THE EFFECT OF MANDATORY RULES OF PUBLIC LAW ON CHOICE OF LAW IN INTERNATIONAL COMMERCIAL ARBITRATION

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Abstract

The general principle of party autonomy gives contracting parties authority to select the substantive law of their contract. In the international arbitration conventions and national arbitration laws, arbitrators encounter the important unanswered question of whether to apply or consider relevant mandatory rules of public law not chosen by the contracting parties. An arbitrator who intends to apply the mandatory rules of public law deals with three problems: 1) party perception that mandatory rules of public law unnecessarily interfere with formation and performance of international contracts; 2) disagreements between the underlying public policy and the contracting parties' will; and 3) enforceability of the arbitration award. In this article, the author defines the concept of mandatory rules of public law, discusses arbitrators' practical application of mandatory rules of public law, examines international arbitrators' discretion in applying the mandatory rules of Public Law, and finally attempts to answer the question of whether arbitrators should apply mandatory rules of relevant national laws.

Keywords: mandatory rules, public law, international commercial arbitration, contracting parties

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I. Introduction

The principle of party autonomy authorizes contracting parties to select the substantive law governing their contract. Therefore, a selected law can be the principle law of one of the contracting parties, the *lex mercatoria*[1]. A significant question may arise about whether an arbitrator should apply or take into account mandatory rules of public law which are relevant, but not selected by the parties. Unfortunately, this question remains unanswered. Neither international arbitration conventions, such as the New York or Geneva Conventions, nor the national arbitration laws, such as the French New Code of Civil Procedure (NCCP), have discussed mandatory rules of law.[2] Recently, some international arbitration bodies, such as the International Chamber of Commerce (the "ICC"), and to some extent the United Nations Commission on International Trade Law (UNCITRAL), have dealt with this matter.[3] Thus, the relationship between an arbitrator's responsibility to apply parties' choice of law and his responsibility to apply the relevant mandatory rules foreign to the substantive law of the contract remains controversial and worth discussing.

Even when an arbitrator is eager to apply the relevant mandatory rules of public law, he encounters some practical problems. First and foremost, the international business community regards the application of mandatory rules of public law as a troublesome national interference in the formation and performance of international contracts. Second, the public policy reasons underlying the enactment of mandatory rules may often conflict with the will of the parties from which the arbitrator gets his authority.[4] Third, the arbitrator must make sure that his award is finally enforceable.[5] Considerations relevant to the recognition and enforcement of arbitral awards are complicated. This is particularly true when the award can be executed in several jurisdictions.

[1] Lex mercatoria refers to "a set of general principles and customary rules spontaneously referred to or elaborated in the framework of international trade without reference to a particular system of national law." Robert Goldmann, (1986). The Applicable Law: General Principles of the Law-The lex mercatoria. *CONTEMPORARY PROBLEMS IN INTERNATIONAL ARBITRATION*, 125.

[2] This failure may be explained by the fact that international arbitration treaties were concluded before notions of mandatory rules of public law were discussed to any significant extent.

[3] See Ole Lando, (1981). Conflict of Law Rules for Arbitrators. *FESTSCHRIFT FOR KONRAD ZWEIGERT*, 176.

[4] See Pierre Lalive, (1986). Transnational (or Truly International) Public Policy and International Arbitration. *COMPARATIVE ARBITRATION PRACTICE AND PUBLIC POLICY IN ARBITRATION*, *3*, 270-71.

[5] See Stephen M. Schwebel & Susan G. Lahne, (1987). Public Policy and Arbitral Procedure. *ICCA*, *3*, 205.

This article investigates the application by arbitrators of mandatory rules of public law in light of recent case law, rules of international arbitration institutions, regional arbitral treaties, and UNCITRAL arbitration efforts.

