International Commercial Contracts : Proper Law of Contract and Arbitration Clauses

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INTERNATIONAL commercial contracts have involvement of nationals or business entities of two or more countries and subject matter of the agreement also involves connection with two or more countries. Different countries have their own systems of law and sometimes there is conflict of law. The same contract may be governed by two or more laws and how to apply the law in a given situation is quite complicated question.

The question whether an arbitration is international or national is significant as most countries have different legal regimes to govern the type of arbitration. International arbitration transcend national boundaries. International arbitrations usually have a foreign element and most countries treat such arbitrations much more liberally like by providing greater respect for the intentions of the parties and far less judicial intervention in the arbitration process than in the domestic arbitration. The Arbitration and Conciliation Act, 1996, has defined international commercial arbitration in section 2(1)(f) as under:

"International commercial arbitration "means an arbitration relating to disputes arising out of legal relationship, whether contractual or not, considered as commercial under the law in force in India and where at least one of the parties is—

(i) an individual who is a national of, or habitually resident in, any country other than India; or

(ii) a body corporate which is incorporated in any country other than India; or

(iii) a company or an association or a body of individuals whose central management and control is exercised in any country other than India; or

(iv) the government of a foreign country;

Clauses relating to proper law of contract and resolution f dispute by conciliation and arbitration are important clauses f international commercial agreements. Parties should not nly be clear about the business deal but should also be clear out the complications of these clauses. A single clause may ange the course of the contract. The law applicable should well understood and its effects should be analyzed in vance at the time of agreement.

International Conventions on Arbitration are designed to provide an effective international regime for the conduct of arbitration and obviate the need for States to establish their own domestically influenced regimes. Proper law governing international contracts is a very important aspect in arbitration proceedings. This article elucidates what is the 'proper law'

PROPER LAW OF CONTRACT

An international commercial agreement has different segments and it is not necessary that the entire contract is governed by single law. It is also not necessary that the same law will apply at all times to the contract. The law applicable may change with the stage of the transaction/case.

There is a standard condition imposed by the Government of India and Reserve Bank of India while approving the technical collaboration and equity participation that the agreement shall be subject to the laws of India. Generally, international commercial agreements in India include clause for application of Indian law to the contract. Indians prefer Indian law to be the proper law of the contract. While concluding an international commercial contract parties have the freedom to choose the governing law, but precise formulations may depend on the negotiation depending on the facts of each case. But it is not sufficient to say that contract is subject to Indian Laws. This is so because of the autonomy of arbitration clause from the main contract.

The proper law of contract is the law or relevant legal rules governing substantive issues in disputes. The expression 'proper law of a contract' refers to the legal system by which the parties to the contract intended their contract to be governed. If their intention is expressly stated or contract itself or its surrounding circumstances, such intention determines the proper law of the contract.

Where the intention of the parties is not expressly stated and no inference about it can be drawn, their intention as such has no relevance. In that event, the courts endeavour to impute an intention by identifying legal system with which the transaction has its closest and most real connection.

Section 28(1) of the Arbitration and Conciliation Act, 1996 provides—

(1) Where the place of arbitration is situate in India—

(a) in an arbitration other than an international commercial arbitration, the arbitral tribunal shall decide the dispute submitted to arbitration in accordance with the substantive law for the time being in force in India;

(b) in international commercial arbitration,—

(i) the arbitral tribunal shall decide the dispute in accordance with the rules of law designated by the parties as applicable to the substance of the dispute;

(ii) any designation by the parties of the law or legal system of a given country shall be construed, unless otherwise expressed, as directly referring to the substantive law of that country and not to its conflict of laws rules;

(iii) failing any designation of the law under sub-clause (ii) by the parties, the arbitral tribunal shall apply the rules of law it considers to be appropriate given all the circumstances surrounding the dispute.

The expressed intention of the parties is generally decisive in determining the proper law of the contract. The only limitation on this rule is that the intention of the parties must be expressed *bona fide* and it should not be opposed to public policy.

