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## DOES INTERNATIONAL ARBITRATION NEED A MANDATORY RULES METHOD?

*Alexander K.A. Greenawalt\**

If the articles in this volume are any guide, the role of mandatory rules in international arbitration remains a persistent source of debate. The basic problem is a straightforward one: contractual arbitration arises as a matter of the parties' consent, but the resolution of contractual disputes can implicate mandatory rules of law that are not waivable and are typically designed to protect broader public rights. Since national legal systems began ceding the application of mandatory rules to party-appointed arbitrators, scholars of international arbitration have struggled to come to grips with the implications of this reality for the resolution of cross-border disputes in which the public policy of several states is at stake.

The literature on mandatory rules has often presented the issue in stark terms, as posing a fundamental “conflict between the will of the State having promulgated the mandatory rules of law, on the one hand, and, on the other hand, the will of the parties—from which [the arbitrator’s] own authority is derived.”<sup>1</sup> Asserting an independent public duty to protect national mandatory laws as well as the enforceability of arbitral awards, a number of writers have further urged arbitrators to apply a so-called “mandatory rules method” to determine, regardless of what the parties have agreed, which particular mandatory rules to apply in a particular dispute. Although the details of the method differ from author to author, the basic proposition is that arbitrators should apply a stand-alone balancing test that considers, based on the nature of the rule and the connection to the parties' transaction, the strength of a particular state's interest in having its mandatory rules enforced.<sup>2</sup>

In these remarks, I take a skeptical view of the mandatory rules literature and argue that arbitration of mandatory rules is readily handled within the standard, contractual view of arbitration. In particular, I argue that the alleged conflict

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\* Associate Professor of Law, Pace University School of Law. The author had the privilege of presenting an earlier draft of this article at the Colloquium on Mandatory Rules of Law in International Arbitration, held at Columbia Law School on June 8, 2007. He extends his gratitude to organizers George A. Bermann and Loukas Mistelis and to the other participants in the colloquium for their helpful comments.

<sup>1</sup> Pierre Mayer, *Mandatory Rules of Law in International Arbitration*, 2 *ARB. INT'L* 274 (1986).

<sup>2</sup> See generally Mayer, *supra* note 1; See also Marc Blessing, *Mandatory Rules of Law versus Party Autonomy in International Arbitration*, 14(4) *J. INT'L ARB.* 23 (1997); Nathalie Voser, *Mandatory Rules of Law as a Limitation on the Law Applicable in International Commercial Arbitration*, 7 *Am. Rev. Int'l. Arb.* 319 (1996); Serge Lazareff, *Mandatory Extraterritorial Application of National Law*, 11(2) *ARB. INT'L* 137, 142 (1995); Daniel Hochstrasser, *Choice of Law and 'Foreign' Mandatory Rules in International Arbitration*, 11(1) *J. INT'L ARB.* 57, 85-86 (1994).

between mandatory rules and party autonomy reflects a mistaken view of national arbitrability doctrines that, once corrected, deprives the case for a special mandatory rules method of much of its force. At the same time, however, the consequences of this insight are more limited than might be supposed because modern arbitration agreements generally give arbitrators far more authority to consider and apply mandatory rules than advocates of the mandatory rules method have assumed. Indeed, because arbitrators can typically claim contractual authority to apply *all* applicable mandatory rules, the actual effect of relying on a separate mandatory rules method will be to narrow rather than to expand the number of mandatory rules within the arbitrator's cognizance. There may be reasons why this narrowing is prudent, but that is not a question to which the existing literature has thus far paid much attention. Future discussion of mandatory rules arbitration should therefore take better account both of national arbitrability laws and the full range of options typically facing the international arbitrator.

My discussion proceeds in two parts. I begin with a review of the national perspective. Drawing from the United States' experience, I consider the choices that local courts and legislatures have in deciding whether, and to what extent, to recognize arbitration of mandatory rules. Although the questions here are distinct from those facing arbitrators themselves, the transnational system by which arbitration agreements are recognized and enforced necessarily plays a critical role in framing arbitrators' choices. In this respect, the U.S. model provides both a representative example of a national arbitration law and an especially important historical force that, largely on account of the U.S. Supreme Court's decision in *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*,<sup>3</sup> provoked the original debate over the mandatory rules method. The second part of the article turns to the perspective of the arbitrator. Here, I critique the position that arbitrators should apply mandatory rules not authorized by the parties' agreement, I consider the extent to which modern arbitration agreements nevertheless do authorize arbitrators to apply a wide range of mandatory rules arising under different legal systems, and I ask whether a mandatory rules method might nevertheless have a role to play once the questions have been properly framed.<sup>4</sup>

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<sup>3</sup> 473 U.S. 614, 631 (1985).

<sup>4</sup> In part, this article condenses ideas that Donald Francis Donovan and I have previously published as a book chapter. See Donald Francis Donovan and Alexander K.A. Greenawalt, *Mitsubishi After Twenty Years: Mandatory Rules Before Courts and International Arbitrators*, in *PERVASIVE PROBLEMS IN INTERNATIONAL ARBITRATION* (Loukas Mistelis & Julian Lew eds., 2006). The article goes beyond that effort, however, in giving more sustained attention to the possible theoretical foundations that might justify some version of the mandatory rules method. As part of this analysis, it considers the ways which United States case law post-*Mitsubishi* may have weakened the non-waivability of mandatory rules, thus establishing a national arbitration law framework that is somewhat more conducive to the mandatory rules method than would be suggested by *Mitsubishi* itself.

