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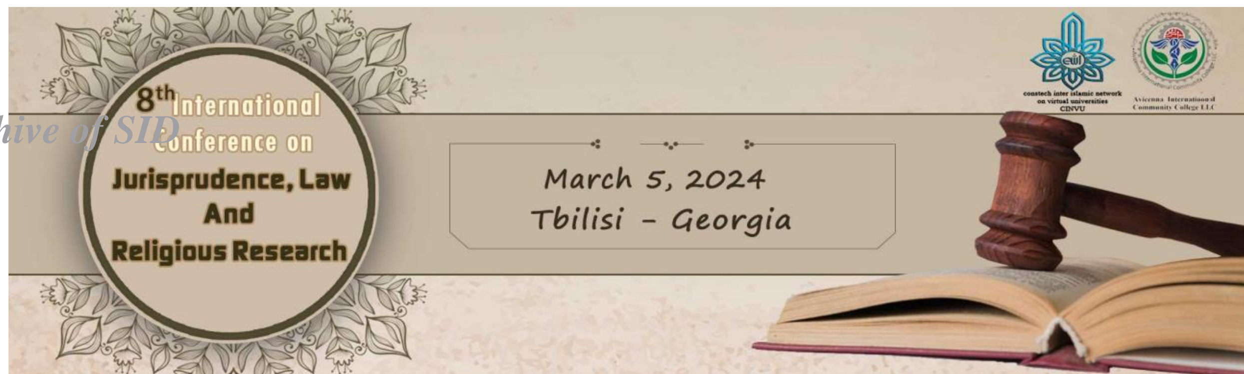

Review of the Governing Law in Arbitration Proceedings

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Abstract
The freedom of the parties in this field is extensive, to the extent that their choice is not subject to the constraints of the fundamental principles of governance. Instead, their will must be respected. In case of silence of the parties, it is the arbitrator who decides based on suitable conflict resolution rules. Suitable conflict resolution rules do not necessarily mean that the arbitrator must refer to Iran's rules to determine the governing law. It implies that the arbitrator should have discretion in choosing suitable conflict resolution rules, a prevalent tendency in international commercial arbitration. This research utilizes a descriptive-analytical method, concluding that Iran's legislator, considering the mentioned factors and for the development of Iran's commerce and economy, has enacted the International Commercial Arbitration Law. The methods for determining the governing law like the dispute by arbitrators include various types such as the law of the contracting party's government, the law of the seat of arbitration, the arbitrator's freedom in applying the most suitable legal conflict resolution system, consolidation of conflict resolution systems, application of general conflict of laws principles, direct choice of substantive law, and application of formal commercial law principles, including general legal principles or international commercial customs and usages, or general international law, which will be discussed in this article.

Keywords: Governing Law, Nature of Dispute, International Commercial Arbitration, Iranian Law

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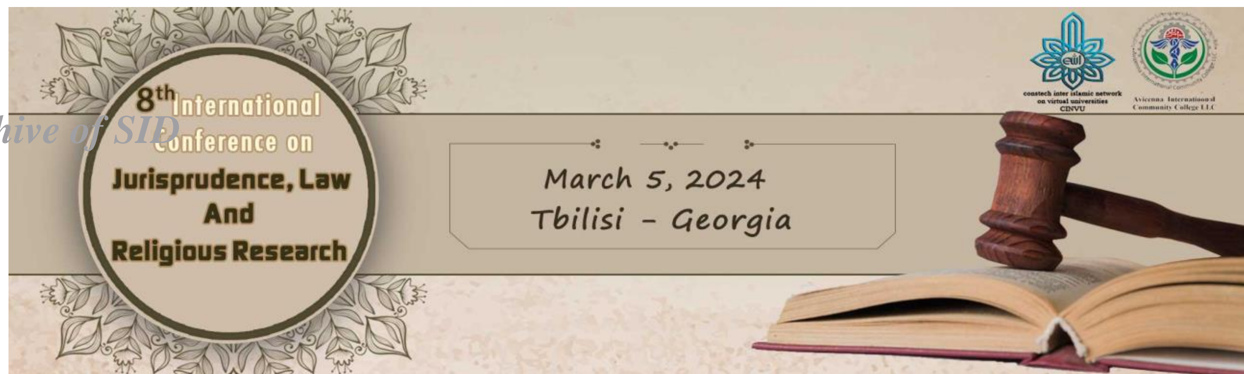

