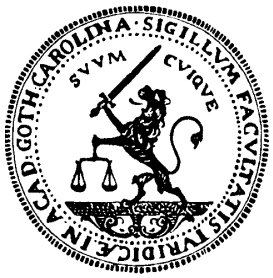


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# INTERNATIONAL COMMERCIAL ARBITRATION
## - Predicaments in relation to state contracts

Master's thesis in International Trade Law
20 points

Supervisor

Professor Michael Bogdan

Autumn 2000

# Contents

# Abbreviations

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| **A.C.** | Appeal Cases (U.K. Law reports series) |
| **A.J.I.L.** | American Journal of International Law |
| **A.L.J.** | Australian Law Journal |
| **B.Y.I.L.** | British Yearbook of International Law |
| **ICC** | International Chamber of Commerce |
| **ICC Rules** | Rules for the Court of Arbitration of the International Chamber of Commerce |
| **I.C.L.Q.** | International and Comparative Law Quarterly |
| **ICSID** | International Centre for the Settlement of Investment Disputes |
| **I.L.M.** | International Legal Materials |
| **I.L.R.** | International Law Reports |
| **J.I.B.L.** | Journal of International Banking Law |
| **J.Int.Arb.** | Journal of International Arbitration |
| **Model Law** | Model Law on international commercial arbitration, adopted by the United Nations Commission on International Trade Law, June 21, 1985 |
| **New York Convention** | Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958 |
| **P.C.I.J.** | Permanent Court of International Justice |

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| **UNCITRAL** | United Nations Commission on International Trade Law |
| **Washington Convention** | Convention on the Settlement of Investment Disputes Between States and Nationals of other States of 1965 |
| **W.L.R** | World Law Review |
| **WTO** | World Trade Organisation |

# 1 INTRODUCTION

International commercial arbitration has grown in importance and complexity over the years. Disputes that arise from international commercial contracts often involve foreign states or state entities, which are controlled to a certain extent by their governments. Arbitration, as a method of dispute resolution, has traditionally been used predominantly by western countries. However, it is evident that there is a growth of acceptance of arbitration in developing countries as investment increases as well as international trade with these nations. There are several aspects that need to be considered when a state or a state entity enters into an international commercial contract with a private party. The choice to resolve disputes between the parties by arbitration raises questions regarding for instance choice of law, jurisdiction predicaments, and enforcement of arbitral awards. Which law should act as the proper law of the contract? Is there an applicable international law that is detached from all national legal systems? Which court or institution is the most suitable to have jurisdiction over the dispute? When can a state plead sovereign immunity and is it possible to enforce awards against a state or a state entity? These are merely a few of the array of questions that may be raised in relation to international commercial state contracts.

International commercial arbitration is recognised as one of the vital elements for the success of international trade and investment. The parties need to be certain of the fact that a well operating and acceptable system is available in the event that a dispute arises to give them predictability in their business relationship. Furthermore, the success of arbitration demands that all participants in the process overcome economic, cultural as well as legal and political differences. Sovereign states have taken on a role of increased trade and commerce, which has previously been handled by private corporations. This reality emphasises the importance of the topic as well as the ongoing debate in this area of law. This work seeks to disclose and analyse the various problems in international commercial arbitration from a

common law perspective, particularly in cases where one party is a state or a state entity. In addition, various authorities on the subject have been exposed to bring out the divergent views on the issues.

The method of research is based on Internet search, international literature, cases, as well as relevant articles. The debate on this topic is quite intense and it has been my purpose to reflect and clarify a few of the most common views in this work, as well as express my own opinion on the matter.

# 2 Choice of law

A dispute over a contract is settled through what an arbitration tribunal finds is fair and reasonable or on the basis of what the applicable law states in the specific situation at hand. The parties to an international contract generally have the liberty to choose which law they wish to have as the law applicable to the contract.[1] The choice should preferably be made at the time when the contract is negotiated and signed as opposed to when a conflict arises. The main reason why this should be the case is to achieve predictability to foresee consequences of the parties' actions. The party autonomy in International contracts, which is widely accepted, is discussed for instance in the case *Amin Rashid Corporation v. Kuwait Insurance Co.*[2], where Lord Diplock has described the law applicable to an international contract as the "substantive law of the country which the parties have chosen as that by which their mutually, legally enforceable rights are to be ascertained."[3] Although party autonomy should be regarded as the main rule, there are some important limitations that should be addressed.

## 2.1 International contracts and conflict rules

The parties' choice of law in an international contract is generally accepted. An arbitrator is not bound by any conflict rules when determining the proper law of a contract and may consequently apply principles that cannot be foreseen by the parties, although domestic rules are customarily relied on. It is in this context very important to examine some principles of the modern conflicts systems to be able to discover the problems that may arise in

[1] Generally on party autonomy and choice of law See: Redfern and Hunter, "*Law and Practice of International Commercial Arbitration"*. 2nd ed. London, Sweet and Maxwell, 1991, at 100-101.
[2] For more specific information on the *Amin Rashid Corporation v. Kuwait Insurance Co.* [1984] A.C. 50, Sornarajah, "*International Commercial Arbitration*", Singapore, Longman Singapore publishers, 1990, at 103.
[3] Sornarajah, "*International Commercial Arbitration*", Singapore, Longman Singapore publishers, 1990, at 69.

relation to state contracts. The choice of law and the doctrine of party autonomy are very vital for the parties' capability to secure predictability and some control over the arbitration process. The exceptions of party autonomy, which deviate from the principal rule, can be regarded as a threat to this vital predictability and control over the process.

### 2.1.1 Party autonomy - limitations

The different limitations have derived from statements in cases over the years and one that has been discussed extensively is the geographical connection.[4] This requirement is evident when there is no expressed choice of law, but also when the parties have agreed on which law that should govern the substantive issues of the contract. The courts have been rather strict on this "connection issue" and have not adhered to the doctrine of absolute autonomy, which would provide that any law, with or without connection to the contract, would be accepted.[5] In some legal systems, e.g. the American, the choice of law is not valid unless there is a connection between the contract and the law chosen.[6] The following statement clarifies this point: "The jurisdiction whose law is adopted by the express intent of the parties must be one which has a real connection with one or more of the various elements of the contract and parties may not arbitrarily select the law of some jurisdiction which has no relation to the matter in controversy."[7] The tendency to disregard an express choice in American law seems rather strong, which might be somewhat controversial in the sense that it overrules the parties' intentions and freedom to enter into agreement.

The E.C. Convention on the Law Applicable to Contractual Obligations, on the other hand, allows an unlimited choice of law without any requirements

[4] Ibid. at 105.
[5] Mann, "The proper Law in Conflict of Laws" (1987) 36 I.C.L.Q:437 at pp. 445-447; see also Sornarajah, "*International Commercial Arbitration*", Singapore, Longman Singapore publishers, 1990.
[6] Sornarajah, "*International Commercial Arbitration*", Singapore, Longman Singapore publishers, 1990 at 106.

of connection.[8] Although there is a provision which states that in the event of a failure by the parties to make an express choice of law, "the contract shall be governed by the law of the country with which it is most closely connected."[9] The Convention also provides an explanation of what should determine "most closely connected": "…the country where the party who is to effect the performance which is characteristic of the contract has, at the time of conclusion of the contact, his habitual residence, or in the case of a body corporate or unincorporated, its central administration."[10] Some authors have suggested that the party autonomy is not absolute, since the judge may find that the choice of law is unreasonable and therefore declare the contractual choice to be void.[11] There may for instance exist mandatory rules of the law with which the contract is closely connected and these may apply in certain circumstances although their choice of law is of another character.

#### 2.1.1.1 Mandatory provisions

International mandatory provisions of law, which in one way or another applies to a contract between parties, may not be escaped from simply by choosing some other law to govern the contract.[12] This would defeat the purpose of the legislature by having parties control the legislation and simply choose a more suitable legal system. This is clearly expressed in Article 7 of the E.C Convention on the Law Applicable to Contractual Obligations which states that: "When applying under this Convention the law of a country, effect may be given to the 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

[7] *William Whitman and Co. V. Universal Oil Products Co.* (1954) 125 F Supp. 137 p. 147.
[8] Sornarajah, "*International Commercial Arbitration*", Singapore, Longman Singapore publishers, at 106.
[9] The E.C. Convention on the Law Applicable to Contractual Obligations, 1980, Article 4(1).
[10] Ibid at Article 4(2).
[11] Lasok, "*Conflict of Laws in the European Community*", Abingdon, Oxon, Professional Books, 1987 at 358.

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."[13]

A court will never give effect to any foreign law that is in conflict with the public policy of the forum, which may include moral and legal principles such as fraudulent choices of law.[14] The outer limits for public policy are not set out, but they do include behaviour of the kind mentioned above.

The principle of party autonomy has its origins in the "Laissez-faire economies", where the parties had a wide discretion of regulating their contracts.[15] Legislatures around the world have striven to protect parties with weaker bargaining power, Although the party autonomy has been recognised as an important feature in contract law.[16] These two interests clearly contradict each other and create a dilemma where the interest of freedom of trade and the protection of those whose bargaining power is weak cannot be protected at the same time. Courts have taken different stands on this issue, which is quite understandable when one considers in which context the different decisions are made. Some good examples of this can be found in the decisions of the U.S. Supreme Court, where a liberal view was taken in the case *Bremen v. Zapata Offshore Corporation.*[17] The court held that choice of jurisdiction and choice of law clauses should be upheld and that the court should respect the party autonomy in these cases. It is, according to the court in this decision, important not to interfere with the interests of international trade. This liberal view was subject to the

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[12] Sornarajah, "*International Commercial Arbitration*", Singapore, Longman Singapore publishers, 1990 at 107.
[13] Article 7 of the Convention on the Law Applicable to Contractual obligations.
[14] Sornarajah, "*International Commercial Arbitration*", Singapore, Longman Singapore publishers, 1990 at 108.
[15] Sornarajah, "*International Commercial Arbitration*", Singapore, Longman Singapore publishers, 1990 at 104; See also Atiyah, *"The Rise and Fall of the Freedom of Contract"*, Oxford, Clarendon Press, 1979.
[16] Ibid.
[17] *Bremen v. Zapata Offshore Corporation* 407 U.S. 1 (1972).

exceptions that the choice of law or jurisdiction was made without unjustified influence or misuse of bargaining power.[18]

This case was also discussed in the "Scherk case" (*Scherk v. Alberto- Culver & Co.*[19]) where it was observed by the dissenting judges that there is a jeopardy in applying an attitude, which is too liberal even in cases of international contracts. The argument being that there may be unsophisticated American citizens who are exposed to fraudulent behaviour, when dealing with foreign companies. This situation would call for a more restrictive attitude where party autonomy must be set aside.[20]

In the case *Mitsubishi Motors Corporation v. Soler Chrysler Plymouth Inc.*,[21] the liberal attitude to choice of law and jurisdiction clauses was confirmed and it was of importance to point out the fact that international contracts differ from domestic contracts when considering the effect of mentioned clauses. The main arguments why international contracts should be viewed differently consisted of the respect for the capacities of foreign and transnational tribunals as well as the need for predictability in the international commercial system and its resolution of disputes. The court also made clear that it would probably come to a contrary result in the event that the contract was of a domestic character.[22] The dissenting views in the "Scherk decision" had an influence on the discussions in this case and the court finally stated that the forum selection clause would be set aside in the event that the agreement was "affected by fraud, undue influence or overweening [sic] bargaining power."[23]

[18] Sornarajah, "*International Commercial Arbitration*", Singapore, Longman Singapore publishers, 1990 at 109.
[19] *Scherk v. Alberto- Culver & Co* 417 U.S 506 (1974).
[20] Sornarajah, "*International Commercial Arbitration*", Singapore, Longman Singapore publishers, 1990 at 110.
[21] *Mitsubishi Motors Corporation v. Soler Chrysler Plymouth Inc.*, 473 U.S. 614 (1985).
[22] Sornarajah, "*International Commercial Arbitration*", Singapore, Longman Singapore publishers, at 109.
[23] Ibid. at110.