In the absence of an express statement about the governing law, inferred intention of the parties determines that law. True intention of the parties, in the absence of an express selection, has to be discovered by applying sound ideas of business, convenience and sense to the language of the contract itself.

Where the parties have not expressly or impliedly selected proper law, the courts impute an intention by applying the objective test to determine what the parties would have as just and reasonable persons intended as regards applicable law, had they applied their minds to the question. The judge has to determine proper law for the parties in such circumstances by putting himself in place of a "reasonable man". He has to determine the intention of the parties by asking himself "how a just and reasonable person would have regarded the problem".

For this purpose place where the contract was made, form and object of the contract, the place of performance, place of residence or business of the parties, reference to the courts having jurisdiction and such other links are examined by the courts to determine the system of law with which the transaction has its closest and most real connection.

It is very important to know the law before agreeing to. In some Middle East countries, the claim of interest is illegal and cannot be allowed. The arbitrators are required to have religious qualification of being Quazi, and provides restriction on women to act as arbitrator etc. Litigation in the international contracts is very costly affair and has far reaching effects. Things are good until dispute arise. The moment a dispute arise all types of claims are raised and defenses are put forth by the parties. Some times the compensation is higher than the total value of the contract.

NEUTRAL LAW AND VENUE OF ARBITRATION

Arbitration in international commercial contracts is preferred over litigation because arbitration is informal, faster, less costly, equitable and conciliatory. Sometimes parties opt for arbitration for a private dispute resolution instead of litigation in open court.

The parties are usually reluctant to submit their dispute to the national courts of one of the parties due to fear of bias and nationalistic sentiments.

Arbitration agreement enables the parties from different nationalities to avoid submitting dispute to the national courts of either of them. It offers choice of judges thereby avoiding fear of biased judgment.

It is repeatedly suggested by the foreign investors with respect to private power projects in India where a foreign investment is attracted that the agreement should be governed by a law neutral to the contracting parties, for example Swiss or English law. It is generally felt that the venue for settlement of disputes should also be out side the countries of the contracting parties. Geneva or London have been agreed as the venue for arbitration in a number of arbitration being arbitration friendly venues. Government of India has agreed to clauses providing for arbitration at London or Geneva. Enron Power Company's dispute with State of Maharashtra was referred for adjudication at London. Foreign parties usually demand the application or rule of arbitration of International Chamber of Commerce, Paris.

In truth, any international commercial arbitration agreement is a forensic minefield. During its course, as many as five or six different national systems of law, or legal rules, may come into play. It would be too much to expect that there will not be material difference between them. On the contrary the potential for conflict is great.

LAW GOVERNING ARBITRATION AGREEMENT

Most legal systems accord parties considerable freedom in determining the arbitration procedure, while reserving the right to ensure the fairness and integrity of the process. International Conventions on Arbitration are designed to provide an effective international regime for the conduct of arbitration and obviate the need for States to establish their own domestically influenced regimes. The New York Convention governs only the recognition and enforcement stage of the arbitral process and does not extend to the arbitration stage. Most states have introduced domestic standards in this area to cover the lacunas left by the convention.

The proper law of the arbitration agreement is normally the same as the proper law of the contract. It is only in exceptional cases that it is not so even where the proper law of the contract is expressly chosen by the parties.

Where there is no express choice of the law governing the contract as a whole, or the arbitration agreement in the particular, there is, in the absence of any contrary indication, a presumption that the parties have intended that the proper law of the contract as well as the law governing the arbitration agreement are the same as the law of the country in which the arbitration is agreed to be held. On the other hand, where the proper law of the contract is expressly chosen by the parties such law must, in the absence of an unmistakable intention to the contrary, govern the arbitration agreement which though collateral or ancillary to the main contract, is nevertheless a part of such contract.