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I. Introduction

Significant developments in commercial relationships in recent decades have led to the expansion of commercial law in many countries. Currently, the development of international trade and foreign investment has become a serious concern, making the discussion of the development and diversification of commercial rules and regulations highly important in many countries. In this context, the role of arbitration institutions in shaping international commercial law has been so crucial that some consider it the foundation of development in international commercial law, as international arbitration holds an excellent position in resolving commercial disputes. Determining the law governing the nature of the dispute is a crucial issue in international commercial arbitration and, in other words, in formal arbitrations. This issue is fundamentally related to private international law, finding a special place in international arbitrations and not completely conforming to the generally accepted rules of private international law.

In international commercial arbitrations, similar to domestic courts dealing with international issues, determining the governing law of the nature of the dispute is of particular importance. The arbitration court, whether international or domestic, must determine which law governs the nature of the dispute. In other words, it must specify which law applies to substantive issues in dispute and how the dispute should be resolved based on which rules. In domestic courts, the judge refers to the law of its governing state and determines the governing law by resorting to its conflict of law rules. However, in international commercial arbitrations, as the arbitrator is not affiliated with a specific group and is, in terms, lawless without the law of the court's domicile, determining the governing law of the nature of the dispute is more significant and presents more challenges.

Nevertheless, what this research aims to achieve is the examination of the methods used by arbitrators in determining the governing law of the nature of the dispute. This determination leads to the final decision on the nature of the dispute as the ultimate purpose and goal of arbitration.

II. Implicit Condition Indicating a Negative Option Regarding the Application of National Law

In commercial contracts between governments, organizations, and state-owned companies, the proposal of one party's national law as the governing law in their commercial relationships often faces serious opposition from the other party. In the absence of an explicit choice of the governing law, arbitrators can interpret their behavior negatively and oppose the application of the national law of the parties. This is because the absence of an explicit choice implies their inability to agree that their commercial relations be subject to the national law of the other party. Therefore, the arbitration panel infers the negative option of the governing law implicitly from this silence (Amir-Moezi, 2016, p. 399). In contracts involving governments, state institutions, companies, and government organizations, it is strongly recommended that the parties explicitly state in the

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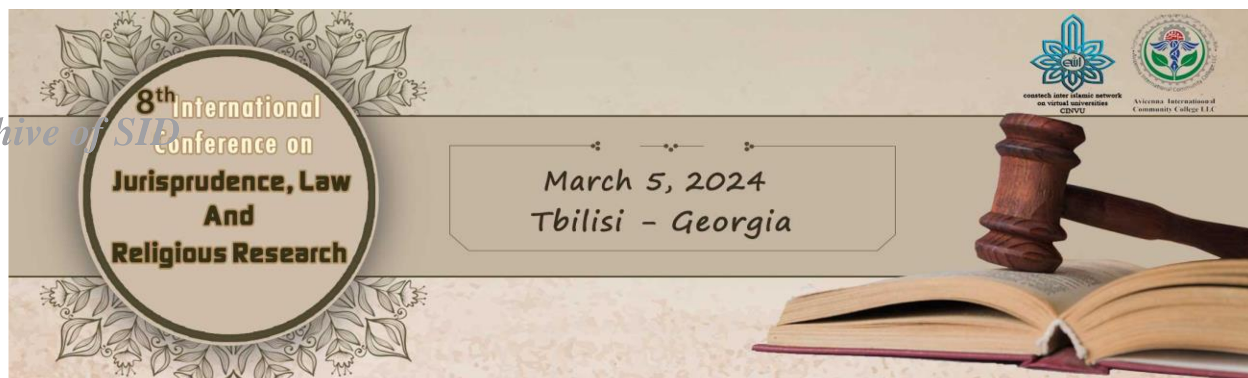

