INTERNATIONAL COMMERCIAL ARBITRATION: THEORY OF DELOCALIZATION

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INTRODUCTION

Arbitration proceedings, though not exclusively, but *consist largely of commercial disputes*. International commercial arbitration, to be simply put, is the method of alternative dispute resolution resorted to by public or private parties belonging to different nations in order to avoid litigation in courts of law.

However, for a more comprehensive understanding of the term, as defined by **section 2(1)(f) of the Arbitration and Conciliation Act, 1996 of India**, it is an arbitration arising out of a dispute, whether contractual or not, but creating legal relationships considered to be commercial under the law of India, and where at least one party is –

i. An individual who is a *national of or habitual resident of any country other than India*,
ii. A body corporate *incorporated in any country other than India*,
iii. An association or body of individuals whose *central control and management is exercised in any country other than India*, or
iv. The Government of a *foreign country*.[2]

Being a recent trend in international commercial arbitration, there are several lacunae in the practical aspects of the theory of delocalization, even though it has gained momentum in recent times. **It may be defined as a type of international arbitration not based on a municipal order**. Its main characteristics are that it is *detached* from –

a. The procedural rules of the place of arbitration,
b. The procedural rules of any particular national law,
c. The substantive law of the place of arbitration, and
d. The substantive law of any particular jurisdiction.[3]

There are several permutations and combinations of delocalized arbitration. For better understanding of the concept discussed herein below, the system of **conflict of laws rules** must be understood –

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[2] The Arbitration and Conciliation Act, 1996 (Amended in 2015), Sec. 2, cl. 1, sub-cl. f.
[3] Janicijevic, Dejan. "Delocalization In International Commercial Arbitration". Post-Graduate. Facta Universitatis, at 64, 2006. Print.

This is a method where the **legal system and laws of jurisdiction are reviewed**, which applies to that particular dispute, and **applies when a dispute has a foreign element**, which is the reason it is considered in this scenario.

Four such permutations are –

I. In the case *where a particular State has jurisdiction over a matter*, the conflict of laws rules would be applied,
II. A *cumulative or comparative system of conflict of laws*, wherein all the laws in relation to the dispute are assessed and applied,
III. A system of *application of the general principles of international law*, or international conflict of laws rules, and
IV. No application of conflict of laws, and *directly proceeding to the applicable law*.[4]

The above-mentioned permutations apply when the seat or place of arbitration is outside the territory of the State that has a connection to or the **closest connection to the contract** related to the arbitration. However, just as each concept or practice, the delocalization theory, when it comes to international commercial arbitration also possesses certain *proponents and opponents* – On one hand, *a rather notable proponent of the theory* – **Jon Paulsson** stated that *parties shall have the utmost freedom to design the framework of their arbitral process*. In his expert opinion, international commerce has since a long time wanted to detach itself from the seat of arbitration, or the localisation theory, **so that arbitral awards can have far reaching consequences**. In addition to the above, he has stated that if the parties are from a foreign State, and so is the agreement, and if the parties do not wish to apply for the recognition and enforcement of the arbitral award from the seat of arbitration, then their rights shall *not* be limited by it.[5] On the other hand, **F. A. Mann** is a *strong advocate for the localisation theory*. As a traditionalist, he has argued that an arbitrator is obligated to make a reference to a particular system of law. Following the system of *lex loci arbitri*, he has opined that each right and/or power enjoyed by a person has been derived from a set of municipal laws, and that **an arbitral award cannot exist in a legal vacuum**. Therefore, one can deduce that he insists that all arbitrations are *national* arbitrations. Additionally, he has stated that all such proceedings are a result of private agreements, but with a *national character*.[6] This means that since arbitrations originate in agreements, which abide by the laws of a particular State, so must the arbitrations.

[4] Supra Note 2.
[5] Chan, Mann-Long. "Harmonization Of Procedural Law In International Commercial Arbitration". Ph.D. 77 and 80, 2009. Print.
[6] Id, at 58 and 143.

