rules contribute to avoiding such an inefficient proceeding?

If the parties have chosen the applicable law, conflict rules will generally confirm their choice – party autonomy is the most important conflict rule for contract disputes. However, following the parties' choice may lead to disregarding other laws, and, in some cases, this may result in an award that is invalid or unenforceable. Imagine a contract containing the choice of a law belonging to a non-EU

state. If the contract violates EU competition law, the defaulting party may invoke EU competition law as a defence: that party has not fulfilled its obligations, because doing so would have infringed EU-competition law. The other party will point at the choice of law made in the contract and exclude that EU competition law is applicable. As known and as confirmed by the famous *Eco-Swiss* decision, an award infringing EU-competition law may violate public policy and may thus risk being set aside or refused enforcement. The tribunal, therefore, may wish to take into consideration EU-competition law, so as to avoid rendering an invalid or unenforceable award. But does the tribunal have the power to disregard the choice of law made in the contract? If the tribunal exceeds its power, the award will be invalid and unenforceable.

How does the tribunal solve this dilemma?

This is where conflict rules may be extremely useful: they give the tribunal a basis upon which it can take into consideration EU-competition law, without disregarding the parties' choice of law and exceeding its power.

If the parties' choice is considered as a conflict rule (rather than being considered as being based on an absolute principle of arbitration law, as is assumed by the delocalization theory), it will follow that it has a certain scope, usually confined to matters of contract law and possibly of tort law. The choice made in the contract, therefore, will not affect issues of competition law. If the tribunal considers EU competition law, it has not disregarded the parties' choice, because the parties' choice did not cover competition law. In addition to having given the tribunal a basis to avoid rendering an invalid and unenforceable award, conflict rules have given the tribunal a basis to do so without exceeding its power. Furthermore, conflict rules have contributed to the predictability of the result.

It is certainly more predictable to acknowledge that the parties' choice is a conflict rule and that therefore it follows the criteria and has the scope regulated in the private international law, than promising that the parties' choice is an absolute principle. This promise may not be kept if the award is to be valid and enforceable. Hence, the tribunal will have to restrict party autonomy. Without the benefit of conflict rules, it will come as a surprise that party autonomy is not absolute. Moreover, there will be no objective criteria for restricting party autonomy, and the tribunal will have to do so on the basis of discretionary considerations. Conflict rules, therefore, may contribute to the predictability and efficiency of the specific proceeding.

*Thirdly*, conflict rules may contribute to the effectiveness of arbitration in general. If arbitration only obeys by the will of the parties, there is a risk that it becomes the instrument for evasion of important regulatory provisions. Parties who desire to ignore competition law, for example, choose for their contract a governing law without competition rules, and insert an arbitration clause. If the tribunal only follows the will of the parties, it will disregard competition law of the state that is actually affected by the disputed transaction. It is deleterious to the effectiveness of regulatory law such as competition law, if such a wide spread mechanism for dispute resolution such as arbitration permits to avoid its application. This is why, decades ago, disputes that involved issues of regulatory law such as competition law were deemed not to be arbitrable. With the famous *Mitsubishi* decision, an era of arbitration-friendliness was introduced: US courts, and later courts in many other states, accepted that disputes involving regulatory issues be arbitrated, because courts maintained the possibility to give a "second look" to the award. Through set aside or enforcement proceedings, courts would have the possibility to annul or refuse enforcement of an award that violated public policy.

This arbitration-friendliness, however, shows signs of erosion. The second look approach is not always sufficient to ensure the effectiveness of regulatory law or other mandatory rules that are deemed particularly important. If the losing party does not challenge the validity of the award, there will be no set aside proceedings. If the winning party does not need enforcement, there will be no enforcement

proceedings. Enforcement may be sought in other jurisdictions, so that the courts of the system whose law has been avoided will not be involved. In these situations, courts will have no possibility to give a second look at the award.

The pendulum seems to be swinging now, and numerous courts in member states of the EU have rendered decisions restricting arbitrability of disputes regarding agency agreements, because they could not be sure that the arbitral tribunal would apply mandatory EU rules on protection of the agent.

Courts might be more prone to trust arbitration, if they could count on the use of conflict rules for the selection of the applicable law in arbitration.

Far from being the useless, arbitration-hostile cage from which arbitration should seek to liberate itself, conflict of laws rules are a useful tool that contributes to predictable and efficient arbitral proceedings, as well as to the effectiveness of arbitration as a dispute resolution mechanism.

Conflict rules are, in other words, more arbitration-friendly than the delocalization theory.

This post is a short summary of part of my scholarship. Various of the mentioned issues are not uncontroversial and require more extensive analysis. More extensive analysis may be found in my publications, a list of which is available [here](#).