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contract that they do not accept the governing law of the other party. In this case, the arbitration panel, regardless of the national law of the parties, seeks impartial law or general legal principles, international commercial law, and commercial customs and usages. During negotiations, when the parties cannot agree on the choice of the governing law, they spend their opportunities negotiating matters and conditions where agreement is possible. Especially in contracts involving governments or government subsidiaries, the governing law is not discussed due to the negative reaction it might elicit. Accepting the national law of the parties is considered incompatible with government sovereignty, and they are not willing to subject themselves to foreign national law (Amir-Moezi, 2016, p. 400). Therefore, arbitrators should not determine the governing law by applying international conflict resolution rules, such as the application of rules closest to the Convention on the International Sale of Goods (CISG) of 1980. The use of these rules ultimately leads to determining the national law of one party, which is evident in conflict with the intentions of the parties. Additionally, the use of other rules such as the place of performance or the location of the main obligations guides arbitrators towards determining the national law from the beginning, against which the contracting parties have been opposed from the outset. according to this theory Governing law of the place of arbitration, the arbitrator should refer to the private international law of the country where the arbitration is held and determine the applicable law based on the conflict of laws rule of that country for the nature of the dispute. In this theory, arbitration is likened to judicial proceedings in domestic courts, and the conflict of laws rule of the place of arbitration is considered the court's governing law. In essence, this theory proposes the same solution as the traditional principles of private international law applied by judicial authorities. One of the most prominent supporters of this theory is Professor Sørensen, a Swiss legal scholar who defended it in his report to the Institute of International Law in 1952. The "Amsterdam Resolution," adopted by the Institute of International Law in 1957, seems to have left no room for the parties. One could even argue that the recent resolution has exclusively delegated the determination of the governing law of the dispute to the rules of the place of arbitration (Eskini, 1990, p. 158). This theory has faced severe criticism. It has been argued against this theory that there is no organic legal relationship between the dispute and the country where the arbitration is held. The arbitration tribunal is not part of the judicial system of the country in question, and, in any case, no decision has been issued by international arbitration authorities to confirm it. Moreover, this theory is not easily enforceable because the place of arbitration is not explicitly specified in all contracts, or even if specified, it may not be a single location. In such cases, it is unclear which of the designated law's rules has been intended by the parties (Safaei, 2016, p. 141).

In some opinions of the International Chamber of Commerce (ICC), even those issued before the adoption of new rules in 1975, which grant arbitrators the freedom to determine the applicable law, the analogy of arbitrators to judges and the comparison of the place of arbitration to the seat of the court have been rejected. In one of these opinions, it is stated: "The rules determining the applicable law vary from one country to another. State judges pull them out of their national law, namely the law of the court's seat, but an arbitral tribunal does not have a law of the seat in the literal sense, especially when the subject matter of the dispute, the choice of arbitrators, and the supervising organization of arbitration give it an international nature" (Y. Derains, 1972, p. 104).

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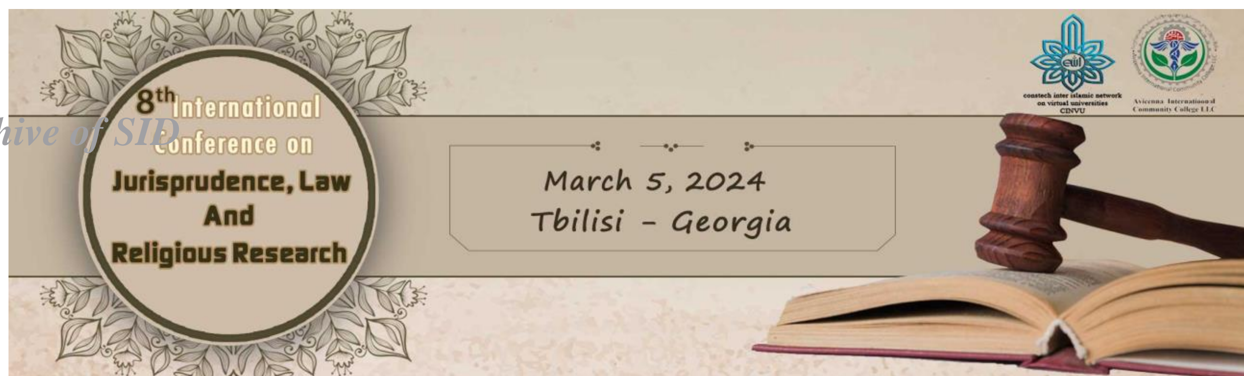

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Thus, the governing law of the place of arbitration for the nature of the dispute is considered a negative factor today and can be discussed alongside other factors involved in the choice of governing law. It is concluded that one can no longer claim that the assumption of the arbitrator's choice is the choice of law. Leo says in this regard: "In recent years, the desirability of this assumption has diminished because the basis on which the assumption is based is illogical and incorrect... Today, this assumption is only one of the factors that may be applicable in special circumstances and conditions" (Jenidi, 1997, p. 206). In some recent cases heard by the ICC, where the rules of conflict resolution of the place of arbitration have been applied, the situation is somewhat such that due to the lack of stronger connections with another country, arbitrators have concluded that, by choosing the place of arbitration, the parties have implicitly demonstrated their non-objection to the application of the rules of that place as the appropriate law, especially if non-local arbitrators are also chosen (Kurdistani, 2013, p. 84).