## I. MANDATORY RULES AND DOMESTIC LEGAL POLICY

Debate over domestic responses to mandatory rules arbitration reduces to one fundamental question: Can arbitrators be entrusted with the adjudication of domestic public policies? Although primarily a question to be answered by individual legal systems, is also has obvious relevance to the work of international arbitrators, both because it impacts the scope of questions submitted to arbitration and because arbitration always takes place in the shadow of the judicial review that a party may seek in a national court.

States wary about the possible erosion of their public policies will be tempted to require greater oversight of mandatory rules than that afforded to contractual claims. Domestic legal systems might prohibit arbitration of mandatory rules entirely, or they might require courts to exercise heightened scrutiny review, for example by reviewing *de novo* the merits of mandatory rule determinations at the enforcement stage. The attraction of this approach is obvious: the domestic state's courts retain the ability to police the application of their own mandatory rules, ensuring perhaps that an arbitral tribunal will not produce an enforceable award that violates the state's public policy.<sup>5</sup>

The fact that many states do not follow this approach, however, reflects the potential impact upon another public policy: that favoring arbitration as a neutral and relatively efficient means of resolving cross-border disputes between parties who may be justifiably wary of being dragged into each others' respective court systems.<sup>6</sup> The U.S. Supreme Court, for instance, has long interpreted its national arbitration laws to impose an "emphatic federal policy in favor of arbitral dispute resolution" which has "special force"<sup>7</sup> in the international context, and we have seen the rise of an international treaty system highly favorable to arbitration as a means of resolving both private party and investor-state disputes.<sup>8</sup> Judicial determination or review of mandatory rules otherwise submitted to arbitration raises multiple concerns: national courts may exploit their review to undo arbitral awards for improper reasons; the efficiencies of arbitration may be lost on account of duplicative litigation, especially where contractual and mandatory claims share a common factual basis; and parties, cognizant of this last point, may invoke frivolous mandatory rules claims as a deliberate means of frustrating the arbitration agreement.

A more relaxed approach allows parties to submit mandatory rules to conclusive arbitration without substantive judicial review. That is the course that the U.S. Supreme Court has endorsed, most famously in its *Mitsubishi* decision, which focused on the arbitrability of U.S. competition law under the Sherman Act.

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<sup>5</sup> See generally Eric A. Posner, *Arbitration and the Harmonization of International Commercial Law: A Defense of Mitsubishi*, 39 VA. J. INT'L L. 647, 647-49 (1999).

<sup>6</sup> *Id.*

<sup>7</sup> See, e.g., *Mitsubishi*, 473 U.S. at 631.

<sup>8</sup> United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, June 10, 1958, 21 U.S.T. 2517, 330 U.N.T.S. 38 (codified at 9 U.S.C. §§ 201-208) [hereinafter N.Y. Convention].

After finding that Respondent Soler's Sherman Act claims were within the scope of the parties' arbitration clause, the Court determined the claims to be arbitrable and dismissed Soler's action to bring those claims in U.S. court. In famous dicta, the Court further emphasized that arbitration was not tantamount to waiver, and that "in the event the choice-of-forum and choice-of-law clauses operated in tandem as a prospective waiver of a party's right to pursue statutory remedies, we would have little hesitation in condemning the agreement as against public policy."<sup>9</sup> Accordingly, the Court also emphasized the availability of judicial review at the award enforcement stage—*Mitsubishi's* so-called "second look,"—but cautioned that such review would be limited to "ascertain[ing] that the tribunal took cognizance of the antitrust claims and actually decided them."<sup>10</sup> *Mitsubishi*, in sum, stands for the proposition that mandatory rules, or at least some of them, may be conclusively left to arbitral determination, but they cannot be waived.

As should be apparent, the success of *Mitsubishi's* two pillars—arbitrability and non-waivability—depends greatly on the reliability of private arbitration as a means of vindicating national public policies. The advisability of this approach depends greatly in turn on how one responds to the following three questions, which I consider in turn:

A. *Is Mitsubishi Worth the Risk of Under-Enforcement of Mandatory Rules in Individual Cases?*

As the premise of this question reflects, *Mitsubishi's* highly deferential review of arbitrated mandatory rule disputes will necessarily lead to some under-enforcement of mandatory law. Arbitrators applying mandatory rules will of course reach the wrong decision in some cases. Because *Mitsubishi* deprives courts of substantive judicial review over arbitrable mandatory rules claims that the arbitrators have "taken cognizance of" and "actually decided," bad decisions will remain uncorrected in cases in which more substantive review would have caught and corrected the adjudicator's error. Those for whom this consideration alone is a deal breaker will reject the *Mitsubishi* approach.

The reason that arbitration of mandatory rules has nonetheless received judicial tolerance reflects at least two inter-related considerations beyond the general public policy favoring arbitration. First, because arbitration itself is voluntary, there is no guarantee that mandatory rules violations will receive judicial enforcement in the first place: the parties are free to settle their claims and may even fail to pursue them. From this perspective, a party who receives a bad arbitration award may seem little different from a party who has entered into a disadvantageous settlement award that fails to capture the full value of her claim.

Second, and more fundamentally, the possibility of individual bad outcomes is far more palatable if there is no reason to expect *ex ante* that arbitration will provide a less secure means of vindicating mandatory rules than litigation. As

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<sup>9</sup> *Mitsubishi*, 473 U.S. at 637.