#### 2.1.1.2 Alterations to the proper law

Another situation where party autonomy may be set aside is when there is an unforeseen change to the proper law and the parties would not have chosen that particular law if they were aware of this fact.[24] A stabilisation clause incorporating the proper law into the contract at the time of the agreement would be one possible method of solving such a problem, although this solution might be rather controversial when keeping in mind that it may pre-empt the role of the legislature. A change of the proper law, in this situation, must be based on the original intentions of the parties and the fact that they had no knowledge of the coming alterations to the proper law. Party autonomy does not seem to extend to the limit of assuring that the contract is subject only to the law, as it existed at the time of covenant. The modification to the proper law has to result in a critical change of the parties' relationship under the contract and constitute a significant alteration that is unexpected, for this circumstance to apply.[25]

### 2.1.2 State party choice of law

The choice of law issue is somewhat different when a state or a state entity is party to an international contract.[26] In the event that the place of performance is identical to the origin of the party represented by the state, then the proper law of the contract is often considered to be the one of that state, due to the strong connection to that system of law.[27] The situation will however be different in a case where the contract does not have any particular connections to the state party's domestic law, such as performance or otherwise. What law should then act as the proper law of the contract? The contract will in this situation most likely have its closest connection to another state's legal system and the proper law should therefore, on objective grounds, be the law of that other state. The proper

[24] Ibid. at 111.
[25] Ibid.
[26] Chukwumerije, "*Choice of Law in International Commercial Arbitration.*" London, Quorom Books, 1994, at 41.

law of the contract is consequently not necessarily the one of the state party. Although the presumption that the proper law will be the one of the state, in the event that the performance is carried out on the territory of the state party, is very strong. This is not merely true because of general principles of conflict of laws, but also because of issues regarding the sovereignty of the state. To apply another state's law, when the state itself is party to the contract, is an insult to that state's sovereignty.[28]

The situation described above is true under the circumstances when there is no expressed or implied choice of law. These problems become even more interesting when the contract contains an expressed or implied choice of law, which is not the one of the state from which the state entity originates. Whether or not it is possible to choose a different system to be applied on such a contract, other than that of the state, is a very interesting question. This issue becomes even more evident when one considers that these state entities are most commonly regulated by state legislation, which should create a significant predicament in the light of party autonomy.[29] The provisions regulating trade conducted by public companies are, in addition, mandatory in most cases. These additional aspects that come into consideration when dealing with states and state entities are rather complex and no easy or certain answers are to be found in all cases. Party autonomy and state sovereignty in state contracts are extraordinarily sensitive issues, which may be tackled in a different manner when it comes to finding solutions through the use of international commercial arbitration.

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[27] Ibid.
[28] Redfern and Hunter, "*Law and Practice of International Commercial Arbitration"*. 2nd ed. London, Sweet and Maxwell, 1991, at 46.
[29] Sornarajah, "*International Commercial Arbitration*", Singapore, Longman Singapore publishers, 1990 at 113.

## 2.2 Choice of law governing substantive issues in arbitration

Party autonomy in the context of arbitration, which deals with international commercial disputes, can in a sense be regarded as absolute since the parties' choice is respected in all cases.[30] No rules concerning conflict of laws are applied when the parties have agreed on the law applicable if it is expressed or implied in the contract. The divergence in opinion regarding party autonomy between the courts and the arbitration tribunals is rather disturbing and may cause problems at the time of enforcement of the award. This issue will be discussed further under the section that deals with enforcement, but it is vital to mention the problems and the manner in which they are connected to each other at this early stage of the thesis.

Arbitral tribunals do generally not pay any attention to the mandatory rules of the Host State's legislation and do not observe the interests that it seeks to protect.[31] This may not cause a problem when parties to a dispute are private entities, but in a case where one party acts for a state, the difficulties may be several. Despite the fact that these problems might occur in arbitration proceedings, there has been no sign of changing the principle of party autonomy and all contracts have been treated the same public or private contracts alike. The strong standing of the principle of party autonomy can be observed in a study, which indicates that a general acceptance exists and that there is a "common private international law" where this principle is recognised.[32] In the event that the parties have submitted their dispute to a national arbitration institution, then the conflict rules of that institution will act as a guide for the arbitrator when deciding on the proper law.

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[30] Lew, *"Applicable law in international commercial arbitration: a study in commercial arbitration awards."*, New York, Oceana Publications, 1978 at 86.
[31] Chukwumerije, "*Choice of Law in International Commercial Arbitration."* London, Quorom Books, 1994, at 109; See also for different view: Sornarajah, *"International Commercial Arbitration"*, Singapore, Longman Publishers, 1990, at 114.
[32] Lew, *"Applicable law in international commercial arbitration: a study in commercial arbitration awards."*, New York, Oceana Publications, 1978.

Parties to some contracts do not expressly make a choice of law, which in some cases may cause unpredictable difficulties. The doctrine of implied choice has been developed because of this fact and it has been used in many cases over the years.[33] The choice of law can be implied by interpreting the contractual agreement between the parties and analyse parts of the document that could give hints, which lead to the conclusion that a certain law should be used. The arbitrator must in this situation attempt to figure out what legal system the parties would have chosen if they would have had a choice of law clause in their contract. The clause most frequently examined, when trying to determine if there is an implied choice of law in the contract, is the clause that deals with the "situs" of the arbitration - the place where the arbitration is held. This was for instance the case in *Tzortzis v. Monark Line AB*[34], where the substantial issues of the dispute and the contract had its closest connection to Sweden. The parties had chosen England as the place of arbitration and the English Court of Appeal interpreted this choice as an implied choice of English law to be the governing law of the contract.[35]

Other factors that could play a role in the decision of what geographical area should be determined to have the closest connection to the contract are: The place where the contract was made, the place of residence of a party, the place where the contract was breached, where the object of the contract is located, the place of the parties' business, the place of the contractual performance, the language used in the contract etc.[36] All these different aspects of a contract can be said to have an impact on whether there is an implied choice of law in the contract or not. It is in other word dependent on the arbitrator's subjective discretion to determine whether such a choice should be said to exist and what the reason for that may be. The only certain point to make regarding the decision of implied choice is that the arbitrator

[33] Chukwumerije, "*Choice of Law in International Commercial Arbitration.*" London, Quorom Books, 1994, at 122-124.
[34] *Tzortzis v. Monark Line AB* [1968] 1 W.L.R. 406.
[35] Chukwumerije, "*Choice of Law in International Commercial Arbitration.*" London, Quorom Books, 1994, at 123.
[36] Ibid. at 122-124.

has to adhere to the factors that relate to the closest connection of the contract.[37]

When making the choice of forum clause to also include a choice of law, as in the *Tzortzis v. Monark* case, there are a few factors that need to be examined. The parties' choice of forum does not have to have anything to do with what law they would like to have applied on the substantive issues of the dispute. The location may be picked simply for practical or other reasons and does therefore have nothing to do with the contract itself. London, as a centre of international business, is for example a choice of forum where many larger corporations may choose to have their arbitrations, even if they do not have any other connections to London.[38] It would then be absurd to presume that English law should apply to this contract. The choice of forum may in some instances even take place at several different locations, which would provide a situation that is totally senseless when using this principle.[39]

The principle of implied choice of law is very questionable and should be used in a very restrictive manner, thus only in cases where standard procedure for those sorts of disputes usually are governed by a certain law. One commentator argues that this doctrine can be used in events when standard contracts are utilised and the parties are aware that it is customary to apply a certain law when using those specific standard contracts.[40]

## 2.3 Lex mercatoria[41]

The normal routine when determining the law that is applicable to the substantive issues of a dispute is to select a national system of rules and

[37] Ibid.
[38] Ibid.
[39] Ibid.
[40] Ibid. at 124.

utilise its provisions regarding private international law. The national law is, according to some commentators, not keeping pace with the developments in international trade and is therefore less suitable to apply to such disputes.[42] The more appropriate would then be a system that is not connected to a national law, but is simply developed in the same fashion as it was during the Roman empire and for traders during the middle ages. At this stage in history, the international merchants who engaged in international trade developed customs to regulate their trade. These customs were not written down or made into statutes, instead they were passed down orally and were presumed to have a binding character. The incorporation into statutes of these customs took place in the 16th century and was then made into national laws in civil- as well as common law systems.[43]

The version of the modern lex mercatoria that some suggest is the only correct law to apply on international commercial relations, has been given diverse denominations such as international trade law, transnational law, and international law of contracts.[44] The supporters of this new form of lex mercatoria proclaim that it differs from the old version in that it is not incorporated into national laws. Instead, it has evolved through international commercial relations and can now be said to consist of general principles and customary rules without any reference to national law.[45] The modern form of lex mercatoria is often used in state contracts because of the reasons that a government does not want to abide by the law of a foreign jurisdiction and a private entity does not wish to submit to the state party's system of law. Hence, the private enterprise needs to guard against the possibility that the government alters provisions in the event that a dispute arises or in a

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[41] See generally: Redfern and Hunter, *"Law and Practice of International Commercial Arbitration"*. 2nd ed. London, Sweet and Maxwell, 1991, at 117-121.
[42] See Lando, "The lex mercatoria and international commercial arbitration.", (1985) 34 I.C.L.Q 747; also in Chukwumerije, "*Choice of Law in International Commercial Arbitration."* London, Quorom Books, 1994 at 110.
[43] Ibid.
[44] Redfern and Hunter, "*Law and Practice of International Commercial Arbitration"*. 2nd ed. London, Sweet and Maxwell, 1991, at 117.
[45] Goldman, "*The Applicable Law: General Principles of Law – The Lex Mercatoria"* in Lew, "*Contemporary Problems of International Arbitration"*, USA, Kluwer Academic Publishers 1987 at 114.

manner that otherwise will act as a disadvantage to the private enterprise.[46] The parties will experience some advantages, by escaping from the provisions of national systems. The rules that could be perceived as unfit for international trade, such as formalities, limitations etc. are avoided. These domestic rules could be unknown for other international traders and the parties are eluding the possibility of unwanted surprises hidden in the unfamiliar domestic laws and regulations.[47]

The general principles of law that lex mercatoria inheres are supposedly principles that are common for most states and thus form a universal practice, which is widely accepted by actors on the international trade arena.[48] This system seems to be the optimal solution, since it provides the most vital features that an international trade law should comprise. The problem with the system becomes obvious when one attempts to find the principles that are common to all existing legal systems such as the common law system, the civil law system and customary law.[49] These principles are most probably rather hard to find and would probably not be enough to sufficiently create a legal system that is adequate to resolve disputes and regulate issues regarding international trade in great detail.[50] There are some principles that could arguably be sorted out as common among most legal systems such as pacta sunt servanda, good faith and estoppel. Even though these principles at first may seem to be a common denominator there are often, in the domestic provisions, subordinate limitations or conditions attached to them, which differentiates the various systems. This gives us a situation were there are no general principles that can be said to be common among all legal systems of the world.

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[46] Huleatt-James and Gould, *"International Commercial Arbitration – A Handbook"*, London, LLP Ltd., 1996, at 17.
[47] Redfern and Hunter, "*Law and Practice of International Commercial Arbitration*". 2nd ed. London, Sweet and Maxwell, 1991, 117.
[48] Lando, *"The law Applicable to the Merits of the Dispute"* ,in *"Essays on International Commercial Arbitration"*, ed. Sarcevi´c, London, Graham & Trotman, 1989 at 143.
[49] Sornarajah, "*International Commercial Arbitration*", Singapore, Longman Singapore publishers, 1990 at 116.
[50] Huleatt-James and Gould, *"International Commercial Arbitration – A Handbook"*, London, LLP Ltd., 1996, at 17.

Even though these common legal principles are difficult to find there have been attempts to harmonise the legislation of international trade. Jurists from around the world have gathered in forums such as the United Nations Commission on International Trade Law (UNCITRAL)[51] and the Unification of International Private Law (UNIDROIT),[52] where attempts have been made to create model laws on different aspects of international trade law.[53] These laws are often the result of extensive compromises and negotiations between representatives from different countries and the aim is to have as many countries as possible to sign the final product.[54] The amount of parties that adopt such a law determines its future authority. These laws can be said to constitute the new lex mercatoria even though they hardly represent common general principles of all different legal systems.

Another source of the modern lex mercatoria is said to be standard form contracts.[55] They are supposedly forming international trade law in a dynamic process, where customs in international trade are reflected in these agreements. International organisations like the International Chamber of Commerce (ICC) develop some of these contracts which deal with risk allocation and serve as a starting point for negotiations between trading partners. Among the more well known contracts developed by the ICC are the ICC "Incoterms" and the "Uniform Customs and Practice for Documentary Credits".[56]

[51] http://www.uncitral.org/en-index.htm.
[52] http://www.unidroit.org/default.htm.
[53] Chukwumerije, "*Choice of Law in International Commercial Arbitration.*" London, Quorom Books, 1994, at 113.
[54] Lando, *"The law Applicable to the Merits of the Dispute"* ,in *"Essays on International Commercial Arbitration"*, ed. Sarcevi´c, London, Graham & Trotman, 1989 at 146.
[55] Ibid.
[56] http://www.iccwbo.org/.