A critical point that can be added to the criticism of this theory is that the theory of the governing law of the place of arbitration has been negative from the outset for a large category of contracts, namely government contracts. According to this theory governing the law of the contracting state, which has also been applied in some international opinions, the arbitrator, in each case, will determine a place for the relevant legal relationship based on its nature and will execute the conflict of law rule of that place. To be more precise, if the legal relationship has a sufficient or more significant connection with a particular country, that country is considered the place of the legal relationship, and the conflict of law rule of that country determines the applicable law. In the case of disputes arising from a contract, the country with which the contract has a greater connection will be determined, and based on the private international law of that country, the governing law of the nature of the dispute will be identified (Ojaaghloo, 2008, p. 21).

III. Application of Common Rules in National Laws

Mr. Mario Rubino-Sammartano introduced the theory of "common rules" in 1987, which has since gained wide attention among legal scholars. This doctrine, although criticized, is somewhat similar to applying conflict resolution rules and serves as an artificial substitute for the parties' intent. The result of this method is the application of national laws that the parties did not intend to use. Other authors have also previously discussed this matter (Amirmoazzami, 2016, p. 405). Sammartano, in explaining this theory, leans more towards interpreting the negative option, stating that the parties did not want or could not reach an agreement on the substantive governing law. He assumes that the negative option means that the parties intended to refrain from accepting certain regulations and did not want to subject themselves to a law that would surprise them. According to him, the parties likely intended to place their relations, at a minimum, under the jurisdiction of a portion of the national law of the other party, i.e., the common part in the national law of both contracting countries (Amirmoazzami, 2016, p. 405). In this method, the common parts of the two national laws of the parties are applied, but it is unclear whether this approach better captures the parties' consent. Nevertheless, Sammartano believes that this theory is closer to the common intention of both parties and concludes that common rules in national laws should naturally be applied as the parties' autonomous choice. An example of an arbitration award based on this theory

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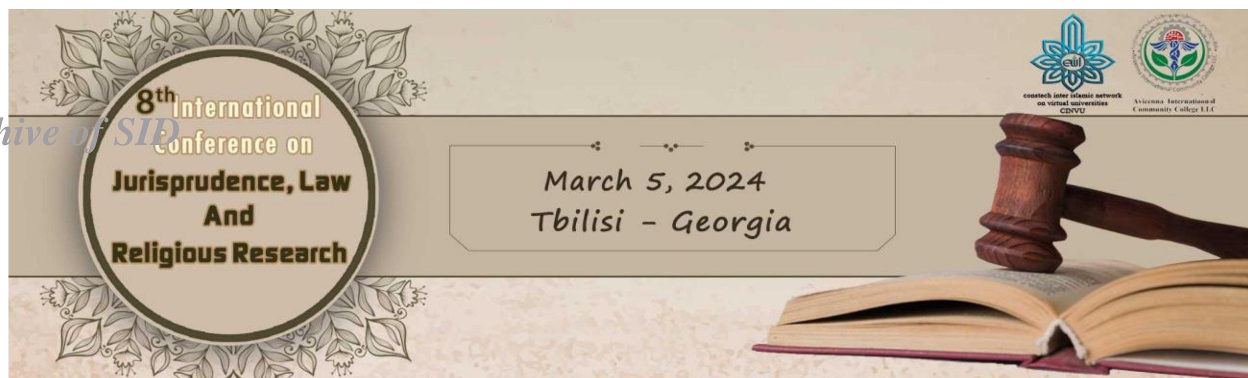

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is illustrated as follows: (Example: ICC Case No. 7304 "Governing Law," it is stated: "In the Femabein contract, the governing law has not been chosen, so it can be inferred that the parties intended to refer to a specific national law to establish the validity, interpretation, and termination of the contract. Both the claimant and the respondent consider their national law as the governing law based solely on the common ground of Article 13(3) of the 1988 ICC Arbitration Rules. In the absence of an explicit choice of governing law in the contract, this provision allows the arbitral tribunal to find the appropriate law using conflict resolution rules. Given the discretionary powers granted to the arbitral tribunal, the claimant's position (Ministry of Defense) is that Iranian law governs the contract as the law of the place of occurrence (Article 968 of the Civil Code), as the place of conclusion is an important factor in the contract for determining the law and serves the purpose of arbitration. This is because one party to the contract is the government of Iran, and the contract was signed in Iran" (Page 19 of the award)).