A. The Concept of Mandatory Rules of Public Law

Various definitions exist about mandatory rules of laws. Professor Mayer defines mandatory rules of law as follow:

> A mandatory rule... is an imperative provision of law which must be applied to an international relationship irrespective of the law that governs that relationship. To put it another way: mandatory rules of law are a matter of public policy (ordre public) and moreover reflect a public policy so commanding that they must be applied even if the general body of law to which they belong is not competent by application of the relevant rule of conflict of laws. It is the imperative nature per se of such rules that make them applicable. One is thus led to conclude that there is an 'approach to mandatory rules of law' different from the classical method of conflict of laws. In matters of contract, the effect of a mandatory rule of law of a given country is to create an obligation to apply such a rule, or indeed simply a possibility of so doing, despite the fact that the parties have expressly or implicitly subjected their contract to law of another country.[6]

On the whole, mandatory rules protect the social and economic interests of a society.[7] The most commonly cited mandatory rules are: competition law,[8] securities regulation,[9] blockade or boycott law,[10] currency control, and confiscation and nationalization[11]. In cases involving foreign investment, the national law of the host country sets the requirements and provisions regarding

[6] Mayer, (1986). Mandatory Rules of Law in International Arbitration, *2 ARB. INT'L 274*, 274-75.
[7] See generally R. van Rooij, (1986). Conflict of Laws and Public Policy. *NETHERLANDS REPORTS TO THE TWELFTH INTERNATIONAL CONGRESS OF COMPARATIVE LAW, 175*, 176-77.
[8] See Ludwig Von Zumbusch, (1987). Arbitrability of Antitrust Claims under US, German, and EEC Law: The "International Transaction" Criterion and Public Policy, *22 TEx. INT'L L.J. 291*, 304-12
[9] See, Scherk v. Alberto Culver Co., (1974). 417 U.S. 506.
[10] See, AB Gotaverken v. (1981). General Nat'l Maritime Transp. Co., ICC Cases Nos. 2977/1978, 2978/1978, 3033/1978, 6 Y.B. COM. ARB. 133
[11] JULIAN LEW, (1978). APPLICABLE LAW IN INTERNATIONAL COMMERCIAL ARBITRATION, 350.

the grant of concessions, the ratification of agreements, nullification, and enforcement of all other relevant constitutional and administrative formalities. A truly general principle of private international law justifies the application of these and similar mandatory rules.[12]

B. The Applicability of Mandatory Rules

Although party autonomy is a general principle of private international law that arbitrators should respect, it is subject to limits imposed by other equally significant general principles of law and public policy.[13] One general principle of law that party autonomy must agree with is the conflict of laws principle providing that certain mandatory rules must be applied in the territory where certain activities are undertaken.[14] This principle is based on the idea of national sovereignty and is designed to protect the public interest. Since this public policy justification calls for imposing certain controls over contractual relationships, the application of these controls may not be left to the parties' discretion.[15] These mandatory rules may also emerge from a "truly international public policy"[16] based not on national public policy concerns, but on supranational tenets of a jus cogens nature.[17]

The modern trend towards application of certain mandatory rules of public law is evidenced in the rules of international arbitration institutions, UNCITRAL, and regional treaties. In 1980, a working group of the Commission on Law and Commercial Practices of the International Chamber of Commerce prepared a draft on the law applicable to international contracts (ICC Draft Recommendations). The UNCITRAL also recently dealt with mandatory rules, which it termed "Mandatory Legal Rules of Public Nature". The 1980 European Convention on the Law Applicable to Contractual Obligations (the "European Convention") also recognizes the application of mandatory rules of law. The Convention gives effect to the relevant mandatory

[12] See, Government of the State of Kuwait v. (1982). American Indep. Oil Co., 21 I.L.M. 976.
[13] See, D.W. Bowett, (1988). State Contracts with Aliens: Contemporary Developments on Compensation for Termination or Breach, *LVIX BRIT. Y.B. INT'L L. 49*, 53.
[14] See HENRI BATIFFOL & PAUL LAGARDE, (1987). DROIT INTERNATIONAL PRIVt 277.
[15] See ALBERT DICEY & JOHN H. MORRIS, (1980). THE CONFLICT OF LAWS, 792.
[16] See Jacob Dolinger, (1982). World Public Policy: Real International Public Policy in the Conflict of Laws, 17 *TEX. INT'L L.J. 167*, 170.
[17] See Ahmed El Kosheri & Fatek Riad, (1986). The Law Governing a New Generation of Petroleum Agreements: Changes in the Arbitration Process, *I FOREIGN INVESTMENT L.J. 257*, 274.