### 2.3.1 Efficiency in the lex mercatoria model

After the process of identifying the principles of the new lex mercatoria, the next step is to analyse their effectiveness. These principles, pacta sunt servanda, good faith and estoppel, are all expressed in very general language. They lack a detailed description that could be useful when applied to complicated contractual relations in international trade. An example, which is provided by a commentator, explains the problem even further:[57] Assume that performance and renegotiations of contracts in good faith are part of the new lex mercatoria. What are the exact definitions of these terms? When should renegotiation take place and what constitutes renegotiation in good faith? The definition of these principles and the answers to these questions may be as many as there are parties to a dispute and they offer no guidance when searching for definite principles to govern international trade relationships.[58]

It is hard to see this system of law as the only system to govern international trade transactions even though developed customs; usages and new conventions are frequently formulated. There is no doubt that a harmonised international trade law would make life easier for all actors in this field, although it is important to note that the goal of total harmonisation is extremely hard to achieve. It is important to take into consideration the many different legal systems that shall be comprised into one harmonised compilation of rules. Some commentators claim that the goal never has been to create a complete law merchant, but that it should merely consist of a system that could offer guidelines.[59] International law should in the event of a dispute, where it is insufficient, receive assistance from a national legal system. The international trade law is not complete and shall only serve as a

[57] Chukwumerije, *"Choice of Law in International Commercial Arbitration."* London, Quorom Books, 1994, at 114.
[58] Ibid.
[59] Berman, *"The 'New' Law Merchant and the 'Old': Sources, Content, and Legitimacy"* in ed. Carbonneau, *"Lex Mercatoria and Arbitration"*, New York, Transnational Juris Publications 1990, at 32.

base, from which national law shall fill in the blanks when the original answers are incomplete or unsatisfactory. Another commentator is of the same vision and proclaims that lex mercatoria is a diffuse and fragmented body of law which will grow, but shall never replace the more detailed and organised domestic systems.[60]

### 2.3.2 Lex mercatoria and national law

In the event that lex mercatoria cannot operate alone, thus need a national law as a supplement, what other law should then act as the supplement? The whole point of developing a lex mercatoria is to solve the problem of the application of inappropriate systems of national law to international issues. Having to use both systems gives us a situation where no system is perfect and they start to collide with each other, creating new problems in relation to conflict rules that shall determine the proper law of the contract.

The supplementing law still has to be chosen, provided the lex mercatoria is insufficient in solving the matter. Should the law of the arbitral situs act as the supplementing law or what other method should be used to find the most suitable supplementary law? One suggestion among the authors is to make a comparative study of national laws to find common denominators that could be applied to the contract.[61] Suppose the arbitrator fails in this study. It then becomes his subjective choice of law when trying to find a better solution in the circumstance. The author claims that the arbitrator will then take on the role of a social engineer rather than a judge who should apply provided rules to a dispute.[62]

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[60] Lando, "The Lex Mercatoria and International Commercial Arbitration", 1985, 34 I.C.L.Q., at 752 in Chukwumerije, "*Choice of Law in International Commercial Arbitration.*" London, Quorom Books, 1994, at 115.
[61] Ibid.
[62] Ibid. See also General are principles is a license to use creativity. Lando, "*The law applicable to the merits of the dispute*", in "*The Applicable Law: General Principles of Law – The Lex Mercatoria*" in Lew, "*Contemporary Problems of International Arbitration*", USA, Kluwer Academic Publishers 1987 at 110.

I strongly agree with the opinion that the parties, who choose international trade law to govern their relation, hardly will be aware of the fact that the arbitrators in most cases apply their own criterions of justice.[63] This would, according to some authors, make the outcome of arbitrations somewhat unpredictable, due to the undefined and undefinable nature of lex mercatoria.[64]

Conflict of laws is another problem that overshadows these procedures providing lex mercatoria has been chosen to act as the governing law.[65] The different norms and various sources of law existing in this context do not have a said order in which they should be ranked against each other. This highlights the problem of uncertainty of what takes precedent over which rule. It is once again left to the arbitrator's discretion to decide what principles should be utilised in solving this predicament. The point emphasised on is the fact that the arbitrator is left with overwhelming freedom when determining different aspects that will have a large impact on the final outcome when settling the dispute. The uncertainty involved when choosing lex mercatoria as the governing law of the contract may not be discovered at first glance, but the hidden difficulties will surface at a time when it might be too late. Predictability has always been an important factor for parties when negotiating any sort of contract. Choosing lex mercatoria is not a manner in which a party will insure such predictability; this choice would rather contemplate a declaration by the parties that the determination of the dispute is entirely in the hands of the arbitrator.

Even though the area of international trade law has seen considerable changes since 1995 as the World Trade Organisation (WTO)[66] was created, there still is a long way to go until international trade law can act as the only law without any supplementary aid from national legal systems to solve

[63] Chukwumerije, "*Choice of Law in International Commercial Arbitration."* London, Quorom Books, 1994, at 115.
[64] Mann, introduction in *"Lex mercatoria and arbitration"*, ed. Carbonneau, New York, Transnational Juris Publications, 1990, at xxi.
[65] See discussion in Chukwumerije, "*Choice of Law in International Commercial Arbitration."* London, Quorom Books, 1994, at 115.

these disputes. Lex mercatoria has the characteristics of a guiding customary law, which is a support in interpreting international contractual obligations. The weakness in these international conventions is usually that they do not regulate trade in detail, thus merely provide general principles that all parties can agree on. The consensus rule in the GATT/WTO, with its about 130 members, does not improve this situation and does not give much hope that trade will be regulated in detail in the future. The model law provides that arbitral tribunals shall decide in accordance with the terms of the contract and shall take into account usages of the trade applicable to the transaction.[67] Lex mercatoria, might in this respect, be viewed as a making of usages and customs of international trade and its principles shall therefore be used. Furthermore, it may be applied to avoid national provisions that are conflicting with the views and expectations of the parties.

The arbitrator will, without the consent of the parties, take on a role as an *amiable compositeur*,[68] if the governing law of a contract is solely lex mercatoria. State contracts are in this regard exposed to a very intricate dilemma, since international trade law is in their case an escape from worse alternatives. The worse alternatives consist of having the Host State's law governing the contract or having the state party sign a contract that is subject to the laws and provisions of another state. Both these alternatives are unfavourable to the parties of a state contract, for the reasons elaborated on above. The lex mercatoria would at first instance seem to be the perfect solution to this problematic predicament, but has, as noted, some uncertainties surrounding the solution and a party should therefore think twice about including this choice of law into an international commercial contract.

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[66] http://www.wto.org.
[67] UNCITRAL Model Law on International Commercial Arbitration, June 21 985, Article 28 (4).
[68] For clarification of this role see Redfern and Hunter, *"Law and Practice of International Commercial Arbitration"*. 2nd ed. London, Sweet and Maxwell, 1991, at 35-38.

## 2.4 International principles of law

Principles of law can be found in national law and attempts have been made to find international principles of law that are generally accepted in all legal systems. These principles are claimed to be applicable to disputes arising from state contracts and should in this event be widely accepted. It is generally recognised that a state, which has objected consistently to a rule or a principle that has derived from a custom, is not bound by it and should therefore not be included in the definition of being generally accepted.[69] Some of these principles should be mentioned and scrutinised to discover whether it can be established that they are internationally recognised principles.

### 2.4.1 Acquired rights

This principle protects property rights and is presumed to be applicable in a case where a foreign party enters into a state. Rights to property according to this principle are universally recognised and therefore sacred. The principle has been mentioned in several arbitral awards and is also commonly accepted and dealt with by academic writers.[70] It is important to be aware of the fact that lex situs governs property rights and the proper law governs contractual rights and obligations.[71] Another principle that is well recognised and contradicts the principle of acquired rights, is the right of a state to expropriate or nationalise property when public interests require such action.[72] The arguments behind the principle of acquired rights are mostly used in international investment contracts by foreign investors. The right of aliens to own property or work in a foreign country is nothing that is protected to a high degree by the Host State. This is something that should

[69] Akehurst, *"Modern Introduction to International Law"*, 7th ed. New York, Routledge, 1997, at 48-50.
[70] See *Aramco Arbitration* 1963 27 I.L.R. at 205, see also Sornarajah, *"International Commercial Arbitration"*, Singapore, Longman Publishers, 1990, at 142.
[71] Sornarajah, "*International Commercial Arbitration*", Singapore, Longman Singapore publishers, 1990 at 142.
[72] Ibid.

be noticed in this regard and compared to the argument behind acquired rights of property in foreign investment contracts. This perspective makes the principles of acquired rights seem rather diminished. The argument that citizens of the Host State are treated differently in this regard is purely irrelevant.[73]

### 2.4.2 Pacta sunt servanda

Another very well known principle is pacta sunt servanda, which is applicable between sovereign states in international treaties and likewise in state contracts. When scrutinising this principle, it could be argued that it in the case of state contracts violates state sovereignty.[74] The reasoning behind this is simply that the state cannot be controlled by agreements with private parties as in concession agreements. Can pacta sunt servanda be said to be part of international law? Well, it has a history in European systems and has for a long time been recognised to bring stability into contractual relations.[75] However, this custom has not been noticed in all legal systems of the world, which the socialist systems with planned economies are a good example of. The individual freedom to enter into contractual relations was in certain circumstances unacceptable, since it minimised the governmental control.[76] This principle that some claim is part of international law does not have any tradition in the socialist states, which are represented by quite a few countries. Pacta sunt servanda may have a very strong standing in some domestic systems, but might not have the same applicability in the specific situation where a private entity and a sovereign state are parties to a contract. After bringing out these arguments, regarding pacta sunt servanda, there are some doubts as to whether it should be recognised as an international principle or not.

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[73] Ibid.
[74] Pearce "The Internationalisation of Sovereign Loan Agreements" (1986) 3 J.I.B.I. 165 at 171.
[75] Tamm, *"Romersk rätt och europeisk rättsutveckling"*, Stockholm, Nerenius & Santerus förlag, 1996 at 112 -.
[76] Pfeffer, "*Understanding business contracts in China*", Harvard University, Harvard University Press, 1973 at 65.

To use general principles of international law and rely on them in state contracts may, as argued above, be a very unreliable source of law. One should be very careful when claiming that a principle has universal status and is generally accepted.[77] This concerns arbitral tribunals in a major fashion when they engage in such expressions and make assumptions that in some cases are simply not correct. Most of these principles are brought forward by investors representing the private party in the process and are supposedly very appropriate in a legal process, where most principles are claimed to be universally accepted, provided that they favour the investor.[78]

## 2.5 Public international law

The division between the two systems of municipal law and public international law was first recognised in the well-known *Serbian loans case*[79], where the Permanent Court of International Justice narrowed the choice of law down to these two categories. The concepts have changed since that decision and the choices of law can now involve transnational law, which is a third alternative that includes both systems: International and national.[80] A private party does usually not have any status in public international law and is consequently forced to rely on its government to take action in the event that a dispute arises with a foreign state. The governments have proven to be unwilling to bring claims against foreign states in cases where the private party, for instance, is a lender that wants repayment from a foreign state.[81] There has been support in the literature in

[77] Huleatt-James and Gould, *"International Commercial Arbitration – A Handbook"*, London, LLP Ltd., 1996, at 17.
[78] Sornarajah, "*International Commercial Arbitration*", Singapore, Longman Singapore publishers, 1990 at 141.
[79] *The Serbian Loans Case* [1929]P.C.I.J. series A, No. 20, p. 41 See more detail in Sornarajah, "*International Commercial Arbitration*", Singapore, Longman Singapore publishers 1990.
[80] Redfern and Hunter, "*Law and Practice of International Commercial Arbitration*". 2nd ed. London, Sweet and Maxwell, 1991, at 106.
[81] Riesenfeld, "The Powers of the Executive to Govern the Rights of Creditors in the Event of Defaults of Foreign Governments", 1982, University of Illinois LR 322; See also article by Pearce, "The Internationalisation of Sovereign Loan Agreements" (1986) 3 J.I.B.I. 165.

favour of the fact that public international law could apply in occurrences, where the bank is an international organisation (e.g. the World Bank[82]) and the borrower is a private entity, which has state guarantees.[83] Public international law is simply unsuitable for private parties since it is not developed with these taken into account, except for situations as the one described above. Public international law is created to deal with states and their legal systems rather than private corporations that engage in international trade. However, the current manner in which international loan agreements are formulated, even in circumstances where two private parties are contracting, is to include international public law to govern the contract.[84]

### 2.5.1 International principles developed by organisations

Applying national law to state contracts seem to be the prevailing view and to overcome the shortcomings of a domestic system of law, e.g. that it sometimes is not appropriate for international transactions, an attempt has been made to apply international principles developed by international organisations. One such organisation is the International Centre for the Settlement of Investment Disputes (ICSID). Article 42(1) of the Convention states that: "The Tribunal shall decide a dispute in accordance with such rules of law as may be agreed by the parties. In the absence of such an agreement, the Tribunal shall apply the law of the Contracting State party to the dispute (including its rules on conflict of laws) and such rules of international law as may be applicable."[85] The last part of this Article provides a wide generalisation regarding international law and its applicability to investment disputes. All states that have ratified this

[82] The International Bank of Reconstruction and Development.
[83] Redfern and Hunter, "*Law and Practice of International Commercial Arbitration*". 2nd ed. London, Sweet and Maxwell, 1991, at 107.
[84] Ibid.
[85] Washington Convention on the Settlement of Investment Disputes between States and Nationals of other States, Washington March 18 1965.