IV. Counterarguments Regarding the Choice of Governing Law

The respondent argues forcefully in favor of choosing German law contrary to the claimant's position. The respondent supports the selection of German law as the governing law, emphasizing that the place of performance of the contract is in Germany, which is a crucial factor in determining the applicable law. Various methods are presented, all of which confirm the application of German substantive law. The place of arbitration is the Netherlands, and Dutch law also confirms the application of German law (closest connection principle) to the mentioned contract. The most significant part of the contract is executed in Germany, where the respondent's activities and shipbuilding factories are located, and the responsibility for building the ship lies with the German party. According to the respondent, even if we apply general principles of private international law, the law of the place of performance will be chosen because Germany is the center of gravity of the contract. Therefore, all the considerations mentioned led the arbitral tribunal to determine German law as the governing law (Amirmoazzami, 2016, pp. 406-410).

The respondent further adds that if we apply the cumulative method, using common legal principles in the laws of the two countries, we cannot reach a conclusion that satisfies all the needs of this case. The place of contract signing happened to be Tehran, and it cannot be a relevant factor in choosing the governing law, lacking a connection to the center of gravity of the contract. The arbitral tribunal (paragraph 25 of the award, page 20) argues that the parties were explicitly referred to in interim order No. 3, stating that, in the opinion of the tribunal, the contract concluded between the parties in March 1978 is exclusively governed by neither Iranian law nor German law. As a result, the actual intent of the parties is implicitly clear from Article 19 of the contract. The dispute resolution mechanism involves friendly negotiations initially, and if unsuccessful, a committee composed of three technical experts will resolve technical issues, and in non-technical matters, arbitration under the ICC will be utilized. Paragraph 7 of Article 19 states that the technical committee or the arbitral tribunal will decide based on the provisions of the contract. This provision is a mere reference to the rules applicable for interpreting the validity and enforceability of the contract. After disputes arise, they are brought before a committee that must decide based on the contract. The contract text alone is not sufficient to address all legal consequences of the contract.

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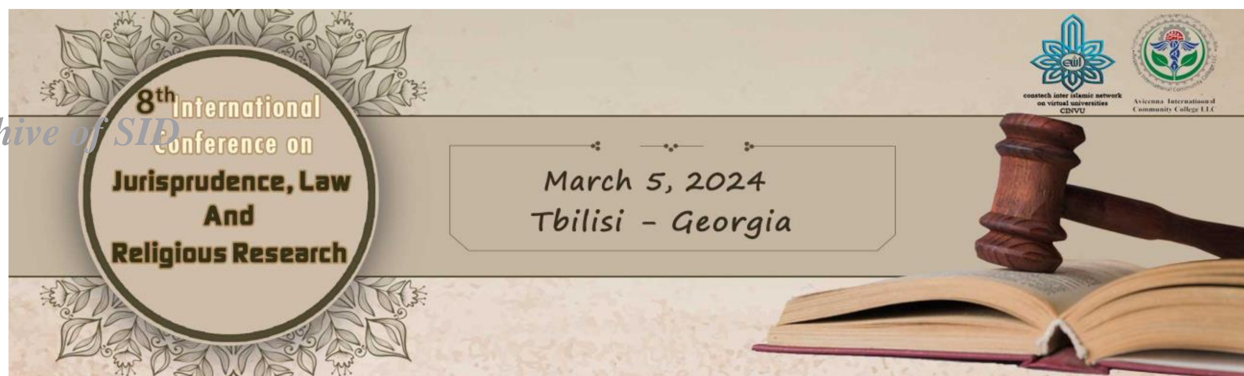