<sup>10</sup> *Id.* at 638.

long as parties have no particular expectation that they can escape mandatory rules by entering into arbitration agreements, those rules will vindicate public policy by exerting a deterrent effect, and parties weighing whether to bring or settle claims will do so in the shadow of mandatory law. Arbitrators may, of course, end up under-enforcing mandatory rules in the individual case, but this prospect may not affect the parties' behavior as long as the arbitrators are just as likely to err in the other direction by over-enforcing mandatory law.<sup>11</sup>

Even so, one might seek to distinguish between mandatory rules, perhaps ceding arbitrators greater deference in the economic sphere of competition and securities laws while perhaps exercising greater scrutiny in areas like discrimination law that speak to deeper, dignitary values that might seem the more appropriate province of the judiciary. The U.S. courts, for their part, have by and large rejected such distinctions and have instead applied the *Mitsubishi* framework broadly in cases where a statute establishing privately enforceable mandatory rules is silent on the question of arbitrability.<sup>12</sup>

#### B. *Is Private Arbitration Biased Against the Enforcement of Mandatory Rules?*

In light of the above, the most sustained academic criticism of *Mitsubishi* approach has focused not on the prospect that individual arbitrations might under-enforce mandatory rules, but on the fear that the arbitral system may be systematically predisposed toward that result. Concern here has focused on the fact that arbitrators are paid by the parties and selected according to a mechanism of the parties' choice. As Eric Posner has argued, "arbitrators would want to ignore mandatory rules because they know that merchants, *ex ante*, prefer that their contracts be enforced as written and would prefer to pay for the services of arbitrators who enforce the contract rather than the mandatory rules that the contract may violate."<sup>13</sup> Following Andrew Guzman's more careful elaboration of this insight, the proposition must be that arbitral appointing institutions—also paid by the parties—reflect this bias, because typically it is the appointing institution, and not the individual arbitrator, whom the contract selects *ex ante* before a dispute has arisen.<sup>14</sup> Thus, the theory is that appointing institutions, when acting

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<sup>11</sup> Notably, the *Mitsubishi* court expressly "decline[d] to indulge the presumption that the parties and arbitral body conducting a proceeding will be unable or unwilling to retain competent, conscientious, and impartial arbitrators." *Id.* at 634.

<sup>12</sup> See, e.g., *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 35 (1991) (Age Discrimination in Employment Act of 1967); *EEOC v. Luce, Forward, Hamilton & Scripps*, 345 F.3d 742, 748-49 (9th Cir. 2003) (Title VII of the Civil Rights Act of 1964); *Bercovitch v. Baldwin School, Inc.*, 133 F.3d 141, 151 (1st Cir. 1998) (Americans with Disabilities Act of 1990).

<sup>13</sup> Posner, *supra* note 5, at 650.

<sup>14</sup> Andrew T. Guzman, *Arbitrator Liability: Reconciling Arbitration and Mandatory Rules*, 49 DUKE L. J. 1279, 1302-07 (2000). Procedures for appointing arbitrators are generally provided in a set of procedural rules that the parties designate in their contract. Often those rules are promulgated by an arbitral institution such as the International

to select sole or tie-breaking arbitrators, will choose arbitrators biased against mandatory rules. By contrast, party-selected arbitrators should not be expected on balance to reflect this bias, because each party will have the opportunity to select an arbitrator after the dispute has arisen, at which point the parties will make their selections in full knowledge of whether they wish to urge or oppose application of a mandatory rule, and can take this circumstance into consideration.

To the extent one may draw conclusions based on the discussion at the symposium giving rise to this volume, this account of arbitrator bias does not find much sympathy among the elite group of scholars and practitioners who actually serve as arbitrators in the kinds of disputes supervised by the major international appointing institutions. Of course, bias need not be conscious: one can imagine a world in which all arbitrators conscientiously seek to apply applicable law and achieve the “right” result but are nevertheless drawn from a slanted pool that, statistically speaking, is less likely to enforce mandatory rules than the average court in the jurisdiction that promulgated the rule. But such conjecture rests on too many untested assumptions that caution against reaching firm conclusions—not to speak of policy prescriptions—based on the simple fact that arbitrators are paid by the parties. One would need to know something about the actual demand for mandatory rule evasion among parties who sign on to arbitration clauses, and in particular whether such demand is significant enough to affect the economics of appointing institutions. One would also need to take account of other arbitrator incentives pointing in the other direction, incentives such as the general desire to provide the neutral and competent decision-making that so many parties seek from international arbitration (and fear that they cannot receive from the national courts of the other party), and the reputational interests of arbitrators both inside and outside the arbitral community.

The complexity of the issue suggests, at minimum, that the specter of arbitral bias must be assessed as an empirical question, not simply a theoretical one. And here, the existing evidence is at best inconclusive. Studies have failed thus far to establish bias in arbitration generally, including, for example, in the context of domestic U.S. employment disputes where the prevalence of repeat player defendants would seem to create a clear incentive for bias against plaintiffs.<sup>15</sup> Focusing on the specific issue of mandatory rules, some commentators, Donald Francis Donovan and myself included, have noted the general dearth of U.S. case law challenging post-*Mitsubishi* mandatory rule determinations by international arbitrators, suggesting perhaps that under-enforcement of mandatory rules is not as common a feature of the system as some have feared.<sup>16</sup>

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Chamber of Commerce (ICC) or the American Arbitration Association (AAA), in which case the promulgating institution will generally be designated as the appointing authority. The commonly used UNCITRAL Rules provide for ad hoc arbitration with the Permanent Court of Arbitration in The Hague, The Netherlands serving as the appointing authority.

<sup>15</sup> For a summary of the literature with citations, see W. Mark C. Weidemaier, *From Court-Surrogate to Regulatory Tool: Re-Framing the Empirical Study of Employment Arbitration*, \_\_ Mich. J. L. Ref. \_\_ (forthcoming, 2008)

<sup>16</sup> See Donovan & Greenawalt, *supra* note 4, at 38; Posner, *supra* note 5, at 667-68.