Convention, here confirm the principle of party autonomy and the fact that international law may be applied.[86]

The Convention on the Settlement of Investment Disputes between States and Nationals of other States (the ICSID Convention)[87] came into existence through the efforts of the International Bank of Reconstruction and Development, which is also known as the World Bank.[88] The purpose behind the Convention was to create a centre where alternative dispute resolution between states and foreign entities would be available. This Convention is the only Convention that deals with disputes between private parties and sovereign states and it came into force on October 14, 1966. The Convention includes provisions regarding enforcement of awards and agreements as well as rules, which regulate the arbitration proceedings. The Convention also established an institution, which provides means for conciliation and arbitration between states and private parties in investment disputes.[89]

Signatories to the Convention have given ICSID jurisdictional authority to settle the disputes that parties have referred to the centre.[90] State signatories to the Convention have a possibility under Article 25(4) of the Convention, to declare some categories of disputes to fall outside the scope of the Convention and consequently outside the jurisdiction of the dispute resolution centre. Saudi Arabia, for instance, has declared that it will not allow any arbitration of matters under the auspices of ICSID that relates to oil.[91]

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[86] Peter, *"Arbitration and Renegotiation of International Investment Agreements"*, Dordrecht, Martinus Nijhoff, 1986, at 99.
[87] http://www.icsid.com, For general information, see Redfern and Hunter, *"Law and Practice of International Commercial Arbitration"*. 2nd ed. London, Sweet and Maxwell, 1991, at 47.
[88] http://www.worldbank.org/.
[89] Redfern and Hunter, *"Law and Practice of International Commercial Arbitration"*. 2nd ed. London, Sweet and Maxwell, 1991, at 46-49.
[90] Delaume, *"ICSID Arbitration"* in *"The Applicable Law: General Principles of Law – The Lex Mercatoria"* in Lew, *"Contemporary Problems of International Arbitration"*, USA, Kluwer Academic Publishers 1987 at 25.
[91] Chukwumerije, *"Choice of Law in International Commercial Arbitration."* London, Quorom Books, 1994, at 47.

This view has been adopted in the Pyramids Arbitration[92] (*S.P.P. v. Egypt*), where the governing law of a contract concerning a tourist complex was concluded to be Egyptian law. The State of Egypt was allowed to participate as a party to the arbitration, since the project had been dependent on the approval of the government. The parties had not exercised their right to make an express choice of law and the contract had most connection with Egyptian law. However, the International Chamber of Commerce (ICC) arbitral tribunal decided to apply principles of international law, since they according to the arbitrators were part of Egyptian domestic law. The tribunal referred to Article 42(1) of the Convention and held that Egyptian law can only be relied on as far as it does not collide with international principles of law.[93] After settling the fact that international principles of law should be applicable in this case, the tribunal stated that the two principles of "*pacta sunt servanda"* and *"just compensation for expropriatory measures"* were part of Egyptian law.

The ad hoc tribunal that decided the dispute in the "Aminoil case"[94] used a choice of law technique that was similar to the one used in the Pyramid case. The law of Kuwait was primarily applied, but it was decided that this law had international law as a part of it and that these two systems had blended rather successfully in the present case.[95] The arbitrators in this case were not faced with conflicts of laws and the manner in which international law was included can only be seen as a comfortable solution that satisfied the final solution of the panel.[96] The interesting aspect that needs to be examined in this context is where the right to incorporate international law into a national system derives from. The ad hoc tribunal in this case has obviously taken the position that it has the power to interpret whether international principles of law are part of a domestic legal system or not.

[92] Pyramids Arbitration, (1983) 22 I.L.M. 752 for discussion see Sornarajah, *"International Commercial Arbitration"*, Singapore, Longman Publishers, 1990.
[93] Ibid. at 768.
[94] *Aminoil v. Kuwait* (1982) 21 I.L.M 976.
[95] Redfern and Hunter, "*Law and Practice of International Commercial Arbitration"*. 2nd ed. London, Sweet and Maxwell, 1991, at 116.

This view gives the arbitrators the role of a legislature, which in my opinion questions the sovereignty of that state.

### 2.5.2 General analysis

The two cases above differ in the sense that the ICC tribunal based its decision on a convention, which is signed by member states. The articles of this convention may be interpreted in different ways by the tribunal, as in the case of Article 42(1). The matter is different in the case of an ad hoc tribunal, which was engaged in the second case. The state party has not recognised the tribunal's existence and the power to determine whether international law is part of their domestic legislation or not, is a matter that should be determined by legislative powers of that state and not by the ad hoc tribunal. Even though there is a contractual relationship between the state party and the tribunal, giving it jurisdiction over the matter, this cannot be sufficient to also include these extraordinary powers that the tribunal indicated in this case. If the view is accepted that the tribunal should possess these powers, then it may also be selective in what international principles should be applied and recognised in different circumstances. A legislative role would then be given to the arbitrator that this writer does not feel is justified, when applying an alternative dispute resolution in settling disputes in relation to state contracts.

It is difficult to see how a compromise between national law and international law would function without creating a system that entails too strong of an influence of the arbitrators' subjective views in the matter. If the parties were to draft a choice of law clause that included a national system of law in combination with international principles of law, then the problem arises what principles of law should be recognised as universally

[96] Ibid.

accepted.[97] The only acceptable method that can be applied in this situation is to incorporate the international principles of law, which the parties agree on, into the contract. These principles in combination with a national system of law will then serve as the law governing the contract.[98] To avoid unforeseen surprises, it is important to make sure that the parties do not only agree on what principles should be applied, but that they also agree on the definition of these principles. To favour predictability even further, the parties ought to clarify the status and hierarchy among the systems incorporated in the contract. Shall the domestic law prevail over the specifically chosen principles or are the international principles of law higher ranked? It will always be difficult to cover all bases when drafting a state contract and there will probably not be total agreement regarding the validity or definitions of the international principles of law. Most important in all this is that the parties are aware of potential problems that may arise and that the mode in which they choose to draft the choice of law clause is influenced by this awareness.

## 2.6 General analysis regarding choice of law

To achieve some predictability in international contractual relations, the parties need to make an express choice of law in the contract that preferably refers the arbitrator to a national system of law. The arbitrator is hereby bound by the choice made by the parties. The parties will most likely experience a situation of uncertainty if they choose not to exercise their right to implement a choice of law clause, since different arbitrators adopt dissimilar methods when determining the proper law of the contract. The arbitrator has in some cases relied on a conflict of law rule without

[97] Applying general principles is a license to use creativity. Lando, *"The law applicable to the merits of the dispute"*, in *"The Applicable Law: General Principles of Law – The Lex Mercatoria"* in *"Contemporary Problems of International Arbitration"*, ed. Lew, USA, Kluwer Academic Publishers 1987 at 110.

disclosing which legal system or principle that has been used to come to a specific conclusion.[99] Furthermore, lawyers with different backgrounds and nationalities practise arbitration. The positive aspect of this is that the arbitrators possess competence in many different areas. However, the negative aspect is the absence of coherence in the published awards. Unless the parties are aware of the background of the arbitrator and also his attitude on different issues that could have an impact on the process, they may be in for a surprise. If the published awards were to be co-ordinated and similar conflict of law rules would be applied in all arbitration procedures, thus become more coherent, then greater predictability would be possible to achieve and the issue of choice of law would be of less importance. When taking into account that the most reasonable system of law to select is a domestic law, the distinction that has to be made between international contracts and domestic contracts becomes to some extent abandoned. The party autonomy will in most cases result in the selection of a law that most probably will be similar to the one that would have been selected by a national court settling the dispute. The invention regarding the principle of party autonomy may seem rather unnecessary in this context, but this discussion really highlights the importance of party autonomy when selecting arbitration as the dispute resolution process. The arbitral tribunal is not bound by any conflict of law rules, as are the national courts, and can therefore choose any method to determine the proper law of the contract from case to case.

As noted in discussions above, state contracts differ from private contracts also when considering the aspects of party autonomy. The law of the state entity or government, which is party to a contract, will most likely be the one applied to their relationship. This may be because of the mandatory provisions which are part of that state's legislation, but also due to the

[98] For information regarding stabilisation clauses see: Redfern and Hunter, *"Law and Practice of International Commercial Arbitration"*. 2nd ed. London, Sweet and Maxwell, 1991, at105-106.
[99] See for examples of awards were this has been the case in Chukwumerije, "*Choice of Law in International Commercial Arbitration."* London, Quorom Books, 1994, at 125.

sovereignty of that state. Party autonomy in state contracts, involving states or state entities, is in this context, much more confined compared to the circumstance where the contractual relation instead is between two private parties.

The old rule of applying municipal law of the Host State to foreign investment contracts seems to enjoy strong support. The most influential factor, making this the main rule, is the stronger bargaining power that a Host State enjoys when negotiating with foreign investors. The bargaining strength of the parties in the resources sector for instance is usually with the Host State, which is able to affect the content of the choice of law clause to a significant extent. This, however, is not always the case. In some circumstances the foreign investor has the same strength as the Host State, due to the fact that the investor has something to offer that is highly desirable. This may for instance include technology development in the host country, which cannot be attained through the use of domestic resources. This may also be the case where a large project needs to be financed and the domestic monetary funds are insufficient. The investor then enjoys a much stronger position in the negotiations because of the strong economy of the corporation. Unless the bargaining power of the investor is equally strong or stronger, the law governing the contract is likely to be the law of the Host State. The bargaining strength of the investor has to be fairly convincing to have the capacity to include a supranational law into the choice of law clause.

The importance of bargaining power is in some cases of less importance. The reason for this may be that there are existing mandatory provisions in the domestic law that exclude applicability of any other law than the one of the host country. Examples where this is the case are some countries in Latin America, Sudan, and Saudi Arabia.[100] In Brazil, for instance, the view

[100] Colombia is another example where it is expressly prohibited from entering into contracts subject to foreign law or jurisdiction unless specific legislative authority is obtained under decree 150 of 1970. See: Pearce, "The Internationalisation of Sovereign Loan Agreements", 1986, 3 J.I.B.1. 165.

is taken that general notions of sovereignty impliedly prohibit submission to foreign law.[101]In some socialist countries, where only joint ventures with domestic companies are allowed, dispute resolution is restricted to domestic courts, which apply domestic law. Party autonomy is clearly restricted in these systems and the chance of applying a supranational system of law is diminutive. Even though some measures can be taken such as insulation clauses, to protect the stability and predictability of the contract, the choice can still be affected by administrative regulations or other measures taken by the Host State. This makes the security of having a choice of law clause in the contract mostly theoretical.

[101] Kahle, "State Loan Transactions: Restrictions on Waivers of Immunity and Submissions to Jurisdiction", 37 The Business Lawyer 1549, 1982, at 1558.

# 3 ARBITRAL JURISDICTION

A national court has to establish its jurisdiction over a dispute before the process may proceed. This very same requirement is true for arbitral tribunals as well and no dispute is arbitrable unless its jurisdiction has been established. The methods used by domestic courts and arbitral tribunals differ when determining this issue and in the case of arbitral tribunals, the requirement that has to be fulfilled to establish jurisdiction is an arbitration clause where the parties agree to submit their dispute to arbitration.[102] It is important to draft these clauses with consistency and certainty to give them a valid status.[103] Some elements that need to be included are; for instance, that the dispute is to be resolved through arbitration as opposed to other alternative dispute resolutions.[104] Furthermore, the parties need to point out the arbitrator and the arbitral tribunal if such institution is to be utilised.[105] Inconsistencies may lead to that the dispute is referred to a national court instead of the original intention of the parties - to apply arbitration.[106] However, most courts in England, for instance, will uphold an arbitration clause even if they find inconsistencies on the ground that the clause represents the parties' general intention.[107] The arbitral tribunal must decide if a certain dispute comes under its jurisdiction, by inspecting the arbitration clause as well as the terms in which the tribunal has been appointed. A national court may then overturn the decision regarding jurisdiction by the arbitral tribunal.[108] The competence to rule on its own jurisdiction or competence is called "Competence/Competence" or in French "Compétence

[102] Pryles, *"International Trade Law – Commentary and materials"*, Sydney, LBC Information Services, 1996, at 673.
[103] Jarvin, *"The sources and limits of the arbitrator's powers"* in *"Contemporary Problems of International Arbitration"*, ed. Lew, USA, Kluwer Academic Publishers 1987 at 51.
[104] Pryles, "Drafting Arbitration Agreements", (1993) 67 ALJ 503.
[105] Redfern and Hunter, *"Law and Practice of International Commercial Arbitration"*. 2nd ed. London, Sweet and Maxwell, 1991, at 278.
[106] Lew, *"Arbitration Agreements: Form and Character"* in *"Essays on International Commercial Arbitration"*, ed. Sarcevi´c, London, Graham & Trotman, 1989, at 51.
[107] Redfern and Hunter, *"Law and Practice of International Commercial Arbitration"*. 2nd ed. London, Sweet and Maxwell, 1991, at 278.
[108] Ibid. at 275.

de la Compétence".[109] This competence is provided in the institutional rules of various arbitral tribunals such as the ICC[110] and the ICSID,[111] they can also be found in the UNCITRAL[112] rules on arbitration. There are, in addition, other requirements that have to be satisfied depending on the sort of dispute that is referred to arbitration and these requirements need to be examined to obtain an understanding of what sort of problems and requirements that may occur when disputes arise in state contracts.