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Therefore, the provisions of this paragraph must be interpreted in a way that covers various aspects of contractual relations between the parties considering all circumstances governing the case. A part of the government, along with a major shipbuilding company, signs a contract for a massive undertaking, such as constructing multiple ships at a very high cost (several hundred million marks), and specifies that the contract text and the methods described should replace the governing law. The arbitral tribunal attempts to give meaning to this clause of the contract to make it executable. It should not be interpreted unjustly and according to the will of one party. While applying general principles of contract interpretation, it seeks principles common in the legal systems of both countries. Moreover, the arbitral tribunal interprets each clause of the contract in conjunction with other clauses in the same field to extract useful and enforceable effects. By using the principles outlined in paragraph 7 of Article 19 as an unambiguous provision, the arbitral tribunal discerns the intent of the parties and refrains from applying the national law of each party individually. In disputes lacking a technical nature, the arbitral tribunal has the competence to resolve them by the ICC arbitration rules. The parties consciously chose to remain silent on the selection of the governing law in the contract. The Ministry of Defense of Iran (one party to the contract) has no interest in applying foreign law, and it has not granted permission for the selection of another law in addition to Iran's private international law (Article 968 of the Civil Code), insisting on the national law of the place of contract conclusion. Internationally recognized practices in government contracts show a strong tendency to apply the law of the party that is a government, especially when there is no explicit choice in the contract. Article 42(1) of the 1965 Washington Convention provides a solution for resolving disputes between a government and private individuals in investment disputes, which is largely consistent with the situation of the parties (government and private entities) in this contract. In such situations, paragraph 7 of Article 19 of the contract means that the parties have reasonably conspired and, considering the particular circumstances of this contract, attempted to refrain from applying the exclusive national law of one party consciously (Amirmoazzami, 2016, pp. 406-410).

V. Interpretation of Governing Law Choice and Use of Lex Mercatoria

The conclusion drawn from Article 19, paragraph 7 of the contract indicates that the parties did not intend for only Iranian or German law to govern their relations. Therefore, the arbitral tribunal asserts that, according to Article 13, paragraph 5 of the ICC Rules, it must give effect to the explicit will and desire of the parties. Consequently, the application of Article 13, paragraph 3, which leads to the determination of one party's national law, is unnecessary. The arbitral tribunal is confident that the parties' intent, as outlined, should find all its effects. This can only be achieved by resorting to Article 13 of the ICC Rules and various clauses of the FIMAVEN contract, along with a proper interpretation of the extraction principles. Where the contract provisions are insufficient, general and common principles in the laws of Iran and Germany, as well as principles in modern commercial law systems, can fill the mentioned gap. The tribunal reserves certain points in interim order No. 3 and paragraph 51 of the award, stating: "The nature of disputes, the validity and interpretation of the contract, and the consequences of its termination and non-performance will be subject to the governance of the contract terms and general legal principles common in the laws

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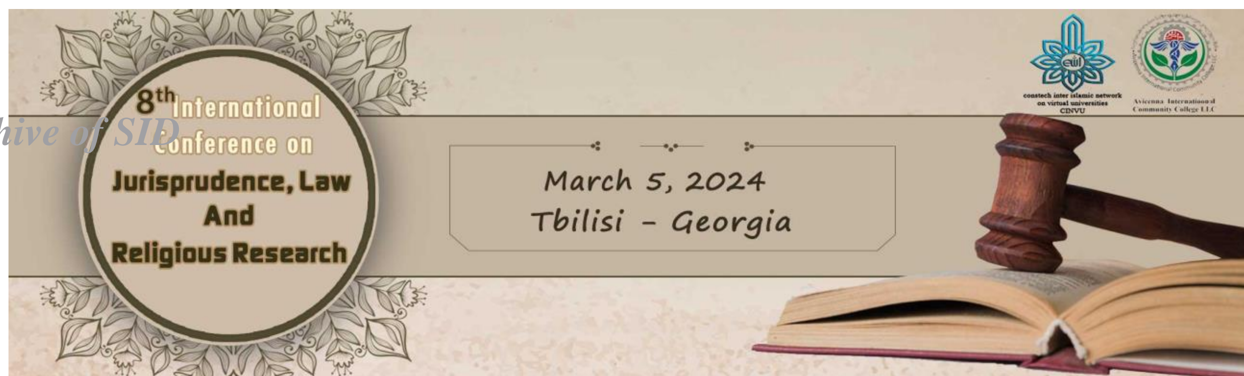

of Iran and Germany, as well as principles specified in modern commercial law." The arbitral tribunal draws inspiration from the legal systems of the parties to the contract and their customs and usages. If no established practice exists between the contracting parties, it considers the prevailing practices in the countries of the parties and strives to adhere to the principle of "searching for a solution close to the expectations of the parties". The theory of common rules is not new, and parties can indeed designate disputes arising from the contract in commercial arbitration clauses as subject to common rules in their national laws, as long as commonalities can be found between the two legal systems. In the absence of common rules in a specific matter, the law of a neutral and impartial third party capable of fairly resolving the dispute is chosen for this purpose. (Amirmoazzami, 2016, pp. 406-410)