PARTY AUTONOMY & DELOCALIZATION

This principle, as the name suggests, stands for *the practice wherein the parties are free to select the place of arbitration, or the laws applying to it, or to not designate it at all*. Thus, it has also been stated that **party autonomy is a far wider principle than the delocalization theory and that the theory is actually a part of or falls within the principle of party autonomy**.[7]

Party autonomy and the place of arbitration find their application in the case of **Gotaverken Arendal v. Libyan General National Maritime Transport Co.**[8], which *helped cement the delocalization theory in the world of international commercial arbitration*, that may have been a triumph for many; but, at the same time, it **spread unawareness and confusion** as well. In this case, the claimant wished to impose upon the defendant the delivery of three oil tankers. The defendant refused to do so, on the grounds of breach of contract by the claimant. At the stage of arbitration, the award was decided in favour of the claimant as per the *rules of the International Chamber of Commerce*. The defendant appealed to the Paris court, on grounds that sufficient reasons for the award were not provided by the arbitrator. The Paris court refused to entertain the matter, stating that since **the nature of the arbitral award was international**, it had no jurisdiction pertaining to the same. The claimant went on to ultimately enforce the arbitral award in Sweden.[9] Thus, one can observe herein that **the seat of arbitration and enforcement of the arbitral award were different, and the rules applied were of an international character**. Still, a court *refused* to entertain the matter. That could be a *potentially problematic scenario for the delocalization theory*, as the whole concept relies on the fact that each facet of the arbitral proceedings are in a different location – **the laws applied, the arbitral award enforced, and the place of arbitration**. The enforcement and annulment of such awards will be discussed in detail in one of the following chapters.

When it comes to **party autonomy and substantive law**, the most important provision that is contained in most statutes and rules concerning arbitration is that *the arbitral tribunal shall decide the matter and pass an award based on the substantive law selected by the parties*. It therefore **imposes a duty on the arbitral tribunal**, to apply a law that may be national or non-

[7] Supra Note 3, at 66.
[8] Cour d'Appel de Paris (Feb. 21, 1980).
[9] Winston and Saleem. "Critically Evaluate The Seat And Delocalization Theories And The Extent To Which These Theories Have Impacted On The Principle Of Party Autonomy In International Commercial Arbitration.". Commercial Arbitration. 2004. <http://www.winstonandsaleem.com/index.php?option=com_content&view=article&id=133:commercial-arbitration&catid=88&Itemid=1294> 26 Nov. 2016.

national. A non-national law, of course, means delocalization, and if the arbitral tribunal is unable to pass an award based on the delocalized substantive law selected, it is an *irregularity of a serious nature* as they have failed in their obligation.

Whereas, when the question is of **party autonomy and procedural law**, it must be understood that *courts have minimum power to intervene in the method of dispute settlement that has been agreed upon and selected by both or all the parties*. So, even while excluding the national law of a particular State, there is limited access to go to courts, whose legal protection is **limited but not absolutely excluded**. Hence, in choosing a delocalized arbitration, the parties agree that the relevant procedural rules will apply, which the national law provides for international arbitration. The courts will therefore **guarantee minimum legal protection to the parties**, to the extent it can, will **letting party autonomy be applied to the maximum extent**.[10]

Party autonomy linked with public policy especially let the arbitral rules and courts at the place of arbitration take a *back seat* in **Minmetals v. Ferco Steel**[11], wherein the judge refused to set aside an arbitral award that was alleged to be violative of public policy. It was held that in international commerce, *a party who contracts the seat of arbitration to be a foreign State, agrees to the arbitration rules applying therein and also respects the supervisory jurisdiction that the courts in the seat of arbitration possess in that matter*. Hence, if any party complains of a defect in the arbitral proceedings, they must avail of this **supervisory jurisdiction of the courts**, and approach them as a **remedy**. The reason being, in their agreement, not only have they agreed to refer all disputes to arbitration, but also that the supervisory jurisdiction in the dispute shall be with the courts. Thus, it was additionally held that **courts do not operate as per the law in arbitration, but adhere to the agreement between the parties**, and by *recognizing delocalized arbitration, but placing a barrier when it comes to its practical application would be wrong*.[12] Therefore, this can act as a problem, because the **courts have restricted authority over the matters**, and may be **refused** to entertain them unless agreed upon by the parties.

[10] Supra Note 3, at 66.
[11] Minmetals, 1 ALL ER (Comm) 315.
[12] Supra Note 3, at 67.