The dispute resolution clause in a contract is said to have a separate existence from the main contract and is therefore valid even though other parts of the contract may be invalid.[113] The arbitration clause is in this regard a contract in itself, which is totally independent of what occurs in regard to the other parts of the contract in which it is included. The main contract may be invalidated for the reasons of force majeure or other instances. However, this event does not have an impact on the validity of the dispute resolution clause if the parties have stated that all their future disputes shall be resolved by means of arbitration. The reasoning behind this becomes evident when reflecting on the situation where one party claims that the main contract is invalid and the other party is of another opinion. It would then be rather absurd to deem the whole contract invalid including the dispute resolution clause, since this shall serve to resolve disputes of this character.

A good example where the situation mentioned above is highlighted is in the *Vsesojuznoje Objedinerije Sojuznefteexport (SNE) v. Joc Oil Case*.[114] A Soviet foreign trade organisation entered into a contract with a company originating from Bermuda (Joc Oil), regarding the sale of oil. Arbitration

[109] Mádl, *"Competence of Arbitral Tribunals in International Commercial Arbitration"*, in *"Essays on International Commercial Arbitration"*, ed. Sarcevi´c, London, Graham & Trotman, 1989, at 92.
[110] ICC Rules Article 8.3.
[111] Washington Convention Article 41(1), (2).
[112] Arbitration Rules Article 21(1), (2).
[113] Pryles, *"International Trade Law – Commentary and materials"*, Sydney, LBC Information Services, 1996, at 673.
[114] *Vsesojuznoje Objedinerije Sojuznefteexport (SNE) v. Joc Oil Ltd.* Bermuda Court of Appeal, XV Yearbook Commercial Arbitration, 1990, at 31.

proceedings were initiated in the Soviet Union and the arbitral tribunal concluded that Joc Oil was obligated to pay two hundred million dollars to NSE. Joc Oil argued that the contract between the parties was non-existent mainly because of formalities that were not fulfilled and the clause to arbitrate as well as the arbitration were therefore invalid. The Court of Appeal of Bermuda came to the conclusion, in the enforcement proceedings that the arbitration agreement is completely separate to the main contract and the tribunal may consequently, award whatever sum they like. The fact that the contract was not valid because of the failure to observe formalities provided by Soviet law did not make the dispute resolution clause "non-existent". The distinction in this case had to be made between a non-existing agreement, e.g. that it was never concluded, and a nullified agreement. The latter is a concluded contract, which may include faults, but the clause to arbitrate is intact and this gives the arbitral tribunal the power to take on the dispute and determine the remaining issues of the main contract. [115]

The agreement to arbitrate does however not live on forever. Article II.3 of the New York Convention[116] deals with the situation when this clause shall be determined to be inapplicable. It provides that: "The court of a Contracting State, when seized of an action in a matter in respect of which the parties have made an agreement within the meaning of this article, shall, at the request of one of the parties, refer the parties to arbitration, unless it finds that the said agreement is null and void, inoperative or incapable of being performed."[117] Reasons for why the arbitration agreement is null and void, incapable or incapable of being performed can be that the parties have revoked the arbitration agreement or they may have failed to comply with a time limit stipulated in the said agreement. It may also refer to a situation where there is an incapability to establish an arbitral tribunal for practical

[115] See Redfern and Hunter, *"Law and Practice of International Commercial Arbitration"*. 2nd ed. London, Sweet and Maxwell, 1991, at 279 for a discussion of the outcome in the case.
[116] New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, June 10, 1958, United Nations Treaty, Series (1959) vol. 330.
[117] New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, June 10, 1958, United Nations Treaty, Series (1959) vol. 330, Art II.3.

reasons.[118] Suppose an award is made by an arbitral tribunal without proper authority and jurisdiction, because of a circumstance such as the absence of an arbitral agreement, then it is possible to have the award declared nullified by a national court. Provisions for this procedure can be found in international conventions as well as in municipal law.[119]

The jurisdiction of an arbitral tribunal may be challenged at several stages of the settlement of the dispute. The challenge is usually directed to the tribunal itself, which then has to make a decision in what manner it should act depending on the type of challenge. Firstly, it may agree that the arbitral tribunal does not have jurisdiction over the matter. Secondly, the tribunal may issue an interim award that may be confronted in domestic courts. Thirdly, it may join the objection of jurisdiction to the merits. These three options are all included in the ICSID Arbitration rules in Article 41:

"(3) Upon the formal raising of an objection relating to the dispute, [and raising the issue of jurisdiction] the proceeding on the merits shall be suspended. The President of the Tribunal, after consultation with its other members, shall fix a time limit within which the parties may file observations on the objections.

(4) The Tribunal shall decide whether or not the further procedures relating to the objection shall be oral. It may deal with the objection as a preliminary question or join it to the merits of the dispute. If the Tribunal overrules the objection or joins it to the merits, it shall once more fix time limits for the further procedures.

(5) If the Tribunal decides that the dispute is not within the jurisdiction of the Centre or not within its own competence, it shall render an award to that effect."[120]

[118] Redfern and Hunter, *"Law and Practice of International Commercial Arbitration"*. 2nd ed. London, Sweet and Maxwell, 1991, at 279-280.
[119] See further discussion regarding French law and the New York Convention in Redfern, "*Law and Practice of International Commercial Arbitration"*, 2nd ed., (1991), at 280.
[120] ICSID Arbitration Rules, 41(3) – (5).

## 3.1 Ad hoc arbitrations

In the event that a tribunal is not created on the grounds of a convention or is set up by a private institution, the tribunal may act as an ad hoc tribunal. There are no provisions regulating the process in this type of arbitration as opposed to the institutions such as ICSID or the ICC. [121]

Ad hoc arbitration may serve its purpose at a time when a dispute is in existence and the parties are aware of the circumstances of their business relationship as well as the characteristics of the dispute.[122] The fact that they have the option to select arbitrators must be regarded as a tremendous advantage in this situation, since the character of the dispute will most likely influence the choice of arbitrator.[123] One commentator has made the comparison between institutional arbitration and ad hoc arbitration to resemble "a tailor-made suit and one, which is bought "off the peg"".[124] The parties must however compose the procedural rules on their own, unless they choose to adopt some well-known model for arbitration rules such as the UNCITRAL Arbitration Rules. There is also a possibility to adopt the rules of an institution such as the ICC, although this may create some difficulties as these rules constantly refer to the institution for which they are "tailor-made".[125]

The risk aspect of ad hoc arbitration is that the parties need to rely upon each other not to try to delay the process by objecting over procedural matters. The tribunal rests on the foundation that is created by the parties and this ground needs to be solid enough to resolve situations like this.[126]

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[121] Sanders, *"Quo Vadis Arbitration – Sixty years of arbitration practice*", Hague, Kluwer Law International, 1999, at 10.
[122] Huleatt-James and Gould, *"International Commercial Arbitration – A Handbook "*, London, LLP Ltd., 1996, at 28.
[123] Ibid.
[124] Redfern and Hunter, *"Law and Practice of International Commercial Arbitration"*. 2nd ed. London, Sweet and Maxwell, 1991, at 56.
[125] Ibid.
[126] Ibid.

The ad hoc tribunal worked effectively, for instance, in the Aminoil arbitration[127] between the Government of Kuwait and the American Independent Oil Company. The flexibility of the process in ad hoc arbitrations was a significant advantage in this arbitration where the parties altered time limits and appointed agents to make crucial decisions, all to suit this particular case and the wishes of the parties. When a state takes part in an arbitration it may become very time consuming, due to the bureaucracy involved when decisions are to be made by the government. This was avoided in this case by using agents that had the authority to make these decisions on a day–to-day basis on behalf of the government.[128]

In some countries the local laws do not permit the state to submit to arbitration settled by a foreign tribunal and Conventions or Treaties cannot solve the jurisdiction issue in cases where the ad hoc tribunal shall serve to settle the dispute.[129] It may also be the case that the local legislation prohibits foreign companies, which have been incorporated in the Host State, to submit to foreign arbitration as well.[130] The arbitration clause does not have any function what so ever in cases where the national law is drafted in such a manner. Another problem arises when the local legislation permits arbitration by foreign tribunals, but it requires a foreign company to be incorporated in the Host State.[131] This is the situation in China where foreign investors have to enter the country by setting up a joint venture with one of the local corporations.[132] This prerequisite inevitably leads to that local arbitral tribunals shall settle disputes within the country. Ad hoc arbitration is practically unknown in China and it is therefore rarely practised, but it is not prohibited.[133] There may exist a bilateral treaty

[127] *Aminoil v. Kuwait* (1982) 21 I.L.M. 976.
[128] Redfern and Hunter, *"Law and Practice of International Commercial Arbitration"*. 2nd ed. London, Sweet and Maxwell, 1991, at 57.
[129] Especially Latin American countries. See Pearce, "The Internationalisation of Sovereign Loan Agreements", 1986, 3 J.I.B.1. 165.
[130] Böckstiegel, *"States in the international arbitral process"*, in *"Contemporary Problems of International Arbitration"*, ed. Lew, USA, Kluwer Academic Publishers 1987 at 48.
[131] Håkansson, *"Commercial Arbitration Under Chinese Law"*, Uppsala, Iustus förlag AB, 1999.
[132] Ibid.
[133] Ibid. at 48.

between the Investors State and the Host State, which provides for arbitration in the event that a dispute originates between the parties. It is then extremely important that this treaty is drafted in a manner that makes it applicable even when the foreign investor is incorporated in the host country. The nationality of a corporation should consequently be determined on the merits of who owns the controlling shares of the company, rather than utilising the theory of determining corporate nationality on where it is incorporated.

## 3.2 ICSID

The main purpose of the International Centre for Settlement of Investment Disputes is to provide an alternative to domestic courts, which often involves time demanding national judicial bureaucracy.[134] It takes the interests of both the foreign investors and the Host States into account and its objective "is to provide facilities for conciliation and arbitration of investment disputes between Contracting States and nationals of other Contracting States in accordance with the provisions of the Convention".[135] A foreign investor will most likely not have faith in the impartiality of the local courts and tribunals of a host country, which makes the ICSID a good alternative.[136] ICSID is also a stronger centre in comparison to other arbitral tribunals, since it is backed by the convention signed by its member states. Its neutrality can for instance be observed in Article 53 of the Convention that provides that the tribunal's award is binding on the parties and not subject to any appeal or any other remedy, except when it is stated in the Convention. Member states have, according to some commentators, bound

[134] Huleatt-James and Gould, *"International Commercial Arbitration – A Handbook "*, London, LLP Ltd., 1996, at 27.
[135] ICSID Convention Article 1.
[136] Giardina, *"The International Center for Settlement of Investment Disputes between States and Nationals of other States (ICSID)"*, in *"Essays on International Commercial Arbitration"*, ed. Sarcevi´c, London, Graham & Trotman, 1989, at 214.

themselves to recognise and enforce awards from ICSID to the same extent as if they were final court judgements from their own national courts.[137]

The three basic jurisdictional conditions that are required to satisfy the requirements of the Washington Convention are Consent, Party Identity and Subject Matter Jurisdiction.[138] The parties have to agree to the submission of the dispute to ICSID arbitration and the second requirement of party identity includes the fact that the dispute must be between a Contracting state and a national of another Contracting state. The character of the dispute has to be legal and arise from an investment to meet the third requirement.[139]

### 3.2.1 Consent

The first requirement regarding consent makes the ICSID tribunal a voluntary institution and this prerequisite includes the parties' agreement to adhere to the rules of the Washington Convention. The tribunal has dealt with the issue of consent in several cases. In the case *Holiday inn et al. v. Morocco,*[140] the government of Morocco challenged the jurisdiction of the ICSID tribunal and claimed that there was a lack of consent on their behalf. The claimant and the tribunal had another opinion and argued that all the assignments that had been carried out were all part of an underlying agreement in which the submission to ICSID arbitration was stipulated.[141] This same view was expressed in the case *Amco Asia et al. v. Indonesia,*[142]