This method of choosing the governing law in oil platform contracts concluded between German and Dutch institutions has been used. The contract is subject to the laws of both countries and in the absence of common rules, Swiss law is applicable. In the quest to find the applicable law for the relations of the parties, where there is no explicit choice in the contract, the arbitral tribunal resorts to theories. The difference between these two approaches lies in the fact that Lex Mercatoria, unlike the Trunc Commun theory, does not pay attention to the commonalities of the national laws of the parties. It has more similarity to a formal law in this regard. Trunc Commun, on the other hand, relies solely on national laws and is based on their commonalities. In cases where there is no commonality, they set aside national laws and resort to a third law to fill the legal vacuum. Therefore, despite these methods, national conflict of law rules may not be sufficient or suitable for international trade. International or formal conflict of law rules are not well-established either. The widespread diversity in conflict of law systems results in instability and dispersion in the applicable law concerning the nature of the dispute.

The instability resulting from conflict of law rules negatively affects international commercial arbitration. Updating substantive rules, both nationally and internationally, and moving towards their uniform application can improve this situation. To achieve this goal, it must be accepted that arbitrators can directly apply substantive laws that they deem appropriate and relevant.

Regardless of conflict of law rules, one of the most significant features of contemporary international commercial arbitration is the inclination towards denationalizing arbitration in terms of substance. This trend is now reflected in the growing application of formal commercial law compared to the nature of international commercial disputes in arbitration forums, which is the clearest manifestation of this trend. Conventions and some international arbitration institution regulations, as well as some national laws, explicitly allow the application of various elements of formal commercial law, which, despite criticism, is in a way more accurate and suitable than other aforementioned methods.

Regarding the application of the principles of justice and fairness, it is essential to note that for a fair and reasonable arbitrator's decision, it must manifest justice, fairness, and reasonableness in the area in which it is applied, not based on personal concepts of justice and fairness. Arbitration based on justice is not necessarily a decision-making process beyond the framework of legal rules; rather, it is the completion and correction of legal rules based on justice and fairness.

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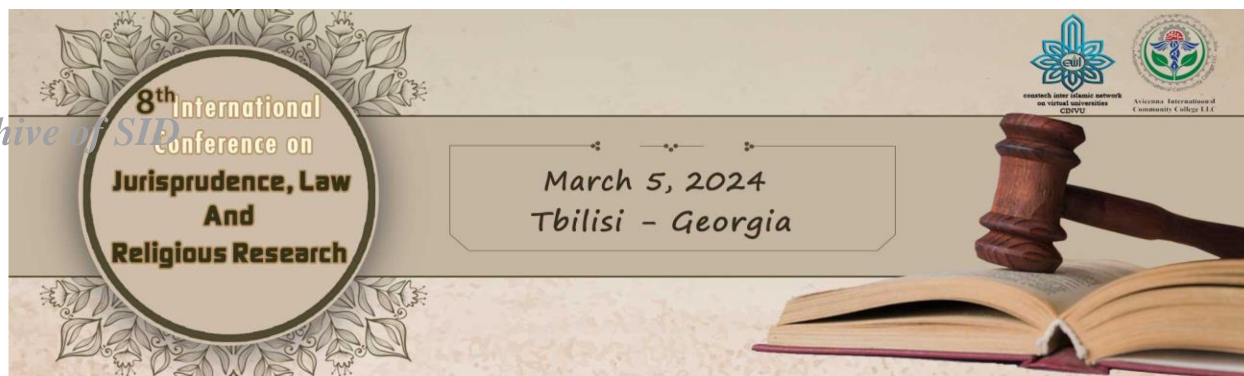