rules of a foreign country whose law would not, in the absence of parties' choice of law, have been the substantive law of the contract.[18] Article 7(1) of the European Convention provides that:

> When applying under this Convention the law of a country, effect may be given to mandatory rules of the law of another country with which the situation has a close connection, if and in so far as, under the law of the latter country, those rules must be applied whatever the law applicable to the contract. In considering whether to give effect to these mandatory rules, regard shall be had to their nature and purpose and to the consequences of their application or non-application.[19]

The above discussion reveals that the international arbitration bodies not only acknowledge the applicability of relevant mandatory rules of law, but these institutions also provide some guidance as to how the arbitrators should determine which rules they may apply.

II. International arbitrators' discretion in applying the mandatory rules of Public Law

One can argue that mandatory rules of law stem from national systems of private international law and are only applicable to litigation in national courts. An international arbitration tribunal has no national forum and hence no lex fori; it derives authority from the agreement of the parties and therefore has an autonomous contractual status.[20] Hence, one could contend, an arbitrator is bound only by the parties' will and, therefore, by their chosen law, not by a national system of private international law that would require an arbitrator to apply mandatory rules of law foreign to the chosen law.

Recent arbitration practice, however, has not completely supported such a view. There are at least two reasons for this. First, as provided in the international arbitration material described in

[18] See O Lando, The Law Applicable to the Merits of the Dispute. *ESSAYS ON INTERNATIONAL COMMERCIAL ARBITRATION 129* (Petar Sarcevic ed., 1989).

[19] See generally O Lando, The Law Applicable to the Merits of the Dispute. *ESSAYS ON INTERNATIONAL COMMERCIAL ARBITRATION 129* (Petar Sarcevic ed., 1989)

[20] Dalmia Dairy Indus. Ltd. v. National Bank of Pak., ICC Case No. 1512/1967-70-71, discussed in W. LAURENCE CRAIG ET AL., *INTERNATIONAL CHAMBER OF COMMERCE ARBITRATION* app. IV, 10, 25 (1984).

the previous section, an arbitrator may take into consideration mandatory public law rules that are foreign to the substantive law specified in the contract. An arbitrator considers mandatory public laws in an effort to guarantee that his award is ultimately enforceable and also to safeguard the credibility of arbitration as an effective mechanism for the settlement of disputes arising from commercial contracts.[21]

Professor Bockstiegel, an expert in the field of international commercial arbitration, recently stated that "[i]n arbitrations involving State enterprises, public law rules or other mandatory law rules of the national legal system of the state enterprise[22] may come into consideration more often than in contracts between private enterprises."[23] An arbitrator may in fact apply such rules when there are reasonable grounds for their application. Yves Derains, the past Secretary of the ICC Court of Arbitration, has summarized the position as follows:

> [A]rbitrators are not usually satisfied with indicating that a mandatory rule is foreign to the lex contractus as a reason for not applying it. Indeed, the designation of the lex contractus does not necessarily imply that the parties had intended all mandatory rules liable to affect the contract to be excluded. And arbitrators prefer to explain that there are no serious grounds for applying the mandatory rules in question in every respect.[24]

Second, an arbitrator's lack of a national forum puts him in the position of an international judge. The Permanent Court of International Justice (the "PCIJ"), in the well-known Serbian Loans case, observed that an international judge may have to apply the lois de police of one state even if the substantive law of the contract is that of another. The Court stated:

> [T]he law which may be held by the Court to be ... applicable to the obligation in the case, may in a particular territory be rendered inoperative by a municipal law of this territory-that is to say, by legislation enacting a public policy the application of

[21] See generally Albert Berg, (1986). Recent Enforcement Problems Under the New York and ICSID Conventions, 5 ARB. INT'L 2; Sigvard Jarvin, (1984). The Sources and Limits of the Arbitrator's Powers, *2 ARB. INT'L 140*.