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[137] Bernstein and Wood, *"Handbook of Arbitration Practice"* 436 (1993) in Mwenda, "International Commercial Arbitration and the International Centre for Settlement of Investment Disputes", 30 Zambia law Journal 91 (1998).
[138] Article 25, Washington Convention.
[139] Delaume, *"ICSID arbitration" in "Contemporary Problems in International Arbitration"*, ed. Lew, London, Martinus Nijhoff Publishers, 1987, at 25.
[140] *Holiday inn et al. v. Morocco* (1980) 51 B.Y.I.L. 123 discussion regarding the case in Redfern and Hunter, "*Law and Practice of International Commercial Arbitration"*. 2nd ed. London, Sweet and Maxwell, 1991 and Sornarajah, "*International Commercial Arbitration"* Singapore, Longman Publishers, 1990.
[141] Mwenda, "International Commercial Arbitration and the International Centre for Settlement of Investment Disputes*"*, 30 Zambia law Journal 91 (1998).
[142] *Amco Asia et al. v. Indonesia* ARB /81/1 Case discussed in Mwenda, "International Commercial Arbitration and the International Centre for Settlement of Investment Disputes", 30 Zambia law Journal 91 (1998).

where the clause stipulating submission to arbitration by ICSID was included in a license contract. The government argued in this case that the matter of whether or not a government has consented to arbitration by the ICSID tribunal has to be interpreted restrictively not to intrude on a state's sovereignty. The tribunal answered this claim negatively and held that an arbitration clause shall not be construed in a restrictive manner. Nor shall it be construed liberally or broadly. The method of interpretation used is the one that helps discover the common will of the parties and there is therefore no formal requirement as to how this consent is expressed. [143]

The position that the tribunal has taken in the matter of consent has to be regarded as somewhat liberal, which can be observed in a case like *Société Ouest Africaine des Betons industriels (SOABI) v. Senegal.*[144] In this instance, there was an investment agreement that included submission to ICSID arbitration, but the dispute between the parties was over a different contract without such a clause. The framework agreement or investment agreement that contained the dispute resolution clause, in this case, was sufficient to fulfil the jurisdictional requirement according to the tribunal. Even though the separate agreement did not stipulate submission to ICSID, the clause in the investment agreement was implicitly incorporated into the other agreement.

One requirement that the ICSID tribunal has been formalistic about is that the consent has to be in writing. Even though the obligation is that it has to be in writing, there is no demand that it has to be included in the investment contract.[145] The consent may be general or include only partial aspects of an investment contract, which means that only some areas are arbitrable by an ICSID tribunal in the event of a dispute. The Contracting State must then notify ICSID in regard to which these disputes are, in accordance with Article 25(4).

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[143] Ibid.

[144] *Société Ouest Africaine des Betons industriels (SOABI) v. Senegal* ARB/82/1, discussion in Pryles, *"International Trade Law – Commentary and materials"*, Sydney, LBC Information Services, 1996.

### 3.2.2 Party identity

Article 25(1) provides that the dispute has to be "…between a Contracting State and a national of another Contracting State…" A Contracting State is one that has sent a ratification, acceptance or approval to the World Bank thirty days prior to the submission of the dispute.[146] This indicates that neither the Host State nor the State of the investor has to be a member of the Centre when they agree to submit to ICSID arbitration.

Among the parties, that are allowed to submit their disputes to the Centre, are agencies or subdivisions of Contracting States.[147] According to Article 25(3) of the Convention, any agreement entered into, which includes consent to submit to the Centre, requires the approval of the State of such agency or subdivision, unless the Contracting state has declared that no such approval is necessary. Foreign nationals may be natural or juridical persons as long as the nationality of the party is one of another Contracting State other than the State party.[148] In the event that the party is a natural person, then it must be a national of another Contracting State when the dispute is submitted to arbitration. Another requirement is that the person may not be on either the date of the consent or on the date, on which the request was registered, a national of the Contracting State.[149]

The ICSID Convention provides, as mentioned above, that the jurisdiction of the centre extends to a Host State and a contracting private party of another state. A problem will then arise in the event that the foreign contracting party forms a legal corporation in the Host State. The foreign investor will then lose its protection under the Convention. This problem is dealt with in Article 25(2) b where it is stated that a national of a contracting

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[145] This was established in *Amco Asia et al. v. Indonesia* ARB/81/1.
[146] Washington Convention Articles 68, 70.
[147] Buckley, "Some Jurisdictional Difficulties with Australia's Ratification of the ICSID Convention", (1993) Asia Pacific Law Review.
[148] Washington Convention Article 25(1).
[149] Washington Convention Article 25(2)a.

state shall be regarded as a national of a foreign contracting state, if the parties have agreed that the party shall be treated in that fashion under the Convention.[150] The Convention can therefore be said to use incorporation as the test when determining the nationality of an entity, but it also recognises the agreement between the parties regarding special recognition under the ICSID Convention. The agreement between the state and the corporation is, of course, very vital and the absence of such an agreement invalidates the jurisdiction of the tribunal.

This exact situation arose in the case *Amco v. Indonesia*, [151]where a dispute occurred concerning the amount that should have been invested into the project and the fact that the Indonesian administrative agency refused to prolong the license to an American company. Amco Asia Corporation established a subsidiary that was being treated as a foreign national in Indonesia. The project consisted of building a hotel that was then suppose to be managed by the American Company through a Hong Kong company and an Indonesian company. Indonesia objected in regard to the jurisdiction of the ICSID tribunal and claimed that Article 25(2) b did not apply since an agreement between the parties did not exist, that the incorporated company should be recognised as a foreign national. The arbitration clause providing for arbitration by ICSID was incorporated in the investment application made by the American Company. Indonesia claimed that no agreement had been reached about treating the incorporated foreign national as a foreign national for the purpose of the Convention. The tribunal held that there was nothing in Article 25(2) b that provided a requisite of an express clause where the parties had to decide to treat an entity as a foreign company of another contracting state.

This decision does not harmonise with the literal interpretation of the Article and it does not concord with the view expressed in a previous case, *Holiday*

[150] Washington Convention Article 25(2)b.
[151] *Amco v. Indonesia* (1987) 27 I.L.M. 1439, discussion regarding the case in Sornarajah, *"International Commercial Arbitration"*, Singapore, Longman Publishers, 1990.

*inns v. Morocco*.[152] In this case the tribunal determined this issue utilising the requirement that the consent was clearly expressed. The tribunal found that the requirement in Article 25(2) b was fulfilled by the application to invest where it was clear that the shares of the company were supposed to progressively become Indonesian owned, but that they were owned by a foreign American company. This is rather surprising, even though precedents do not exist in the practice of arbitration, and it does make the predictability suffer when one cannot even be sure of that the correct interpretation of the Convention is being applied.

In the case *Klöckner v. Cameroon*[153] views regarding Article 25(2) b were expressed that continued to diminish the importance of the Article. Three corporations (Belgian, German and Dutch) had created a joint venture with the Cameroon government and a dispute arose between the parties. The foreign corporations submitted the dispute to ICSID arbitration, which was contested by the Cameroon government on the grounds that the joint venture was set up as a national corporation and there was no agreement, as required by the Article. The grounds for the decision of the tribunal in this case differed somewhat from the Amco case even though the outcome was identical. The tribunal came to the conclusion that the incorporation of an ICSID arbitration clause gives a hint that the joint venture should be regarded as a foreign national. This satisfies the requirement of explicit consent of foreign control of the corporation. The tribunal did therefore dismiss the objection from Cameroon and claimed jurisdiction over the dispute. The award was later annulled.[154]

[152] *Holiday inns v. Morocco* (1980) 51 B.I.Y.L. 123, discussion regarding the case in Sornarajah, *"International Commercial Arbitration"*, Singapore, Longman Publishers, 1990.
[153] *Klöckner industries and others v. The United republic of Cameroon* (1984) 1 J. Int. Arb. 145.
[154] *Klöckner industries and others v. The United republic of Cameroon* (1986) ICSID Rev. 89.

### 3.2.3 Subject matter jurisdiction

Disputes in areas of politics and economics are excluded from the jurisdiction of the ICSID, as well as disputes of a purely commercial character. The dispute has to have legal characteristics and arise directly out of an investment.[155] This limitation to the jurisdiction was mainly incorporated to avoid the situation where foreign investors would demand that all disputes with the Host State should be submitted to the Centre.[156]

An interesting aspect of the Washington Convention, which provides the fundament for the jurisdiction of the ICSID tribunal, is that the key word "investment" is not defined.[157] The definition has deliberately been left out to make it possible to provide a dispute resolution centre for both more traditional investments as well as for technology transfers and service contracts.[158] The interpretation of the word investment can consequently be said to be very broad as a number of modern types of investment disputes have been submitted to ICSID arbitration.[159]

The word investment has, however, been defined in the case *Alcoa Minerals of Jamaica v. Government of Jamaica*.[160] A contract was signed between Alcoa Minerals (a U.S. corporation) and the government of Jamaica where it was stipulated that the U.S. company was given the rights to bauxite mining as well as tax concessions. Alcoa mining agreed to construct a refining plant, which would extricate alumina from the mineral bauxite and then create aluminium. A "no further tax clause" and an ICSID arbitration clause were included in the contract. The event that initiated the dispute was when the Jamaican government decided to raise the taxes, which the U.S. Corporation claimed was a breach of contract. The tribunal had to determine

[155] Article 25 (1).
[156] Mwenda, "International Commercial Arbitration and the International Centre for Settlement of Investment Disputes", 30 Zambia law Journal 91 (1998).
[157] Redfern and Hunter, "*Law and Practice of International Commercial Arbitration*". 2nd ed. London, Sweet and Maxwell, 1991, at 47.
[158] Delaume, "*ICSID arbitration*", in "*Contemporary Problems in International Arbitration*", ed. Lew, Martinus Nijhoff Publishers, London 1987, at 26.
[159] Ibid.

whether or not an investment had been made in this case to satisfy the jurisdictional prerequisite. The tribunal held that a private company has made an investment when it "…has invested substantial amounts in a foreign State in reliance upon an agreement with that State."[161] The investment of capital is in this context one kind of investment. All issues relating to investment may be dealt with within the scope of the tribunal. Claims or counterclaims may also be tackled if they arise directly out of the substantial issues of the dispute.[162] This might lead to a situation where a wide range of issues are settled by the tribunal.

### 3.2.4 Analysis

The reasoning in the *Klöckner case* can be criticised on several points. One point is the argument that the incorporation of an arbitration clause is sufficient when determining whether the Host State has consented to treat its corporate national as a foreign entity, thus giving Article 25(2) b no purpose what so ever.[163] Furthermore, the model clauses prepared by the Centre, supposed to be used in this context, do not have any function whatsoever and their creation has therefore in my opinion been a lost cause.

It is important not to undermine the credibility of arbitration of international investment disputes, by delivering such reasoning that has been exemplified in the Klöckner case. *Holiday Inns v. Morocco*, which has been discussed above, took a more reasonable position by upholding the importance of Article 25(2) b, thus providing a view that is consistent with the wording of the Convention. The tribunal in the Amco case was too quick when it assumed jurisdiction and acted inconsistent with the Convention on the issue of corporate nationality. Loss of predictability in these proceedings

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[160] *Alcoa Minerals of Jamaica v. Government of Jamaica* ARB /74/2.
[161] Ibid. at 207 For details see: Mwenda, "International Commercial Arbitration and the International Centre for Settlement of Investment Disputes", 30 Zambia law Journal 91 (1998).
[162] Washington Convention Article 46.
[163] See discussion on this topic in: Sornarajah, "*International Commercial Arbitration*", Singapore, Longman Singapore publishers, 1990 at 182.

may lead to a general dissatisfaction among member states, which might argue that the tribunal is deviating from the original purpose of the Convention. This deviation may further result in an objection from member states that the interpretation made by the tribunal is inconsistent with the Convention, which has been signed by the state, and that these awards should therefore be nullified.

The point that needs to be highlighted is the seriousness of enlarging the jurisdiction of the ICSID tribunal by sacrificing consistency with the convention as well as essential predictability. There is no doubt in my mind that this practice is harmful for international commercial arbitration in general and in international commercial arbitration arising from state contracts in particular. ICSID serves as a very important alternative for dispute resolution in these circumstances, since the institution is trusted by member states as well as by private investors. In the event that a state feels that its sovereignty is threatened by this institution, then ICSID loses its effectiveness and private investors will stand without proper dispute resolution alternatives. The balance between the interests of foreign investors and states must be kept and the practice of undermining the Convention for the purpose of claiming jurisdiction in manners, as noted above, will not favour this balance.