C. *Is Mitsubishi Justified Even It Results in the Under-Enforcement of Mandatory Rules?*

Even if arbitration of mandatory rules does result in some under-enforcement of national public policies, might the *Mitsubishi* approach be justified nonetheless?<sup>17</sup> The issue might be viewed as one of balancing competing public policies: the public policy in favor of arbitration versus the public policies reflected by mandatory rules. William Park has noted, for example, that a “special rule of arbitrability for the international realm would be justified under a hierarchy of societal policies that take into account the peculiar need for neutrality in resolution of international contracts disputes.”<sup>18</sup>

Although *Mitsubishi’s* anti-waiver principle would seem opposed to such balancing, lower federal courts have used the precedent to do precisely that. In a series of cases arising out of the *Lloyd’s of London* bankruptcy, and exemplified by *Roby v. Corp. of Lloyd’s*,<sup>19</sup> the federal courts of appeals have enforced arbitration and judicial forum selection agreements even on the assumption that English courts and arbitrators would not enforce applicable U.S. securities and racketeering laws invoked by the plaintiffs. Emphasizing considerations of comity, the *Roby* Court reached this somewhat surprising outcome by effectively redefining the non-waivable “right” protected by *Mitsubishi* to be one that allows some dilution of mandatory law.<sup>20</sup> The fundamental question, in the Court’s view, was not whether the specific content of U.S. mandatory law would apply, but instead whether the available remedies were sufficient to vindicate the statutory policies underlying that mandatory law. Although English law allowed neither the “controlling person” liability of U.S. securities law nor the treble damages offered by the RICO statute, the Court reasoned that English law was nevertheless sufficient “to deter British issuers from exploiting American investors through fraud, misrepresentation or inadequate disclosure.”<sup>21</sup> In other words, while mandatory rules must be protected, that protection may take a diluted form.

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<sup>17</sup> An added complexity which deserves mention is that not all cases of reduced enforcement properly count as under-enforcement. One obvious example is the fear that national courts are biased against foreign parties. If that fear is justified, then arbitration may well avoid the illegitimate and discriminatory application of mandatory rules by national courts in cases involving foreign parties. Similar, although more complex, is the situation in which a nation’s courts are more aggressive about the application of mandatory rules than the legislature intended or than might otherwise be desirable according to some other benchmark. The latter problem raises the difficult question of how exactly one measures the “correct” amount of mandatory rule enforcement.

<sup>18</sup> See William W. Park, *Private Adjudicators and the Public Interest: The Expanding Scope of International Arbitration*, 12 BROOK. J. INT’L L. 629, 667 (1986).

<sup>19</sup> 996 F.2d 1353, 1361-66 (2d Cir. 1993). See also *Haynsworth v. The Corp.*, 121 F.3d 956, 969-70 (5th Cir. 1997); *Allen v. Lloyd’s of London*, 94 F.3d 923, 928-30 (4th Cir. 1996); *Bonny v. Soc’y of Lloyd’s*, 3 F.3d 156, 161-62 (7th Cir. 1993).

<sup>20</sup> *Roby*, 996 F.2d at 1364-65.

<sup>21</sup> *Id.* at 1365.

## II. THE MANDATORY RULES METHOD

I turn now to the perspective of the arbitrator deciding whether or not to apply a particular mandatory rule in a particular dispute. Although distinct from the question of arbitrability, the debate over what arbitrators should do with mandatory law has focused heavily on the implications—both real and perceived—of national arbitration law. Beginning with Pierre Mayer’s seminal article published shortly after the *Mitsubishi* decision, the debate has largely been defined by the writings of those who, like Mayer, have urged the adoption of a special “mandatory rules method” to govern arbitration of mandatory rules. The argument proceeds roughly as follows: By ceding arbitrators the authority to apply mandatory national law, decisions like *Mitsubishi* have exploded the traditional contractual basis of arbitration.<sup>22</sup> Because mandatory rules are not subject to party consent, the parties’ own choice of law cannot bind the arbitrator’s determination of which, if any, mandatory law to apply. The arbitrator must therefore move beyond the contract and make an independent determination—typically via a balancing test based on the totality of the circumstances—of which states’ mandatory rules deserve application in a particular dispute.<sup>23</sup> The precise criteria vary from author to author, but generally draw inspiration from conflict of laws doctrines applied in domestic courts, in particular Article 7 of the European Union’s Rome Convention on the Law Applicable to Contractual Obligations, which provides that states parties may give effect to “to the mandatory rules of the law of another country with which the situation has a close connection.”<sup>24</sup>

As I outline below, arbitrability of mandatory rules does not in fact involve a departure from the contractual basis of arbitration. That fact alone, however, does not doom the mandatory rules method, because in most cases the contract itself will afford arbitrators great discretion to determine whether and which mandatory rules should apply. Seen in its proper context, however, the mandatory rules method is the progeny not of *Mitsubishi*, but of the *Roby* line of cases. In other

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<sup>22</sup> Blessing, *supra* note 2, at 38 (“under the US perspectives set on the basis of *Mitsubishi v. Soler* and the threat of the ‘second-look doctrine’, it is quite clear that an arbitral tribunal has a perceived duty, and not only a right, to examine the compatibility with US antitrust laws *ex officio*, wherever a matter could have anti-competitive effects within the United States.”); Mayer, *supra* note 1, at 297-80 (The [*Mitsubishi*] decision is nonetheless of fundamental importance in that it demonstrates the connection between the issue of the right to apply mandatory rules and the obligation to do so. In holding that arbitrators have a right to apply such rules, the Supreme Court appears to presume that they are in some manner obliged to do so, which in turn makes it possible to trust them in this matter.”).