[22] See Leo J. Bouchez, (1991). The Prospects for International Arbitration: Disputes Between States and Private Enterprises, *8 J. INT'L ARB.* 89, 90.

[23] KARL-HEINZ BOCKSTIEGEL, ARBITRATION AND STATE ENTERPRISE 30 (1984)

[24] Yves Derains, Public Policy and the Law Applicable to the Dispute in International Arbitration, in 3 ICCA 227, supra note 6, at 249.

which is unavoidable even though the contract has been concluded under the auspices of some foreign law.[25]

Although an international arbitrator does not have a lex fori, he has some authority in arbitral matters beyond the parties' will. This is equally true in cases where all parties are private and in cases where one of the parties is a state.[26] In state contracts, arbitrators should take special caution in applying the mandatory public law rules of the state party in order to avoid results oppressive to private parties.[27] On the whole, while arbitrators must consider conflict of laws rules, they should remain free to determine the applicable conflict of laws rules according to guidelines derived from general principles common to developed conflict of laws systems. Thus, although the principle of party autonomy is the basic conflict of laws rule according to which the law applicable to a contract must be determined, competing conflict of laws principles may call for the application of mandatory rules, especially if they are of a public law nature. The scope of the substantive law of the contract cannot be determined in abstract. The public law nature of some contracts[28] requires that their public law elements be governed by mandatory public law rules of the state where the agreement or contract is to be performed.[29]

A. Determining the Applicable Mandatory Rules

Determining the source of applicable mandatory rules is a matter of controversy. According to the traditional view, mandatory rules must be derived from the substantive law of the contract, whereas the modem approach favors a determination independent of the substantive law applicable to contractual matters. This controversy does not arise when the parties choose a substantive law which contains the applicable mandatory rules.

Real difficulties arise, however, when the relevant mandatory rules derive from a legal system outside of the chosen law of the contract. Arbitrators and experts in the field have proposed three

[25] Payment of Various Serbian Loans Issued in France, 1929 P.C.I.J. No. 14, 2 Hudson W.C. 340 (1929).
[26] See, e.g., International Bank of Washington v. OPIC, 11 I.L.M. 1216 (1972).
[27] See, Allied Bank Int'l v. Banco Credito Agricola de Cartago, 757 F.2d 516 (2d Cir. 1985); Adams v. National Bank of Greece, 2 All E.R. 421 (1960); Metliss v. National Bank of Greece, 2 All E.R. 509 (1957).
[28] See Colin C. Turpin, Public Contracts, *7 INT'L ENCYCLOPEDIA COMP. L. ch. 4* (1982).
[29] See Rainer Geiger, (1974). The Unilateral Change of Economic Development Agreements, *23 INT'L & COMP. L.Q. 73*, 83-85.

different approaches to this situation. One approach is for arbitrators to give effect to the trade regulations and other basic economic legislation of a state where the contract will be performed. Even if these mandatory rules make the performance of the contract difficult or impossible, arbitrators may nevertheless consider applying them.[30]

A second approach applies the mandatory rules of the prospective place of enforcement of an award. An arbitrator must ensure that the enforcement of his award does not violate the national public policy where enforcement is sought.[31] This proposition is based on the assumption that the national courts where enforcement is sought will recognize the award by the standards of their own public policy.[32] An arbitrator, therefore, should not render awards which violate the mandatory rules integral to the public policy of the state where enforcement of his award is likely to be sought. The second alternative of Article 9 of the ICC Draft Recommendations expressly refers to this consideration.

The third approach applies the mandatory rules of a state if the contract or the parties have close contact with that state and if, in view of the circumstances, application of such rules is called for. Article 7(1) of the European Convention and Article 9 of the ICC Draft Recommendations illustrate this approach.