STATE AS A PARTY IN INTERNATIONAL COMMERCIAL ARBITRATION

It has also been stated that *the delocalization theory has its origin in the doctrine of sovereign immunity held by a State*. In terms of delocalization, this doctrine **helps the States in gaining immunity in the international system from the jurisdiction of foreign courts**, which shall be discussed in detail below. In addition to that, it also **exempts the application of national arbitration laws of any particular State**, when the party involved is the *Government of a sovereign nation.*

The aspect where international law must be applied when even one of the parties is a State was best illustrated in the case of **The Kingdom of Saudi Arabia v. Arabian American Oil Company (Aramco)**.[13] A contract was entered into between the two parties, and when a dispute arose, they took the matter to Geneva, in Switzerland. The questions that lay before the arbitral tribunal were that *firstly*, if the **procedural law of any State shall be applied to this dispute**, and *secondly*, if the **Government of Saudi Arabia enjoyed sovereign immunity**. It was noted that this dispute is *not* between two States, but one State – Saudi Arabia and an Oil Company. Since States enjoy immunity in the international system owing to their sovereignty, it was *held that this right entails that the judicial authorities of another State cannot exercise control or interference in such matters or disputes*. Therefore, the main reason for disallowing another State's laws to apply to an arbitral proceeding when even one of the parties is a State was given as **respect for the dignity of the sovereign State**. Thus, international law had to be applied in this case.[14] *10 years later*, the principle followed in the above-mentioned judgement was reinforced, and these two cases went on to be the very first ones where the **arbitral proceedings were detached from the law of the seat of arbitration**, or *situs*. In the case of **Texaco Overseas Petroleum Company and California Asiatic Oil Company (Texaco) v. Government of Libya**[15], the doctrine of State immunity due to its sovereignty was enforced at two stages – *first*, when the parties **appointed a sole arbitrator with the help of the President of the International Law Court**, and *second*, when the **sole arbitrator chose to apply international law** in the settlement of the dispute before him.[16]

[13] (1963) 27 I. L. R.
[14] Supra Note 5, at 120 and 121.
[15] (1978) 17 I. L. M. 3.
[16] Supra Note 5, at 131.

Sovereign immunity, also called *state immunity* infers not only the exemption from applying the laws of a particular State, but also **jurisdictional immunity**. It has already been established above that States enjoy immunity from application of domestic laws, but it has also been laid down that **the sovereign acts of a sovereign State cannot be brought into question by a national court, as long as the aspect of lawfulness of these acts is being considered**. Thus, **unless** a State *voluntarily submits to a legal process or proceeding*, they **cannot** be dragged into it.[17] There are, however, *two* types of sovereign immunity – **absolute and restricted**. While the connotations are self-explanatory, *absolute immunity follows that unless a State voluntarily waives its right to immunity, neither its public nor private acts shall be questioned as a State*. Whereas, *restricted immunity means that only the public acts –acta jure imperii of the State enjoy immunity, and the private acts – acta jure estionis are not exempt from the jurisdiction of national courts, or courts of a particular State*. These **private acts include commercial acts**, which in a way help the courts to determine the **difference between sovereign and commercial acts**.[18] The United States previously followed the rule of absolute immunity, before there was a paradigm shift in the international community. At present, the restricted immunity rule is followed by the U.S., wherein the district court held in the case of **Ipitrade Int'l v. Federal Republic of Nigeria**[19] that if the parties agreed to arbitrate outside of the United States, it would constitute as a *waiver of the foreign State's immunity if the winning party wishes to enforce the arbitral award in the U.S.*, as the enforcement is taking place as per a State's national laws, which does **not** follow the principle of sovereign immunity, as one of the parties herein, i.e. Nigeria is a State.[20]

MUNICIPAL & INTERNATIONAL PROVISIONS

In the matter of international provisions, **the Convention on the Recognition and Enforcement of Foreign Arbitral Awards** – also known as the *New York Convention*, is widely accepted when it comes to recognition and enforcement of private agreements between parties in other States. It was **signed in 1958, and as of 2015 has 156 signatories**, 153 of whom are members of the UN. In the area of international conventions recognising arbitral awards passed in other States, *the New York Convention is by far the most important piece of legislation that has been passed and signed on the matter*.

[17] Supra Note 5, at 122-123.
[18] Supra Note 5, at 125.
[19] Supp. 824 (D.D.C 1978).
[20] Supra Note 5, at 124.