Considering the aforementioned factors, the Iranian legislature, in line with the development of Iran's trade and economy, has approved the International Commercial Arbitration Act. In this context, having two inconsistent and conflicting rules in Article 968 of the Civil Code and Article 27 of the International Commercial Arbitration Act does not seem appropriate. Therefore, regardless of the theories of imperative and discretionary nature raised around Article 968 of the Civil Code, a reconsideration of this conflict resolution rule in Article 968 and its amendment in line with the International Commercial Arbitration Act seems necessary based on contemporary interests and unavoidable necessities. Now, it must be examined whether there is a difference between lex mercatoria and commercial customs. It has been argued that lex mercatoria is "general" and commercial customs are "specific." Summary of topics, it appears that a distinction must be made between lex mercatoria and commercial customs. Given that Article 27(4) of the International Commercial Arbitration Bill only addresses commercial customs, lex mercatoria is not covered by this provision. However, considering the application of Article 27(1) of the International Commercial Arbitration Bill, which allows the parties to agree to use the legal principles as the governing law of their contract, and since lex mercatoria is systematic, it can be considered as the governing law of arbitration according to Article 27(1), provided the parties agree. With this in mind, it should be noted that in the long run, the preference for the theory of Böckstiegel and some other experts in international trade is in favor of developing countries. This theory allows these countries to meet the regulations required by international trade while exercising the necessary control and supervision to protect their economic interests. Such control cannot be exercised over how a legal system is formed and shaped, whether it is non-national or extraterritorial. Perhaps for this reason, developing countries have not shown much enthusiasm for the de-localization of arbitration in terms of lex mercatoria.

Conclusion

Regardless of the reasons for disputes in commercial and economic contracts, the benefit for both parties is recumbent in resolving them in a proper, secure, and specialized manner. Cost-benefit logic in economic enterprises also dictates the prompt resolution of commercial disputes. Moreover, methods for resolving commercial disputes should be designed and implemented according to the needs of business and economic requirements. Arbitration is considered the best, most specialized, and fastest method for resolving commercial disputes. It prevents disputes from becoming entangled in the regulations and complexities of court proceedings. The prevalence and support for arbitration are indicators of the strength and coherence of the legal system of any country, reflecting progress and prosperity in economic and commercial endeavors. Therefore, the expansion and support of arbitration are deemed essential. Methods for determining the governing law in a dispute vary. The first method arises from the nature of arbitration, emphasizing the independence and free will of the parties. Recognizing the principle of the sovereignty of will and accepting the right to choose the law empowers the parties to participate in resolving their disputes, leading to more fair and just decisions. The second method includes various approaches, such as the law of the state where the contract is made, the law of the seat of arbitration, the freedom of arbitrators to apply the most appropriate system of conflicting laws, the consolidation of conflict

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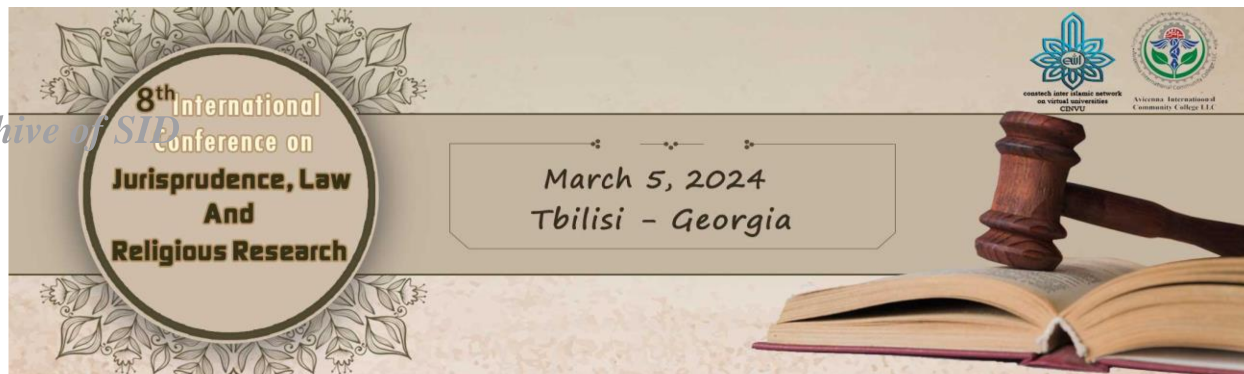

resolution systems, the application of general principles of conflict of laws, the direct choice of substantive law, and the application of formal commercial law, including general legal principles or international commercial customs and usages or general international law.

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