B. Grounds for Applying Mandatory Rules of Public Law

The main policy reason for applying mandatory rules is the need to advance a nation's public interest. Most nations have recognized the importance and development of public interests. A number of United Nations resolutions and declarations on this subject have affirmed this need.[33] Although it may be argued that an arbitrator is not entrusted with the mission of defending the public interest, and is instead entirely at the service of the litigants, he should not disregard the state's mandatory public law rules.

[30] See, Dutch Buyer v. (1982).Austrian Seller, *7 Y.B. COM. ARB. 141*, 142-43.
[31] see Christopher B. Kuner, (1990). The Public Policy Exception to the Enforcement of Foreign Arbitral Awards in the United States and West Germany Under the New York Convention, *7 J. INTL. ARB. 71*.
[32] See generally Joel R. Junker, (1977). The Public Policy Defense to Recognition and Enforcement of Foreign Arbitral Awards, *7 CAL. W. INT'L L.J. 228*.
[33] See, e.g., G.A. Res. 1803, U.N. GAOR, 17th Sess., Supp. No. 17, at 15-16, U.N. Doc. A/5217 (1962).

An arbitrator should keep in mind the fate of his award as well as the credibility of arbitration as an institution in general. When deciding whether to apply relevant mandatory rules, an international arbitrator must be mindful of the award's enforceability. Article 26 of the 1976 ICC Rules of Arbitration emphasizes this issue by providing that the arbitrator "shall make every effort to make sure that the award is enforceable at law."[34] This means that the arbitrator should be aware riot only of the law of the place of arbitration[35] and the legal views prevailing in the state where the enforcement of an award is sought, but also the mandatory laws of the place of the contract's enforcement.

Some scholars have emphasized that arbitrators should consider the interest of arbitration as an institution in rendering their awards. Lando believes that the arbitrator will have to consider not only the interests of the parties but also those of international commercial arbitration considered as an institution.[36] Arbitration today, he asserts, still enjoys the prestige which has induced the liberality shown to it by most Western countries. If it becomes known that arbitration is being used as a device for evading the public policy of States which have a governmental interest in regulating certain business transactions, its reputation may suffer. Arbitration, Lando concludes, can only survive as long as it is tolerated by the States.

An arbitrator should take into account the public interests of all the communities involved in the arbitration, otherwise his decision may be ignored. Professor Mayer also emphasizes that the enforcement of arbitration awards requires that arbitrators give serious consideration to the mandatory rules of public law. Finally, Professor Mayer concludes that an arbitrator should give effect to mandatory rules of law out of a sense of duty to the continuation and development of international arbitration as an institution.

III. Should arbitrators apply mandatory rules of relevant national laws?

[34] ICC Rules of Arbitration, reprinted in 13 Y.B. COM. ARB. 185, 196 (1988).

[35] Lipstein, International Arbitration Between Individuals and Governments and the Conflict of Laws. *CONTEMPORARY PROBLEMS OF INTERNATIONAL LAW, ESSAYS IN HONOR OF G. SCHWARZENBERGER 177*, 192 (Bin Cheng & Edward Duncan Brown eds., 1988).

[36] Lando proposes that "[t]he arbitrator should also consider whether the contract has such a connection with the economy of the enacting country that it would be fair and reasonable to give effect to the mandatory rule in question." Id. at 170.

Do contract disputes remain arbitrable, or does a contract remain valid, if a party claims that enforcement of the contract will violate the mandatory rules of law? This issue is often raised as a defense for noncompliance or breach of contract. The plaintiff either demands performance or damages for nonperformance, while the defendant alleges that the contract is unenforceable or void because its enforcement violates mandatory rules of law.[37]

Generally, an arbitrator's decision whether to consider or give effect to the mandatory rules of law depends on one of the following conditions: whether (a) the parties have chosen the substantive law of the contract and the mandatory rules are part of it; (b) the parties have chosen the substantive law, but the mandatory rules are not part of it; or (c) the parties have left the choice of substantive law to the arbitrator.