<sup>23</sup> See generally Mayer, *supra* note 1; Blessing, *supra* note, 2; Voser, *supra* note 2; Lazareff, *supra* note 2.

<sup>24</sup> Rome Convention, Art. 7, 1980 O.J. (L 266) 1. The Convention will be replaced by Regulation No. 593/2008 of June 17, 2008, 2008 O.J. (L 177) 6, when the Regulation enters into force in 2009.

words, it is a method which operates to *limit* rather than expand the mandatory law potentially applicable in arbitration. Whether such limitation is in fact desirable remains a question that has received insufficient consideration.

#### A. *Mandatory Rules Beyond the Arbitration Clause*

Consider the following hypothetical scenario. During the course of their contractual negotiations, Soler discovers that Mitsubishi has a reputation for anti-competitive practices. Desiring the protections of the Sherman Act, and fearing that a panel of Japanese arbitrators will be reluctant to vindicate U.S. competition laws, Soler succeeds in narrowing its contractual arbitration clause via express language stating that the arbitration agreement shall not extend to claims or defenses arising out of the Sherman Act. By doing so, Soler does not seek to waive mandatory law, but instead merely wishes to preserve a judicial forum for any such claims or defenses. Surely, an arbitrator faced with this language would not be justified in bypassing the contract and applying the Sherman Act nonetheless on account of a mandatory rules method. Indeed, an arbitrator who did so would jeopardize the award under Article V(1)(c) of the New York Convention which permits courts to refused enforcement where “[t]he award deals with a difference not contemplated by or not falling within the terms of the submission to arbitration.”<sup>25</sup>

As this hypothetical suggests, the mandatory nature of competition law must not be confused with the discretionary nature of arbitration itself. Just as no one is forced to sign contractual arbitration clauses in the first place, no one should be forced to arbitrate disputes arising under mandatory rules. The point of *Mitsubishi’s* anti-waiver principle is that some forum must remain available for the vindication of mandatory rules, but that forum need not be an arbitral forum.

This basic logic provides a contractual rationale for mandatory rules arbitration that stands up remarkably well to the arguments put forward by those who urge arbitrators to look beyond the contract. It is true, for example, that arbitral refusal to take cognizance of a mandatory rule may result in that rule being bypassed because the victorious party seeks enforcement in a jurisdiction that does not recognize the rule.<sup>26</sup> Assuming Soler had assets in Japan, one can imagine Mitsubishi enforcing an eventual arbitral award there, thus avoiding the U.S. court system and, to the extent the Japanese courts refused to apply it, the Sherman Act as well. But that would also be the result in the event that the parties had never entered into an arbitration agreement in the first instance and Mitsubishi had pursued its case in Japanese court from the very beginning. And in both cases

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<sup>25</sup> N.Y. Convention, *supra* note 8.

<sup>26</sup> This particular concern prompted debate among the participants at the June 8, 2007 Colloquium on Mandatory Rules of Law in International Arbitration at Columbia Law School, where I presented an earlier draft of this paper. The broader concern that arbitration might provide a means of evading applicable mandatory rules has been a constant theme of the mandatory rules literature since Mayer wrote on the topic in 1986. See Mayer, *supra* note 1.

Soler remains free to pursue its Sherman Act claim in U.S. court. That route may or not provide an effective remedy: much depends on the strength of the claim, whether the U.S. courts will entertain it, where enforcement will be sought, and what effect, if necessary, foreign courts will give to the outcome of the U.S. proceeding. But these potential roadblocks exist regardless of the existence of an arbitration agreement.

A second argument observes that the arbitrator's refusal to apply a mandatory rule may lead to the annulment or non-enforcement of the resulting award, thus violating the arbitrator's putative duty to produce an enforceable award.<sup>27</sup> But what exactly is the nature of this duty, such as it may exist? It is, of course, reasonable to assume that when parties elect to submit their disputes to arbitration, they do so with the expectation that this method will prove effective and efficient. Indeed, parties will often adopt procedural rules that explicitly instruct the arbitrators to safeguard award enforceability.<sup>28</sup> But this is merely to say that a general duty to protect enforceability can be implied from the parties' agreement. It is a very different proposition to argue that arbitrators should invoke this duty as means of exceeding or violating the parties' agreement, particularly where application of a mandatory rule excluded by the parties will operate to change the result of the dispute. This approach is especially problematic in cases where the arbitrator does not know where enforcement will be pursued, or where a victorious claimant has the ability to enforce the award in multiple jurisdictions. For example, an arbitrator invoking a public policy against punitive damages drawn from the anticipated jurisdiction of enforcement might end up denying significant relief to a deserving claimant who actually intends to enforce in a different jurisdiction that has no such rule.

A third argument focuses on scenarios in which the parties' motive for excluding arbitration of mandatory rules might be less pure than in the hypothetical I posed above. It might be the case, for example, that the parties have entered into an illegal venture involving money laundering, bribery, child trafficking or some other corrupt activity. Wishing to resolve a particular dispute without calling attention to the illicit nature of their transaction, the parties commit to arbitration but preclude the tribunal from applying the mandatory rules that render the entire contract unenforceable. Although the arbitrator could simply resolve the contractual dispute while leaving mandatory law for the enforcing court to apply, the arbitrator may well be in a better position to detect the illegality, given the richer factual record before her, and the disincentive the parties may have to raise the issue before an enforcing court. The arbitrator

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<sup>27</sup> See, e.g., Mayer, *supra* note 1. (“[The arbitrator] should seek to respect the contract and the intent of the parties, but at the same time be concerned with the efficacy of his award and the avoidance of annulment.”)