# 4 ENFORCEMENT OF AWARDS

The future of international commercial arbitration and its effectiveness is very much dependent on the extent to which the given awards can be enforced. Arbitration is a dispute resolution process that in most cases results in a winner and a loser. The process differs on this point from for example mediation and conciliation, where the parties leave the dispute resolution with some sort of satisfaction. The last resort for a loser in a process of arbitration is to challenge the award in domestic courts, at a time when the winning party attempts to enforce it. Enforcement of awards derived from arbitrations between private parties does usually not cause any major predicaments.[164] The reason for this fact may be that the losing party does not want to challenge the award through litigation, which involves high costs and it may also jeopardise their commercial credibility. This may be true when the parties are private enterprises, but the same incentives, to agree to the enforcement of an award voluntarily, do not apply to sovereign states. This has in many cases caused problems especially when the state party, which contests the award, has not appeared before the foreign tribunal because of its view that the matter should be settled by domestic courts of that state. This is often true in disputes over changes of the state's policy, where the business of a foreign investor in that state is negatively affected. [165]

Awards made in delocalised tribunals are much more difficult to enforce compared to the ones that are made in domestic systems, which are usually also enforced under the laws of those national systems. It may seem rather ironic that a system of international commercial arbitration is created to avoid the unsuitability of national systems and domestic courts, but is still dependent on these very institutions when it comes to the most crucial part of the dispute resolution process - enforcement. A supranational system that

[164] Redfern and Hunter, "*Law and Practice of International Commercial Arbitration*". 2nd ed. London, Sweet and Maxwell, 1991, at 416.
[165] Sornarajah, "*International Commercial Arbitration*", Singapore, Longman Singapore publishers, 1990 at 198.

is competent to solve this problem is non-existent and will not evolve for as long as the sovereignty of states is of such significance.[166] The sovereignty of states obstructs the evolution of new and more efficient systems, since a system that is to be efficient needs the acceptance and support of a vast majority of all states. The evolution of this system must be regarded as a utopia at this point in time, when taking all interests of different states into account.[167]

The debate regarding a better solution in our present system must continue since we lack a system as discussed above. The two main problems when trying to enforce an arbitral award against a foreign state are sovereign immunity and the act of state doctrine. These two defences shall be scrutinised to highlight the predominant predicaments of international commercial arbitration arising from state contracts.

## 4.1 Sovereign immunity

The meaning of the doctrine of sovereign immunity is that a state cannot be forced to accept the jurisdiction of another state.[168] This is the obvious defence against enforcement in a domestic court outside the jurisdiction of the state party. The literature makes a distinction between two types of immunity in this context: absolute immunity and restricted immunity. Absolute immunity includes all acts carried out by a state, while restricted immunity only covers acts of a state in its capacity as a state (*jure imperii)* and not in its commercial capacity.[169]

Nationalisation is a common cause for breaches of contracts between private parties and sovereign states. This often occurs when a state decides to alter its policy on public ownership, thus taking over the property which was

[166] Ibid.
[167] Ibid.
[168] Redfern and Hunter, "*Law and Practice of International Commercial Arbitration*". 2nd ed. London, Sweet and Maxwell, 1991, at 423.

previously owned by the private party. It is generally accepted that this kind of behaviour by a state is lawful under international law, even if the private party has taken precautions through such measures as incorporating insulation clauses into the contract.[170] There has been one case where the arbitrator regarded the nationalisation as illegal, but this case stands alone and the view of the arbitrator in this case has not enjoyed any wide support.[171] The distinction between a commercial act and a governmental act has to be applied when determining whether or not it shall be protected by sovereign immunity, in accordance with the restrictive theory. The governmental aspects of an act of nationalisation are overwhelming even though there may be instances when one can claim that a nationalisation had the character of being a commercial act.

There are also two different kinds of immunity that may be argued in the domestic courts: Immunity from jurisdiction and immunity from execution. The first of these two is usually settled by an arbitration clause in the contract. It is generally accepted that such a clause represents a waiver of immunity by the state, since it agrees to that the arbitral tribunal, mentioned in the dispute resolution clause, shall have jurisdiction over the settlement of future disputes between the parties.[172] The other form of immunity is argued in cases where pursuit litigation is practised, which means that a party is seeking to enforce the award by transferring the title of property from the state party in a jurisdiction of a domestic court. The private party cannot expect much success in having the award executed in a system where a state and its property enjoy absolute immunity, since the state, in these systems, will escape all responsibility for its actions. Malaysia, Indonesia and Thailand are examples of countries where the doctrine of absolute immunity still exists or is considered uncertain.[173] Some countries offer the possibility

[169] Sornarajah, "*International Commercial Arbitration*", Singapore, Longman Singapore publishers, 1990 at 200-204.
[170] Ibid. at 204.
[171] The Texaco arbitration, *Texaco v. Libya* (1977) 53 I.L.R.
[172] Huleatt-James and Gould, *"International Commercial Arbitration – A Handbook"*, London, LLP Ltd., 1996, at 35.
[173] Sornarajah, "*International Commercial Arbitration*", Singapore, Longman Singapore publishers, 1990 at 202.

to enforce an award against a foreign state through execution of that state's commercial assets, situated in the state where enforcement is sought. Countries where this is possible are for instance: England, the United States, Germany and Austria.[174]

Giving a practical example of one of the cases where the problem of sovereign immunity was most obvious – the Liamco case, easiest makes an illustration of the problems that may occur in regard to sovereign immunity.[175]

Liamco attempted to execute property in seeking to enforce an award against Libya. The courts in Switzerland rejected to deal with the case because of lack of connection. The fact that the arbitration was held in Geneva was still not sufficient to satisfy the "connection requirement". Liamco then turned to the United States in hope of a successful outcome, but it was once again refused and the District Court argued the Act of State doctrine as the ground for its decision. The "Tribunal de Grande Instance" in France did also refuse to execute, but did nominate a committee to determine the public or commercial use of the funds for which execution had been requested. However, this solution did not aid Liamco in its search for a national system that would enforce the arbitral award. At last, a Court of Appeal in Sweden did not grant Libya sovereign immunity and adopted the view that the immunity was waived by submitting to arbitration.[176]

### 4.1.1 The arbitration clause - a waiver of immunity?

The significance of the arbitration clause in contracts between private entities and states has been discussed extensively in the literature. It has for

[174] Redfern and Hunter, "*Law and Practice of International Commercial Arbitration"*. 2nd ed. London, Sweet and Maxwell, 1991, at 427.
[175] *Liamco v. Libya* (1981) 20 I.L.M.1, The Case is discussed in Bernini and Van den Berg, "*The enforcement of arbitral awards against a state: the problem of immunity from execution*.", in "*Contemporary Problems in International Arbitration*", ed. Lew, Martinus Nijhoff Publishers, London 1987, at 368.
[176] *Liamco v. Libya*, The Court of Appeal of Svea, June 18, 1980, reported in VII Yearbook: Commercial Arbitration 359 (1982).

example been suggested that the existence of an arbitration clause in a contract is an indication that the contract is a commercial transaction.[177] This would mean that the state, according to the restrictive theory, would lose its immunity because of the inclusion of this clause in the contract. The clause does, without a doubt, signify the character of the transaction, but the reasons for why it was included into the contract can be many. It may for instance be a result of the stronger bargaining power of the private party. In the event that the arbitration clause would be regarded as the determinative factor when deciding whether the act should be considered commercial or public, it may result in fewer submissions to arbitration by sovereign states. A sovereign state would most likely contest the validity of the arbitration clause if this was to serve as the determinative factor.[178] It would all in all be a development that hardly favours international commercial arbitration or the actors that are involved.

Another interesting aspect in regard to arbitration clauses and sovereign immunity is to what extent such a clause can be said to be a waiver of enforcement of an arbitral award. There is support for the view that the submission to arbitration in fact could amount to a waiver of immunity in this context.[179] The argument that the commentators largely base their view on is the New York Convention on the Enforcement of Foreign Arbitral Awards.[180] In the event that both parties are signatories to this Convention, the submission to arbitration should additionally result in the submission to the jurisdiction where the award is to be enforced.[181] This broad interpretation of the Convention does not accord with its purpose. Nor did

[177] See *Petrol shipping Corporation v. Kingdom of Greece* (1966) 360 f. 2d. 103 (2d. Cir.) in Sornarajah, "*International Commercial Arbitration*", Singapore, Longman Singapore publishers, 1990 at 204.
[178] Sornarajah, "*International Commercial Arbitration*", Singapore, Longman Singapore publishers, 1990 at 209.
[179] Delaume, "State Contracts and Transnational Arbitration" 1981 75 A.J.I.L. 784 at. 787 and in Sornarajah, "*International Commercial Arbitration*", Singapore, Longman Singapore publishers, 1990 at 212.
[180] New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, June 10, 1958, United Nations Treaty Series (1959) vol. 330.
[181] Delaume, "State Contracts and Transnational Arbitration" 1981 75 A.J.I.L. 784 at. 787 and in Sornarajah, "*International Commercial Arbitration*", Singapore, Longman Singapore publishers, 1990 at 212.

the parties to the Convention sign a document that dealt with the issue of state sovereignty.

The English legislation (the State Immunity Act) is equivocal on this issue. A narrow interpretation of this legislation is represented by the view that an arbitration clause is an implied waiver, only if it consists direct submission to the forum.[182] To avoid the confusion in this area of law, it has been suggested that the private parties need to include an express waiver of immunity by the state both in regard to adjudication as well as enforcement. In the event that the agreement lacks such a waiver there will be no certain answer to the question of sovereign immunity and a waiver thereof; caused by the incorporation of arbitration clauses.

The opinion in Switzerland was divided in the Liamco case, where the majority upheld enforcement and considered the arbitral clause to be a waiver of immunity. The Swiss Court of Appeal felt differently and refused to enforce the award without commenting on the issue of sovereign immunity. The reason for why the award could not be enforced was simply because of the lack of connection with its jurisdiction.[183] The U.S. has also been reluctant to enforce awards against foreign sovereign entities and has in one case stated that "a waiver of immunity by a state to one jurisdiction cannot be interpreted as a waiver to all jurisdictions".[184]

As noted in the discussion above, the issue whether sovereign immunity shall be said to be waived or not is dependent on the inclusion of an arbitration clause into the commercial contract and not determined through the use of the restrictive theory. This theory has however had an effect on the debate regarding these clauses and this debate would most likely not be existent if the change had not been made from absolute immunity to the restrictive theory of immunity. Different jurisdictions have solved this issue

[182] Fox, *"Sovereign Immunity and Arbitration", in "Contemporary Problems in International Arbitration"*, ed. Lew, London, Martinus Nijhoff Publishers, 1987, at 323.
[183] *Libyan American Oil Co. V. Socialist People's Republic of Libya* (1980) 62 I.L.R. 225.
[184] Pollock J. in *Ohntrup v. Firearms Centre Incorporated* (1981) 516 F. Supp. 1281.

in various manners. Legislation in some jurisdictions, for instance, provide that immunity does not apply in the event that an arbitration clause is present in the contract.[185]

There is, in other words, no certain answer to the problem of whether an arbitration clause is an indication that sovereign immunity is waived, or an indication of the commercial nature of the contract, or even that it constitutes a general waiver of enforcement of an arbitral award. Various jurisdictions have different answers to the problem of sovereign immunity, even though they all have in common that it is very arduous to invalidate the sovereign immunity of a state.

### 4.1.2 Sovereign immunity in the ICSID

Awards made by an ICSID tribunal shall according to the Convention be recognised as if they were final judgements of a signatory's High Court. The relevant article provides that:
"Each contracting state shall recognise an award rendered pursuant to this Convention as binding and enforce the pecuniary obligations imposed by that award within its territories as if it were a final judgement of a court in that state."[186]

The ICSID award is therefore superior the awards made in other tribunals that do not have the support of a convention, which forces the member states to enforce an ICSID arbitral award. Although, this does not solve the problem of sovereign immunity, since the ICSID Convention actually maintains immunity in all member jurisdictions and an ICSID award is to be regarded as an award made by any tribunal in relation to sovereign immunity. This fact truly strengthens a state's sovereign immunity instead of weakening this defence. The relevant article in the Convention states that:

[185] See sec 9 State Immunity Act in the United Kingdom.
[186] Washington Convention Article 54 (1).

”Nothing in Article 54 shall be construed as derogating from the law in force in any contracting state relating to the immunity of that state or of any foreign state from execution.”[187]

Liberia opposed an award that was made by an ICSID tribunal, in the Letco case,[188] at the stage when it was to be enforced in the United States. The court in the United States decided that it had jurisdiction over the matter on the grounds that a state that had agreed to submit a dispute to an ICSID tribunal waived its immunity both to the ICSID tribunal as well as to all courts of all other member states. The court went on to determine whether the award could be enforced or not, deciding on the character of the funds held by diplomatic mission, as it was in this case. The court decided that Liberia’s defence of immunity was justifiable due to the governmental character of the funds.[189]

The ICSID awards can therefore not be said to be more effective when it comes to enforcement regarding the obstacle of sovereign immunity. The ICSID Convention can merely solve the jurisdictional issues in this regard, but is rather weak when enforcement of an award is attempted against a sovereign state.