A. Mandatory Rules Are Part of the Substantive Law

There is no real difficulty when the mandatory rules are part of the substantive law chosen by the parties because an arbitrator is bound to apply such law in its entirety. Thus, an arbitrator must apply such substantive law including its mandatory rules, even if they run contrary to the contractual stipulations of the parties.[38] The only exception to this rule is when giving effect to all provisions of the chosen substantive law would violate truly international public policy.[39] In such a situation, the arbitrator should explore the parties' intentions regarding the effects of their chosen law. The arbitrator's decision should be guided by the parties' power to choose the most appropriate law to meet their needs, and to exclude the application of unfavorable national laws. The parties, however, may also restrict beforehand the scope of the application of substantive law by stipulating that the chosen law should apply only to certain parts of the contract.

B. Mandatory Rules Are Not Part of the Substantive Law

[37] The application of the mandatory rules may be raised as an incidental issue or the main issue of the case.

[38] Even when the parties have excluded the application of some of the mandatory rules of their chosen law, the arbitrator should still apply the chosen law in its entirety. Unlike domestic public policy, the application of mandatory rules of public law is not dependent on the parties' choice of substantive law. See generally Dolinger, supra note 16, at 184-85.

[39] See BOCKSTIEGEL, supra note 23, at 30

Different considerations prevail if the relevant mandatory rules are not part of the substantive law. In such situations two types of arbitrations should be distinguished. The first type merely requires the arbitrator to take notice of the mandatory rules of law, without actually applying them. For example, a Greek seller who is a party to a contract governed by French law may argue that his failure to deliver goods sold for export was due to an embargo decree in Greece. The embargo decree is a mandatory rule, but it is invoked as a simple fact that has made the performance of the contract impossible, that is, an incident of force majeure.

Here, the seller merely wants the force majeure incident to be taken into consideration, although the substantive law of the contract is not Greek law. The arbitrator would not, however, be able to apply the Greek embargo decree by reason of its very nature. He will only consider its effects on the contract when he decides the dispute under French law, the substantive law of the contract.[40]

Rearranging the facts of the above example illustrates the second type of arbitration in which the arbitrator will apply the Greek mandatory rules rather than merely considering them. Assume the Greek seller alleges that the sale contract was void because he failed to obtain a prior authorization from the relevant authorities before he entered into the contract. The arbitrator then has to decide whether he can declare a contract subject to French law void by application of a Greek mandatory rule.

In most cases, the principle that requires an arbitrator to apply the law chosen by the parties is sufficient to prevent him from having to give effect to a foreign mandatory rule.[41] An award of the Court of Arbitration of the Chamber of Foreign Trade of the German Democratic Republic (G.D.R.) illustrates this situation. This decision involved the validity of a license contract between a firm in the G.D.R. and a firm in the Federal Republic of Germany (F.R.G.). The contract provided that all disputes should be decided under G.D.R. law.[42]

A dispute arose and the F.R.G. firm argued that the contract was void under its own country's competition law and Article 85 of the Treaty of Rome. Rejecting the argument and giving effect

[40] See, ICC Case No. 2216/1975, 2 INT'L ARB. 281 (1986); Case No. 2138, 4 INT'L ARB. 112 (1988).
[41] See, Dalmia Dairy, ICC Case No. 1512/1967-70-71, discussed in CRAIG ET AL., supra note 20, at app. IV, 10, 24-27.
[42] See G.D.R. Party v. F.R.G. Party, 4 Y.B. COM. ARB. 197 (1979)

to the parties' choice of law clause, the arbitrators held that "[t]he validity of the agreement must be judged under the law of the GDR designated in the arbitral clause as the law applicable to the agreement."