<sup>28</sup> For example, Article 35 of the ICC Rules establish the “general rule” that “[i]n all matters not expressly provided for in these Rules, the Court and the Arbitral Tribunal shall act in the spirit of these Rules and shall make every effort to make sure that the Award is enforceable at law.”

should also have well founded ethical concerns about deciding the dispute in the first instance.

This last hypothetical presents a more troubling scenario, but for reasons that will be clarified below, it properly arises only when the parties explicitly exclude arbitral application of one or more mandatory rules. My sense, however, is that this is a rare scenario, and certainly not the case that advocates of the mandatory rules method seem to have in mind as their paradigmatic model. Although parties should certainly be allowed to reserve mandatory rules claims for the courts, doing so by way of an explicit contractual provision in order to cloak illicit activity would only seem to risk calling the courts' attention to that activity. It is also not the typical case in which privately invocable mandatory rules are likely to prove meaningful: generally speaking, private enforcement of mandatory rules offers an effective deterrent because one of the parties will have an incentive to invoke the rule after a dispute arises. For obvious reasons, private enforcement will provide weaker protections in cases where both parties persist in cloaking their mutually illegal activity even after a dispute has arisen.

In any event, the arbitrator facing such a contract has several options. One possibility is to simply refuse to decide the dispute on ethical grounds. Another is to decide the dispute but expose the potential illegality in a way designed to draw the attention of an enforcing court.<sup>29</sup> Finally, to the extent that the mandatory rule violation is one that draws universal or near universal condemnation from the world's legal systems, the arbitrator might invoke the rule as a matter of so-called "truly international public policy."<sup>30</sup> Although this last option resembles the mandatory rules method to the extent that it contemplates an arbitrator applying law beyond the scope of the contractual mandate, truly international public policy (so-named to distinguish it from specialized domestic public policy doctrines that are applicable to international disputes) should be less controversial to the extent the doctrine focuses on the clearest cases of illicit activity that violates universal public policies shared by every or virtually every modern legal system.<sup>31</sup> If the mandatory rules method were only concerned with this narrow set of cases, then surely it would not have occasioned the debate that it has.

#### B. *Mandatory Rules Within the Contract*

If advocates of the mandatory rules method have failed to explain why vindication of national public policies requires arbitrators to look beyond the

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<sup>29</sup> Of course, the parties might well settle the dispute post-arbitration without ever reaching the courts.

<sup>30</sup> See, e.g., Yves Derains, *Public Policy and the Law Applicable to the Dispute in International Arbitration*, in *COMPARATIVE ARBITRATION PRACTICE AND PUBLIC POLICY IN ARBITRATION* 227, 251-52 (ICCA Congress Series No. 3, Pieter Sanders ed., 1986).

<sup>31</sup> Note, however, that not all advocates of applying truly international public policy have viewed the doctrine in such narrow terms. See *id.* (including within the category of "truly international public policy" situations in which enforcement of a contract would violate the law of the place of performance)

litigants' contract, the irony is that such adventurism may almost never be necessary in order to give effect to applicable mandatory rules. In this respect, the perceived necessity of the mandatory rules method on the part of its advocates appears to flow from an overly narrow view of the arbitrator's mandate in the standard case. In particular, much of the literature appears to rest on the mistaken assumption that application of any mandatory rule arising under a law other than that specified by the parties necessarily creates some tension with arbitration's contractual foundations.<sup>32</sup> In fact, the international arbitrator will typically have adequate contractual authority to look to additional mandatory laws, and in many instances will even be required to do so.

The clearest example of this phenomenon is where the parties' choice of law itself gives effect to foreign mandatory law, as is the case where the doctrine of *force majeure* excuses a contractual obligation based on an unforeseen illegality in the place of performance regardless of whether or not the conduct in question is independently proscribed by the law governing the dispute.<sup>33</sup> The parties' chosen law may also prohibit the parties from employing a choice-of-law clause as a means of evading an illegality in the place of performance.<sup>34</sup> In such cases, arbitral reliance on the law of the place of performance can hardly be described as a departure from the contract. Nevertheless, commentators have analyzed the arbitral case law in these terms. The Swiss *Hilmarton/OTV* case, for example, has been described as "clear application of the mandatory rules approach, under which the arbitrator felt entitled to give effect to the mandatory rules of a law other than that governing the contract."<sup>35</sup> Yet the case report reveals that the arbitrators applied an Algerian prohibition on the use of intermediaries to invalidate a contract not because they claimed extra-contractual authority, but because they believed that the parties' contractual choice of Swiss law required them to honor the public policies of the place of performance.<sup>36</sup> Indeed, a previous review that

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<sup>32</sup> Surveying the literature, Lazareff concludes, for example, that "[t]here is a growing tendency of arbitrators to consider that they are exercising a judicial function that goes beyond the will of the parties, thus accepting more and more frequently the need to take account of laws other than the *lex contractus*." Lazareff, *supra* note 2, at 142.

<sup>33</sup> See, e.g., FOUCHARD GAILLARD GOLDMAN ON INTERNATIONAL ARBITRATION 849 (Emmanuel Gaillard & John Savage eds., 1999) (noting that "a law other than that governing the contract which prohibits the export of goods under the conditions set forth in the contract could be considered, under the law governing the contract, to be a *force majeure* event").

<sup>34</sup> For example, courts applying New York law have held that a contract that is otherwise unobjectionable under New York law should not be enforced if the contract violates the law of its place of performance and the parties entered into the contract with the intent to violate that foreign law. See *Lehman Bros. Commercial Corp. v. Minmetals Int'l Non-Ferrous Metals Trading Co.*, 179 F. Supp.2d 118, 138 (S.D.N.Y. 2000).