## 4.2 Act of state doctrine

The other impediment in the process of enforcement, when dealing with a foreign state, is the act of state doctrine. This doctrine is a nationally and judicially developed doctrine and not a rule of international law. It comprises situations where judges refuse to try cases where certain acts have been executed by foreign governments. The act of the state is in focus rather than the fact that a foreign state is party to a contract. The domestic

[187] Washington Convention Article 55.
[188] *Liberian Eastern Timber Corporation v. The Government of the Republic of Liberia* (1987) 26 I.L.M 695.
[189] More details about the case and a discussion see Sornarajah, “*Pursuit of Nationalised Property”*, Boston, M. Nijhoff, 1986, at 272.

courts are likely to apply the act of state doctrine in cases, which involve some degree of nationalisation especially when it comes to sovereignty over natural resources.[190]

The doctrine is based on the separation of powers where the judicial branch should not interfere with the political branch, by examining acts of a foreign state. The hinder posed by the act of state doctrine and sovereign immunity provides a situation that makes enforcement against states and state entities quite strenuous and is truly rather frustrating in the eyes of a businessman. States do not often voluntarily participate in arbitrations and they do usually not accept the awards made by tribunals. Commentators have suggested that the lack of co-operation by states in these proceedings, is a result of the development of international commercial arbitration and that this process has not been consistent with the economic values of developing states.[191] Their interests have not been considered adequately and the system will not be functioning properly without the consent of these states in matters regarding international dispute resolution processes.[192]

## 4.3 The New York Convention

### 4.3.1 The New York Convention – Introductory remarks

The success of international commercial arbitration is to a high degree dependent on the New York Convention of 1958,[193] which ensures the enforcement of arbitral awards in member states. The foundation of the Convention can be found in its predecessor, which was the Geneva

[190] Examples of cases where this has been established see Sornarajah, "*International Commercial Arbitration*", Singapore, Longman Singapore publishers, 1990 at 236.
[191] See discussion in Sornarajah, "*International Commercial Arbitration*", Singapore, Longman Singapore publishers, 1990 at 237.
[192] Ibid.
[193] The New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, June 10, 1958, United Nations Treaty Series (1959) Vol. 330 at 38, No. 4739.

Convention for the Execution of Foreign Arbitral Awards.[194] The New York Convention provides, as did the Geneva Convention, that disputes which are subject to arbitration must not be litigated before the courts in member states.[195] The main difference between the two Conventions is that the Geneva Convention provided that the parties to an agreement of arbitration, which the Convention applies to, shall be "subject respectively to the jurisdiction of different contracting states." The New York Convention plainly states that it applies to international arbitration agreements. The domestic jurisdictional approach, which provided that an arbitration agreement should be subject respectively to different contracting states, has in other words been simplified and widened in the New York Convention.[196] Furthermore, the main objective of the New York Convention is to deal with recognition and enforcement of foreign arbitral awards.

A signatory to the Convention is bound to recognise and respect the effect of an award, which is subject to the Convention. A member state is also obligated to enforce awards, which apply to the Convention in the member states' domestic courts in correspondence with its procedural provisions.[197] There are two reservations made in the Convention, which have to be satisfied for the Convention to apply – Reciprocity and Commercial character.[198] Reciprocity in this context simply means that countries will only recognise and enforce awards, which are made under the Convention. The reservation regarding the commercial character of the award entitles a signatory to the Convention to refuse recognition or enforcement of awards, which are not considered to be commercial under the laws of that state.

[194] The Geneva Convention for the Execution of Foreign arbitral Awards, September 26, 1927, League of Nations Treaty Series (1929-1930) Vol. XCII, at 302.
[195] New York Convention Article II.3.
[196] Redfern and Hunter, "*Law and Practice of International Commercial Arbitration*". 2nd ed. London, Sweet and Maxwell, 1991, at 63.
[197] Coulson, "*So far, so good; enforcement of foreign commercial arbitration awards in United States courts.*", in "*Contemporary Problems in International Arbitration*", ed. Lew, London, Martinus Nijhoff Publishers, 1987, at 353.
[198] The New York Convention Article I(3).

The domestic courts must not review the award on the merits. The only grounds for refusal of recognition or enforcement of an award, which apply to the Convention, are in the event that refusal has been requested by a party and that one of the following requirements is satisfied:

1. Incapacity of the parties to the dispute or the invalidity of the arbitration agreement.[199]
2. Lack of fairness in the arbitration process.[200]
3. Insufficient authority or lack of jurisdiction.[201]
4. Prohibited procedural deviation.[202]
5. Invalidity of the award.[203]

A domestic authority is, in accordance with the Convention, authorised to refuse recognition or enforcement, without it being requested by a party, on two grounds:

1. Arbitrability.[204]
2. Public policy.[205]

The New York Convention has proved to be a success, as mentioned above, and is very valuable to private parties that are utilising arbitration as their means of alternative dispute resolution. However, this may not apply to the same extent when examining the efficiency of the Convention in relation to state contracts.

### 4.3.2 The New York Convention and state parties

It is fairly clear that the recognition and enforcement of awards in state contracts were not considered at the time when this Convention was drafted. The reservation that the Convention shall only apply to awards that derive

[199] The New York Convention Article V.1(a).
[200] Ibid. Article V.1(b).
[201] Ibid. Article V.1(c).
[202] Ibid. Article V.1(d).
[203] Ibid. Article V.1(e).
[204] Ibid. Article V.2(a).
[205] Ibid. Article V.2(b).

from commercial disputes is obviously the first impediment in regard to state contracts. This means, in effect, that disputes with a political aspect will fall outside the scope of the Convention. Political aspects of a dispute, where states or state entities are involved, can always be found if searched for. Foreign political policies are often the reason why certain states or state entities act the way they do. A government of a country involved in a dispute has most certainly been involved in making the policy decision, which is nothing but a political act. Consider a nationalisation for instance. The act of nationalisation is executed because of political policy decisions in order to uphold the policy of public ownership in that country. A dispute that derives from an act of nationalisation can therefore not lead to a commercial award.[206]

The grounds that are accepted to refuse recognition and enforcement of an award under the Convention can all raise several defences that are far more effective when claimed by a state or a state entity. An obvious example is the defence regarding incapacity to enter into the agreement to arbitrate by one or both parties. A defence of this character poses a large number of questions relating to constitutional law as well as aspects concerning the extent of which a domestic court has the authority to examine the validity of an act of a foreign government.[207]

The two grounds of refusal that may be used by a domestic court, without being requested from a party, are however the ones that are most interesting. A domestic court can refuse to recognise or enforce an award that is based on a dispute that is not *arbitrable* in accordance with the laws of that state.[208] The view of what shall be considered an arbitrable issue varies of course in different jurisdictions. The legislation in developed countries is most likely different from the legislation in developing countries. The latter

[206] Sornarajah, "*International Commercial Arbitration*", Singapore, Longman Singapore publishers, 1990 at 239.
[207] Ibid.
[208] Coulson, "*So far, so good; enforcement of foreign commercial arbitration awards in United States courts."*, in "*Contemporary Problems in International Arbitration*", ed. Lew, London, Martinus Nijhoff Publishers, 1987, at 357.

group of nations may not consider investment agreements to be commercial contracts, since they may be subject to special legislation and are therefore not considered arbitrable issues in those jurisdictions.[209] The diverse view taken in various jurisdictions makes the issue of arbitrability of state contracts highly uncertain and no confident answer can be given in these cases.

The second ground, on which a domestic court may refuse recognition or enforcement of an award, is when it is against that state's *public policy*.[210] This is based on the morality in each jurisdiction and what constitutes public policy varies, naturally, from jurisdiction to jurisdiction.[211] Public policy shall, according to one interpretation of the Convention, be regarded as being an international public policy and not a domestic one. This interpretation is applied to avoid a situation where the determination of what public policy should signify, becomes subjective in the domestic courts.[212] Separating between public policy in a national legal system and public policy in an international legal system is something that can only operate sufficiently in theory. Thus when it comes to actual cases where domestic courts have to make this distinction, which means accepting that a different public policy should be adhered to than there own, the courts will in the end adhere to their own public policy in one way or another.

A lex mercatoria solution, in this circumstance, may operate in a satisfactory fashion in the states that accept a system which favours international trade. They may choose to sacrifice their own public policy to profit from the increase of international trade. However, in the states, mainly developing countries where international trade is not that prioritised, such a system will

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[209] Sornarajah, "*International Commercial Arbitration*", Singapore, Longman Singapore publishers, 1990 at 243.
[210] Sajko, "*The New York Arbitration Convention of 1958 from the Yugoslav Point of View: Selected Issues.",* in "*Essays on International Commercial Arbitration",* ed. Sarcevi´c, London, Graham & Trotman, 1989, at 208.
[211] Coulson, "*So far, so good; enforcement of foreign commercial arbitration awards in United States courts.",* in "*Contemporary Problems in International Arbitration*", ed. Lew, London, Martinus Nijhoff Publishers, 1987, at 357.
[212] Sornarajah, "*International Commercial Arbitration*", Singapore, Longman Singapore publishers, 1990 at 244.

not be acceptable to the same degree.[213] Domestic courts in these countries will consequently find a way to refuse the recognition and enforcement of foreign arbitral awards. Either on the ground provided in the Convention or by employing the act of state doctrine.

The New York Convention may be praised in certain situations, but it is apparent that it does not provide much aid when attempting to enforce an award against a state or a state entity.

[213] Ibid. at 245.

# 5 CONCLUSION

The problems arising from state contracts and the problems arising from private contracts in international commercial arbitration are quite different. The reason lies in the development of the arbitration process, which in the beginning favoured private parties and the rules for arbitration were developed with these parties in mind. However, the sovereign states have increasingly moved into areas of trade and commerce, which has shifted the emphasis from disputes between private parties to disputes between sovereign states or state entities on the one hand and private parties on the other.[214]

Many international contracts contain clauses which expressly submit them to the law of a certain national legal system. However, there are still contracts where the choice of law clause has been left out or is inadequate. The parties need to be aware of the risks and possible consequences of their actions when choosing or simply forgetting to incorporate this clause into the contract. The choice of law is then left in the hands of the arbitrator, who is not bound by any conflict rules and may therefore select any principle to determine which law should govern the substantive issues of the contract. Parties to the contract will surrender their control over the process and the essential predictability will consequently suffer. The importance of the inclusion of a choice of law clause in an international contract cannot be stressed enough.

The evolution of a successful supranational system of law is a complex process and has not yet resulted in a reliable system. The aim, for such a system to operate satisfactory in state contracts, is to take the interests of all parties into consideration. A balance needs to be found between the interests of the Host State and the foreign private entities where more neutral

[214] Redfern and Hunter, *"Law and Practice of International Commercial Arbitration"*. 2nd ed. London, Sweet and Maxwell, 1991, at 44.

principles have to govern the relationship, which are all approved and accepted by these parties. Mechanisms, such as renegotiation of the agreement in the event that adverse changes that affect the contract occur, should also be provided for in the contract to maintain the business relationship and accommodate for a more dynamic resolution of arising disputes.

International commercial arbitration has been widely used to obtain a third party decision, hence escaping from the need to litigate in domestic courts. Arbitration is often an approved option, which is frequently utilised by contracting parties in global trade. The reason for why arbitration is such an accepted dispute resolution process is that neither party may wish to submit to the jurisdiction of the domestic courts of the other party. Furthermore, it may not be possible or feasible to submit to a court system of a third jurisdiction.

The enlargement of the tribunal's jurisdiction, which has been a trend in literature as well as in awards, can be regarded as a threat to the success of international commercial arbitration involving state contracts. It undermines the sovereignty of states, which in turn will result in a loss of confidence in the arbitration process as a dispute resolution mechanism. In the event that sovereign states refuse to submit to arbitration, when negotiating agreements with foreign investors, then international trade will suffer due to the lack of an acceptable dispute resolution system. Finding a balance between the parties in this process is crucial to maintain good relations in international trade and investment.

The enforcement of awards arising from state contracts continues to be an unresolved problem. It is unfortunate that arbitration, as an otherwise successful dispute resolution process, suffers because of insufficient methods of enforcement of awards from disputes arising from state contracts. Not even the ICSID Convention, which is tailor made for state contracts, provides for adequate enforcement measures. Sovereign immunity

and the act of state doctrine continue to obstruct the enforcement process and they are frequently applied in domestic courts.

Multinational corporations continue to emerge and they become more powerful both politically and economically. Sovereign states progress to be increasingly dependent on private entities due to this fact and the bargaining power between these parties is more balanced than ever before. Voluntary recourse to arbitration and voluntary acceptance of the binding character of the award is already a fact between private parties of international contracts. However, the expanded power of multinational corporations may increase the pressure on sovereign states to become more aware of the importance of a good reputation in world trade. Until this awareness becomes a reality, international commercial arbitration arising from state contracts will continue to be a weak dispute resolution process that rests only in the realm of the sovereign state's desire to have a system that operates sufficiently.

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