The law governing arbitration agreement applies to issues such as consent of parties (such as whether or not the agreement was induced by fraud, mis-representation or undue influence), validity, effect, interpretation and scope of the arbitration agreement. Such law will decide whether the arbitration clause is wide enough to cover the dispute between the parties.

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f what they are doing, but should also shoulder a fair of the burden of protecting the environment. A review ounting literature of the recent years reveals that not have standard setting bodies set up environmental ch groups and launched projects to tackle the related nting and reporting issues but the business community preoccupied with improving it's performance on nmental front. Accounting for environmental costs is, ver, in it's embryonic stage at present. The first ational initiative came from the Intergovernmental ing Group of Experts on International Standards on unting and Reporting (ISAR) during 1989-90 when it shed a standard on the effect of environmental factors or tion on the valuation of fixed assets for financial statements. In valuing assets corporations tend to ignore the true environmental costs.

The issue has evoked a lot of interest among professional accounting institutes and academicians and it may be hoped that standards would be evolved and enforced in this regard in this future. Till this is done the accounting and reporting of environmental protection and expenditures on it will be restricted to only the enlightened few.

It will thus be seen that the extent to which accounting practices would be influenced by standards relating thereto in a particular country depends on a host of factors. Issuance of standards alone will also not eliminate diversities in accounting practices prevalent. ❐

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PREME COURT ON ENVIRONMENTAL PROTECTION

P.C. which allows the Court to take cognizance of persons included in the original complaint if the evidence at the l points to their culpability.

In the case of *J.K. Industries Ltd. v. Chief Inspector of Factories* c. (1996-5 CLJ 13-SC) the Supreme Court has held that mination of an "Occupier" to be made by the company der proviso (ii) to section 2(n) of the Factories Act can only that of a Director, the directing will and mind of the mpany, its alter-ego and of no other officer or employee of factory or the company which owns the factory. The n'ble Supreme Court of India also ruled that the strict ility principle under which Directors of a company are d vicariously liable for wrongs of the company applies not y for offences under the Companies Act, but applies also to wrongs of the company under other public welfare statutes concerning industry, food adulteration, prevention of pollution and welfare and safety of employees in a factory and that in the absence of a notified Director, any one of the Directors of a company, is liable to be prosecuted and punished as "deemed occupier" under the Factories Act.

CONCLUSION

The aforementioned decisions clearly show that environmental angle has assumed enormous importance and profitability and viability of any industry are no doubt its legitimate objectives, but these objectives have to be achieved without prejudice to public interest and any industry which is not environment friendly will find it tough going in future. ❐

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ERNATIONAL COMMERCIAL CONTRACTS

uch law will also ordinarily decide whether the arbitration e binds the parties even when one of them alleges that the act is void, or voidable or illegal or that such contract has discharged by breach or frustration.

e proper law of arbitration agreement will also decide ner the arbitration clause would equally apply to a ent contract between the same parties or between one of parties and a third party. Proper law of arbitration ment should be distinguished from the law applicable to ty of the parties to arbitrate (subjective arbitrability) and enability of the subject matter of a dispute to arbitration ive arbitrability).

GOVERNING ARBITRATION PROCEDURE

itration proceedings are conducted, in the absence of reement to the contrary, in accordance with the law of ntry in which the arbitration is held. On the other hand, arties have specifically chosen the law governing the conduct and procedure of arbitration, the arbitration proceedings will be conducted in accordance with that law so long as it is not contrary to the public policy or the mandatory requirements of the law of the country in which the arbitration is held. If no such choice has been made by the parties, expressly or by necessary implication, the procedural aspect of the conduct of arbitration will be determined by law of the place or seat of arbitration.

Challenge, recognition and enforcement of the award is subject to local law where award has been made and is subject to International conventions on recognition and enforcement of foreign awards.

International arbitration awards are like an international currency which can be encashed in any convention country where other party has the property. Hence, one should be very careful while agreeing the law applicable and include provisions with clear understanding. ❐

Writing Down Allowances for Finance Companies

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THERE is a self-perpetuating growth, of late of finance companies all over the world engaged in the trade of acquiring and hiring out plant and machineries, to the end users. In order to claim writing down allowance or depreciation allowance or other capital allowance by whatever name called, such companies have to show that, at the material times, the plant belonged to them, even though leased out to the end-user.