Section 48 of the Arbitration and Conciliation Act, 1996 – Conditions for Enforcement of Foreign Awards that is currently in force in India, which **falls within Part II of the Act that deals with Enforcement of Foreign Awards**, has been *derived from Article 5 of the New York Convention*. Both the provisions discuss *refusal to recognise or enforce an arbitral award*. The grounds for which have been laid down as –

i. The parties under the arbitration were **not under capacity**,
ii. The arbitration **agreement is invalid** either because the law to which the parties have subjected it or the law of the country under which it was made are inconsistent with the agreement,
iii. The party against whom the award is to be invoked was **not given a chance to represent his case properly, or notice of the proceedings or the appointment of the arbitrator(s)was not duly given**,
iv. The **award is inconsistent with the terms of the arbitration agreement**, or has been passed on a matter not contained in the arbitration clause,
v. The **composition of the arbitral authority was not as per the arbitration agreement** or the law of the State where the arbitration took place, or
vi. The **law has not yet become binding upon the parties and has been set aside** by a competent authority.[21]

However, in the case of **National Thermal Power Corporation v. The Singer Company**[22], there was an application before the Supreme Court to set aside an award that had been passed in London. The *Supreme Court assumed jurisdiction in the matter on the grounds that Indian Law governed the contract*. It was held that *since the matter contains references to Indian laws, rules, and regulations, the place of arbitration as London was chosen accidentally*, and that **an attempt to exclude the jurisdiction of Indian courts and laws would be inconsistent to the contract** entered into by parties.

The **UNCITRAL Model Law**, **in Section 19(1)**, expresses the rules of procedure in an arbitration proceeding, *allows the parties autonomy up to a certain extent*, in deciding mutually the rules that will apply to their matter, as per their requirements and needs.

[21] Belohlavek, Alexander. "Importance Of The Seat Of Arbitration In International Arbitration: Delocalization And Denationalization Of Arbitration As An Outdated Myth". Association Suisse de l'Arbitrage 31.2 (2013): 262-269. <http://www.academia.edu/10270800/Importance_of_the_Seat_of_Arbitration_in_International_Arbitration_Delocalization_and_Denationalization_of_Arbitration_as_an_Outdated_Myth> 26 Nov. 2016.

[22] (1992) 3 S.C.C. 551 (India).

However, it **goes on to add that the same is subject to the Model Law provision**, which *restricts* the party autonomy.[23]

Model Law countries that follow the UNCITRAL model, such as **India and England**, *tend to follow the seat theory*, **denouncing** the **floating arbitration method**, which for the purposes of this research paper has been referred to as the theory of delocalization. The same can be observed from the following case law.

In the case of **Bank Mellat v. Hellinki Techniki**[24], the *English Court of Appeals opined that if there are no contractual provisions, the procedural law that must be followed is that of the place or seat of arbitration*. It was held that despite the modern theory of delocalization, **English jurisprudence does not recognise it**, and disallows detachment from a municipal system of law.[25]

ENFORCEMENT & SETTING ASIDE OF AWARDS

International trade and commerce is **not restricted** by territorial boundaries, but with the **intertwining** of several jurisdictions and States, there come certain **complications and conflicting interests**. However, arbitration remains to be, in spite of this conundrum, the *most sought-after* method of dispute settlement when it comes to international trade and commerce.

One of the most, if not the most important feature of international commercial arbitration, is the **universal enforceability of the award** against the losing party – formally known as the *award-debtor*. But, it is pertinent to note here that this principle of universal enforceability of the award, which allows an award to be enforceable in any State or international court, is **not absolute and is constrained to the extent wherein the court** – whether municipal or international **has to accept this award** and give it the effect of a binding decree.[26]

When the question of enforcement by a court is raised, one can consider the case of **Bhatia International v. Bulk Trading**[27] in 2002, wherein the court held that *Part I of the Arbitration and Conciliation Act, 1996 is applicable to Part II of the same*. It is important to know here that **Part I deals with the arbitration proceedings that take place in India, whereas Part II**

[23] Henderson, Alastair. "Lex Arbitri, Procedural Law and the Seat of Arbitration: Unravelling the Laws of the Arbitration Process". Singapore Academy of Law Journal 26 (2014): 893-896. Print. 29. Nov. 2016.
[24] (1984) 1 QB 291 at 301.
[25] Supra Note 23.
[26] Dar, Wasiq Abbas. "Enforcement Of Annulled Arbitral Awards: A Dichotomy Of Approaches". The Indian Arbitrator 6.8 (2014): 7-12. <http://www.arbitrationindia.org/pdf/tia_6_8.pdf> 25 Nov. 2016.
[27] Civil Appeal No. 7019 of 2005.