Choosing the substantive law, however, does not necessarily imply that the parties intend to exclude all mandatory rules which may affect their contract. In such cases, arbitrators should analyze the parties' intentions and the surrounding circumstances in light of truly international public policy, in order to decide whether to apply such mandatory rules. An arbitral tribunal may refuse to give effect to the mandatory rules of law of the parties' respective countries when such rules are foreign to the substantive law of the contract. In an ICC arbitration involving a dispute between Swedish shipyards and a Libyan buyer, the arbitral tribunal refused to apply Libyan laws and regulations relating to the boycott of Israel, because the contract was subject to Swedish law. The tribunal stated that "[t]he application of the Swedish law leads to the obvious consequences that the Libyan boycott law and regulations cannot apply to those contracts-except if a special reference is made in the contract to this boycott law."

Although there is no unanimous view among arbitrators as to the applicability of mandatory rules foreign to the substantive law of the contract, most scholars seem to favor the application of the mandatory rules of the place of performance of the contract.[43] Opinions are much more divided on the question of the mandatory rules of the parties' respective countries.[44]

One way of resolving these conflicting views is to resort to the theory of truly international public policy. If the object of the mandatory rules of law is to guarantee respect of the principles considered by the arbitrator as forming part of truly international public policy, the arbitrator should apply such principles over the will of the parties. For example, it is unlikely that an arbitrator would find a mandatory rule of municipal law providing that a corporation shall not contract to pay for its obligations in foreign currency to be a provision coming within the ambit of truly international public policy.[45]

[43] See JARVIN & DEfLAINS, supra note 37, at 33, 58 (reporting ICC Case Nos. 3033/1978 and 1512/1967).
[44] See, Gotaverken, 6 Y.B. Com. ARB.; Dalmia Dairy, ICC Case No. 1512/1967-70-71, discussed in CRAIG ET AL., supra note 28, at 24-27
[45] See JULIAN LEW, (1978). APPLICABLE LAW IN INTERNATIONAL COMMERCIAL ARBITRATION 350 .

A well-known case illustrating the respect which courts hold for truly international public policy was decided by the House of Lords in 1956. The case involved a contract between a Swiss middleman, the plaintiff, and an Indian seller of jute sacks which were to be shipped to South Africa via an Italian port. Indian law prohibited the export of jute to South Africa. The contract was governed by English law and the defendant failed to deliver the jute. Deciding in favor of the defendant, the House of Lords stated that "[j]ust as public policy avoids contracts which offend against our own law, so it will avoid at least some contracts which violate the laws of a foreign State, and it will do so because public policy demands that deference to international comity ...."[46]

In this case, the truly international public policy was the opposition to racial discrimination.

IV. Conclusion

Until recently, international commercial arbitration practice showed itself imaginative in its determination to apply the relevant mandatory rules foreign to the substantive law of the contract. An examination of the arbitral jurisprudence reveals a body of decisions that all have a common denominator: the desire of the arbitrators to meet the legitimate expectations of the parties for whom they act. Arbitrators felt that they were not the guardians of public policy, with the primary function of remedying unlawful situations. Rather, they were the private judges of the concerned parties whose mission was to settle the disputes according to the law chosen by the parties.

International arbitrators have realized, however, that they should apply relevant mandatory public law rules on reasonable grounds or at least take them into consideration to promote the survival of international commercial arbitration as an institution and the respect for international comity. Most importantly, they have observed that their awards may not be enforced if they do not so proceed. Because mandatory public law rules of a state are meant to protect its social-economic interest, they should be applied when a certain contractual relationship has substantial relevance to such rules in respect of formation, performance, or enforcement of the contract.

[46] See Regazzoni v. K.C. Sethia, Ltd., 2 All E.R. 489-90 (1956).

Therefore, among the relevant mandatory public law rules that an international arbitrator may apply are: (i) those which necessarily affect the performance of a contract; (ii) those which form part of the public policy of the state in which enforcement of an award is likely to be requested; and (iii) those of the countries closely connected with the contract.

Although in contractual matters the principle of party autonomy is the basic conflict of laws rule according to which the law applicable to a contract must be determined, mandatory rules, especially if they are of a public law nature, follow their own conflict of laws principles. An arbitrator applies mandatory rules of a state as foreign lois de police or foreign rules of public law, since he has no national forum and hence no lex fori.