<sup>35</sup> FOUCHARD GAILLARD GOLDMAN, *supra* note 33 at 854; see also JULIAN LEW, LOUKAS MISTELIS & STEFAN KRÖLL, COMPARATIVE INTERNATIONAL COMMERCIAL ARBITRATION 422 (2003) (same).

<sup>36</sup> Final Award in Case No. 5622 of 1988, XIX Y.B. COM. ARB. 105 (1994). Switzerland's Court of Appeal disagreed and annulled the award on the ground that the

Donovan and I conducted of the cases cited in the mandatory rules literature confirms Fouchard et al.'s more general observation that there are "virtually no cases where the arbitrators have relied on the application of a mandatory rule to justify a decision other than that would have resulted from the application of the law chosen by the parties."<sup>37</sup>

Even where the parties' choice-of-law clause does not require application of foreign mandatory law, it rarely precludes it. That is because contractual dispute resolution clauses are typically broader than choice-of-law provisions. Parties routinely commit to arbitration not merely breach-of-contract claims, but a broader range of actions having some nexus to the contractual relationship. The International Chamber of Commerce ("ICC"), for example, urges parties to use a model arbitration clause dictating that "[a]ll disputes arising out of or in connection with the present contract shall be finally settled under the Rules of Arbitration of the International Chamber of Commerce by one or more arbitrators appointed in accordance with the said Rules."<sup>38</sup> Although the efficiencies of broad arbitration clauses are readily apparent—they help parties reduce the risk of having their disputes split between multiple fora—, it is also largely on account of these provisions that the mandatory rules claims become subject to arbitration. Choice-of-law provisions, on the other hand, are typically narrower. They tend to specify the law "governing" the contract itself,<sup>39</sup> not the law applicable to all disputes "arising out of or in connection" with the contract.

The critical point is that arbitrators facing this standard pairing of broad arbitration provision and narrow choice-of-law clause need not limit their consideration of mandatory rules to those arising under the parties' chosen contractual law. The *Mitsubishi* case itself is illustrative. Although the contract contained a provision choosing Swiss law, the U.S. Supreme Court accepted the parties' submission that the dispute resolution provision encompassed Soler's Sherman Act and RICO claims arising under U.S. law, and it noted that these claims were in fact before the arbitrators.<sup>40</sup> This logic applies most clearly to non-contractual claims, but the savvy arbitrator might even extend a similar argument to contractual *defenses* on the ground that, unless the parties have specified otherwise, choice-of-law clauses should be read as limited to waivable default rules and not extending to any applicable mandatory law whether affirmative or

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arbitrator had misapplied Swiss law and that the result was arbitrary. Tribunal Fédéral [Supreme Court], 17 April 1990, XIX Y.B. COM. ARB. 214, 217 (1994). There was no disagreement, however, that the issue was one of correctly applying the parties' own choice of Swiss law.

<sup>37</sup> FOUCHARD GAILLARD GOLDMAN, *supra* note 33, at 856-57; Donovan & Greenawalt, *supra* note 4, at 54.

<sup>38</sup> International Chamber of Commerce, "The standard ICC arbitration clause: Drafting the arbitration agreement," available at [http://iccwbo.org/court/english/arbitration/model\\_clause.asp](http://iccwbo.org/court/english/arbitration/model_clause.asp).

<sup>39</sup> Looking again to the ICC, its rules advise that "it may also be desirable for the parties to stipulate in the arbitration clause itself . . . the law governing the contract." *Id.*

<sup>40</sup> See *Mitsubishi*, 473 U.S. at 637 n.19.

defensive in nature. A true conflict between the parties' agreement and consideration of mandatory law may not arise, in other words, unless an arbitrator faces a rare instance in which the contract expressly excludes consideration of mandatory law. To the extent arbitrators adopt this approach, conflicts between contractual law and mandatory law will largely disappear.

*C. Is There an Alternate Basis for the Mandatory Rules Method?*

By now it may seem that there is less than meets the eye to the debate on arbitration of mandatory rules. The standard arguments for ignoring the parties' contractual commitments appear to rest on a mistaken reading of the *Mitsubishi* decision and are not persuasive on their own terms. And this point itself may largely be moot because arbitrators routinely can find authority within the parties' agreement to apply applicable mandatory rules. Still, this reappraisal of the debate does not eliminate the problem of mandatory rules in international arbitration. The fact remains that whether or not there is authority in the contract to apply mandatory rules, the arbitrator still faces the question of which, if any, mandatory rules to invoke. The simple answer, of course, is that the arbitrator should obey the contract. But that prescription is of little help when the contractual command is far from clear in the face of a broadly phrased dispute resolution clause that does not provide clear instructions on the matter. If anything, contractual language of this sort operates as a kind of delegation from the parties to the arbitrators to determine which laws to apply. How should the arbitrator go about this task? Does a distinct mandatory rules method have any role to play in this context?

To unpack this question, it helps to start with the maximal option. Why shouldn't arbitrators simply apply any applicable mandatory rules that are not expressly excluded by the contract? The *Mitsubishi* arbitrators, for example, would not need to choose between U.S. and Japanese competition laws. In the event that the laws of both states (or even a third state) extended to the parties' conduct, the arbitrators could simply entertain and decide all applicable claims. *Mitsubishi's* anti-waiver principle itself supports this approach as a policy matter: If parties are not allowed to waive applicable mandatory law, arbitration will prove more effective if the arbitrators take cognizance of more rather than fewer mandatory claims. After all, as I have already detailed, a decision to limit or exclude consideration of mandatory rules may well preserve those rules for the courts, leading to additional, potentially duplicative proceedings that undermine the parties' decision to employ arbitration.