discusses the enforceability of foreign awards. This led to a great deal of *confusion* in the country, as various other arbitral awards that were brought to Indian courts, whether national or international, followed suit and *were tried and disposed off as domestic arbitral awards*. The **repercussion of international awards being entertained as domestic awards in the national courts was that they were at times not allowed to be enforced; and at times were even set aside, which is only possible under Part I, that is domestic arbitrations**.[28] Although precedents hold no value in arbitral proceedings, however enforcing them in courts of law entails at least some legal recognition of these enforcement decrees of the courts. Therefore, in the case of **Bharat Aluminum Company v. Kaiser Aluminum Technical Service**[29], it was held that *Part I and II of the Arbitration and Conciliation Act are mutually exclusive*.[30]

But, as it has been highlighted with the help of case laws herein below, *not only does the enforcement of such awards pose a difficulty, but once they have been annulled, there are several difficulties as well*. The reason is that there is no textbook method to set aside these awards. This has led to the **enforcement of even annulled arbitral awards** sometimes.

In the case of **Hilmarton Ltd v. Omnium de Traitement et de Valorisation**[31]an arbitral award was *set aside* by the Swiss Court on grounds of public policy. It was held that since an arbitral award is not attached to the legal system of a certain State, it **continues to be in existence even after being set aside**, and its enforcement in France is not opposed to public policy.[32] It brought out the *impractical aspect of the delocalization theory, when it comes to enforcement of annulled awards.*

In the case of **Putrabali Adyamulia v. Rena Holding**[33], the parties chose the seat of arbitration as London, wherein *the tribunal in favour of the claimant granted the arbitral award*. The defendant approached a High Court, which returned the matter to *the tribunal that passed an award this time in favour of the defendant*. The claimant then approached the French Court for enforcement of the *previous* award in their favour, who approved of it. It was **held that an international arbitral award that is not linked to any particular legal framework,**

[28] Roy, Ashutosh. "Discussions On Developments In Arbitration And Related Areas In India And Worldwide". Lex Arbitri - the Indian Arbitration Blog, 2012. <http://lexarbitri.blogspot.in/2012/09/indian-supreme-courts-landmark.html> 26 Nov. 2016.
[29] Civil Appeal No. 3678 of 2007.
[30] Supra Note 23, on 27. Nov. 2016.
[31] (1997) XXII Comm. Arbn. 696 (Cour de cassation, June 10, 1997).
[32] Supra Note 9, on 26. Nov. 2016.
[33] CA Paris, June 29, 2007.

its decision depends on international justice and the **validity is as per the applicability of these international rules in the country where the enforcement of the award is sought**.[34] This leads to a rather *perplexing* situation, as the award was in the first instance passed in favour of one party and *subsequently* in favour of another. Therefore, allowing enforcement of annulled awards **defeats the whole purpose** of arbitration, allowing discrepancies to creep in, by multiple awards being passed and thereafter enforced, *without previous ones being struck down*, as annulled awards continue to be enforced.

CONCLUSION

The delocalization theory, as has been the crux of this paper, is the practice **wherein the arbitral proceedings in international commercial arbitration are not attached to the law of any nation, that is, any municipal law**. The procedure, award, composition of arbitrators, among other facets are all based on *party autonomy*, which means that the parties are given *full freedom to tailor-make their own arbitral proceedings, as per their requirements and wishes*. The delocalization theory remains detached from substantive as well as procedural laws of the place of arbitration, and any specific national law or jurisdiction as well for that matter.

Apart from the erratic nature of the foreign and international courts with regards to this theory, **it is pertinent to note a stark difference in the manner in which the cases were entertained or disposed of, and the reasons that have been provided for the same**. It begs the question and makes one inclined to deduce that there is *absolutely no regards to procedure given when considering the delocalization theory*. However, that is *not* true.

The researcher acknowledges herein that there may be some amount of procedure involved, when it comes to a State being a party, or legislations that support the theory. However, the enforcement of annulled arbitral awards and confusion in the international commercial arbitration system, with the seat being located in one country and the enforcement of the award in another, the confusion, as per the researcher, is far more, and has far reaching consequences, which are mostly negative in nature. There may be no States involved in international commercial arbitration as well, which has to be considered. And the States may be model law States as well. Therefore, the researcher concludes that the cons of this theory, in its practical application, far outweigh the pros.

[34] Supra Note 9, on 26. Nov. 2016.