In India, a substantial controversy is in rage regarding the claim of depreciation under income-tax law so far as leasing companies are concerned. In case of finance lease, the CBDT had taken the view that depreciation should be allowed only to the lessee. In this context the view taken by the House of Lords in the case of hire purchase agreements in a recent decision must engage the attention of finance companies, particularly with reference to the ownership of the hired assets.

Non-banking financial companies carrying on leasing and hire purchases activities have grown in numbers over the years. In order to claim depreciation allowance such companies have to show that at the material times the plant, machinery etc. belonged to them even though leased out to the end user. The law with regard to such depreciation claims is elucidated here in the light of a recent ruling.

The legislative conditions require that such person who wants to be entitled to such capital allowance must be—

- one who is engaged in carrying on a trade;
- one who has incurred capital expenditure on the provision of plant or machinery for the purposes of the trade;
- one to whom, in consequence of his incurring the expenditure, the machinery or plant belongs; and
- one whose machinery or plant is or has been in use for the purposes of his trade.

When a finance company engaged in such business acquires machinery or plants, it, no doubt owns it at that time. The plant or the machinery does, at the time of acquisition belong to the finance company. Subsequently, such machinery or plant is leased or hired out to its customer who then fixes the same to the land for the purpose of being put to use, if that is the requirement of the physical logistics of the plant. Does such an event sever the ownership of the plant or the machinery (hereinafter also called the chattel) from the finance company and therefore, disentitles the finance company for the capital allowance. This question, with all its shades of variation, was discussed and decided by the *House of Lords in Melluish (Inspector of Taxes) v. BMI (No. 9) Ltd. (1996) 218 ITR 548.*

In the said case the House of Lords had an occasion to consider related substantive issues, which are discussed in this article as the *ratio decidendi* of the House of Lords' Order would affect finance companies in general. The appeals of five taxpayer companies were decided by the *House of Lords*. The facts were: each of the five taxpayer companies carried on the trade of acquiring and hiring out plant and machinery to users. The companies were part of the Barclays Mercantile Group. The relevant users of the plant were local authorities who were (or were at the time of affixation) freeholders of the premises in which the items of plant were affixed. There were 28 local authorities involved in the present case. The nature of the plant was such that, for the most part, it had to be fixed to the structure of the building in which it was installed so that, on being so fixed, it would on ordinary principles of the general law be regarded as a fixture. Various types of plant and machinery were involved, viz—*(a)* central heating installed in council flats and houses; *(b)* video door entry systems installed in blocks of council flats and alarm systems in sheltered housing accommodation; *(c)* lifts installed in council car parks; *(d)* boilers installed in council offices; *(e)* cremators installed in a council crematorium; *(f)* ventilation and filtration plant installed in a council swimming pool.

There were altogether 201 relevant transactions between the taxpayer companies and the local authorities. Of these, 180 concerned central heating in council dwellings and the remainder concerned plant of other kinds. The only relevant difference between the various transactions was that in the case of plant and machinery installed in council flats or council houses (and possibly also in the case of alarm systems installed in sheltered housing) the flats or houses were, either at the time of installation or shortly thereafter, let to council tenants on weekly tenancies. In all other cases the buildings in which the plant has been installed have at all times remained in the occupation of the local authority.

The arrangements between each taxpayer company and the local authority were as follows. There was a master equipment lease between the taxpayer and the local authority. This master lease was entered into before the relevant plant and machinery was acquired. It purported to relate to equipment, rent, term and location as stated in the schedule, but the schedule was initially blank. In relation to each transaction, a schedule was subsequently inserted into that master lease. The schedule set out certain details of the transaction, including the identification of the equipment, the term, the commencing date of the term, the rent and how it was