Seen in this light, the prevalence of dispute resolution clauses reaching more broadly than choice-of-law clauses makes sense. Where waivable default rules are at issue, the parties to the contract can make their agreement more concrete and predictable by choosing the body of law that will govern contractual interpretation. But unless the parties actually wish to preserve certain mandatory claims for the courts, there is no point in limiting arbitrable mandatory rules to those arising under only one particular set of national laws. Thus, the maximal

approach provides a plausible reading of the parties' legitimate expectations in cases where the contract does not specify an approach to mandatory rules.

What then of the balancing approach endorsed by advocates of the mandatory rules method? As should already be apparent, this approach needs to be recharacterized. In the vast majority of cases—and indeed in virtually all of the cases cited in the literature<sup>41</sup>—the balancing approach does not, as frequently claimed, involve reaching beyond the parties' agreement in furtherance of some higher duty to protect national public policies. What the method does instead is provide a way of *narrowing* the range of mandatory rules that might otherwise be authorized by the contract.

Taken at face value, this strategy would appear to be self-defeating given the non-waivability of the rules being excluded. However, the picture becomes more complex on account of two inter-related considerations. The first of these is that my argument in favor of the maximal approach rests on the perhaps overly simplistic assumption that international arbitrators are able to identify and apply all of the substantive mandatory law that would otherwise control the dispute were the parties to pursue their remedies in multiple national fora. But doing so may not always be so simple a task. To truly mirror the likely result in national courts, arbitrators would need to consider not only the substantive applicability of those rules,<sup>42</sup> but also a range of court access issues such as jurisdiction and forum convenience. Would the relevant court system possess personal jurisdiction over the suit? What role would doctrines such as forum non conveniens and international comity play in each potential forum? How would each particular court respond to the possibility of parallel proceedings in different countries, and what effect would each court (particularly in jurisdictions where assets are located) give to foreign judgments concerning the same dispute? And what effect would each jurisdiction give to foreign mandatory rules in resolving the merits of the dispute? In addition, arbitrators might find that different mandatory rules conflict with each other, preventing a single resolution to the dispute which gives each rule its due. One state's mandatory rule requiring punitive damages might, for example, run up against another state's prohibition on such damages.<sup>43</sup> In complex disputes touching upon multiple jurisdictions, it may simply be

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<sup>41</sup> Donovan & Greenawalt, *supra* note 4, at 54.

<sup>42</sup> In assessing whether to apply statutes outside U.S. territory, for example, courts have at times employed a multi-factor comity analysis inspired by the very kind of choice-of-law balancing that underlies the mandatory rules method. See *Timberlane Lumber Co. v. Bank of America*, 549 F.2d 597, 614-15 (9th Cir. 1976); cf. *Hartford Fire Ins. Co. v. California*, 509 U.S. 764 (1993). What this means is that an arbitrator following this approach would have to undertake substantially the same analysis in applying the Sherman Act itself as required by advocates of the mandatory rules method.

<sup>43</sup> Arbitrators might in theory deal with this conflict problem by acknowledging the conflict and leaving it to the national courts to decide which parts of the award they wish to enforce. For example, an arbitrator might award punitive damages under one mandatory law while noting simultaneously the prohibition of another mandatory law, leaving it to the latter jurisdiction to refuse enforcement if it so wishes.

impossible—not to speak of costly and time consuming—for an arbitrator to confidently determine exactly which mandatory rules would be available to the parties absent the arbitration agreement. For the arbitrator wishing to avoid wading into these difficulties, some kind of stand-alone mandatory rules method might provide a more streamlined and manageable approach that provides a decent approximation of the result the parties would otherwise be able to achieve.

The second, perhaps farther reaching consideration, is that national courts may approve of arbitral reliance on some form of mandatory rules method. As the Lloyd's cases reflect, the non-waivable character of mandatory rules can be recharacterized to focus on protecting the core interests behind the mandatory rule rather than on honoring every aspect of the rule as codified in a particular national law. One must be careful not to make too much of these precedents, but the reasoning exemplified by the *Roby* decision has potentially far reaching consequences for the arbitrator, whose goal need no longer be to apply all applicable mandatory laws, but instead to select and apply laws whose protections are sufficient to advance the various policies of those states claiming an interest in the dispute. One consequence of this shift may be to mollify, to some degree, the concerns of those who fear that, biased or not, international arbitrators lack the competence to give national mandatory rules their due. If, for example, foreign-trained arbitrators find it difficult to navigate the complexities of U.S. securities laws, perhaps the situation is not so dire if those arbitrators are free to select and apply the laws of a cognate legal system with which they are more familiar.

An even farther reaching question is whether there is anything in the *Roby* approach that limits the analysis to *national* mandatory laws. Indeed, if the goal is simply to apply some law that is adequate to protect the policy interests underlying a particular mandatory law, then one might even imagine the harmonization of national laws into a common international or transnational mandatory law that arbitrators rely upon irrespective of the particulars of any given case. That of course remains a distant goal, and it is one certain to be fraught with difficulties.

## CONCLUSION

It is beyond the scope of this paper to attempt a comprehensive evaluation of these issues. I will conclude, however, with the more modest proposal that future work on the mandatory rules method take more careful account of the context within which arbitrators select and apply mandatory rules. These include not only national policies concerning the arbitrability of mandatory rules, but also national laws governing the consequences of both arbitral refusal to entertain mandatory rules and arbitral overreaching in the form of applying laws not authorized by the parties' agreement. Perhaps most importantly, as I have already suggested, advocates of the mandatory rules method should grapple with the fact that, in the

vast majority of cases, this method provides a mechanism not to honor public policies ignored by the contract, but instead to *limit* the range of mandatory rules which the contract otherwise might make applicable. Further work on the mandatory rules method should proceed from this realization.