Contracts without a proper law in private international law and non-state law in Serbia and Montenegro law

by Maja Stanivuković
Professor of Law, Novi Sad University Faculty of Law

1. The expression "le contrat sans loi"

The expression "contract with no governing law" (le contrat sans loi) has been discussed in Serbia and Montenegro's legal theory mainly in connection with the choice of applicable law to merits of the dispute in arbitral proceedings, and in particular in investment disputes. This term is usually associated with the possibility for the parties in an international contractual dispute to choose non-state rules ("non-national", "a-national", "transnational" rules) as applicable law to their contract. The possibility is also referred to as the right of the parties to "internationalize" their contract, or to choose lex mercatoria as applicable law. It is explained that this possibility is primarily advocated by international commercial arbitration scholars for contracts concluded between a State or one of its agencies on one side and a private party on the other. The 1989 IDI Resolution is cited as an authority for the position that the parties in contracts between a State and foreign enterprises may be free to choose rules and principles deriving from non-national sources of law, such as principles of international law, general principles of law and usages of international commerce. On the other hand, the 1991 IDI Resolution concerning the

---

autonomy of the parties in international contracts between private persons or entities indicates, that the parties in such contracts have less freedom. The Resolution provides that they may choose the law of any State as the law applicable to their contract, while expressly reserving in the preamble the question whether they may choose the application of rules of law other than those of a particular State. This distinction is generally accepted as legitimate in the writings of domestic scholars, but it is not reflected in the new arbitration laws. As will be indicated further, according to new arbitration law in both Serbia and Montenegro, private (non-state) parties in an international commercial arbitration are free to subject their contract to non-state rules.

In an international commercial arbitration it is also possible to withdraw a contract from the strict application of any State or non-state law. This can be attained by a contractual clause providing for the resolution of the dispute on the basis of justice and equity (ex aequo et bono, or as amiable compositeurs). Such contract, however, is usually not referred to as le contrat sans lois in legal theory, although it is effectively even more a "contract without a governing law" than the contract subjected to application of non-state rules. "Arbitrating on the basis of the principle of equity (amiable composition, i.e. ex aequo et bono) means that amiable compositeurs are not bound to stick to regulations....Arbitrators in international commercial arbitration have the task to resolve the dispute not according to this or that law of a country, i.e. according to a state law (statute)...but according to rules that originate in the manner customary in the international business community. These rules constitute a type of true international commercial law or a-national law".6

According to some views, the specific situation of contract without a governing law should be distinguished both from a contract which is submitted to non-state rules and from a contract which provides for arbitrating on the basis of the principle of equity. A contract without a governing law implies a situation in which the parties have expressly stated their intention that the provisions of their

---

contract should supersede any contrary provisions of any national law. This is a contract in which the parties wish to avoid the control of any law over their contract and want their dispute to be resolved independently from the provisions of any laws, conventions or other legal sources. The concept so defined is different from deciding on the basis of justice and equity, because it obliges the arbitrators to give precedence to one instrument - contract (which embodies the will of the parties) over the provisions of any other potentially applicable rules.

2. The limits of party autonomy

a. Permissibility

The law in Serbia and Montenegro allows the parties to withdraw their international commercial contract from the application of any specific substantive law. If the parties wish, they can provide for the resolution of their dispute by arbitration that will decide on the basis of justice and equity (ex aequo et bono). The clause is recognized as valid under the European Convention on International Commercial Arbitration (1961), which is in force in Serbia and Montenegro, and under the Rules of Procedure before the Foreign Trade Court of Arbitration at the Serbian Chamber of Commerce in Belgrade. It should be pointed out that the European Convention on International Commercial Arbitration conditions the validity of such choice upon the permission of the lex arbitri: "if they may do so under the law applicable to arbitration".

The law applicable to arbitration is not uniform in Serbia and Montenegro. The legislative competence in this field belongs to two member states and each of the member states has its own law in this area. The law of arbitration in Serbia is currently in the state of transition. The old provisions on arbitration dating from 1990, found in the 1976 Code of Civil Procedure have been kept in force until the enactment of the New Arbitration Act, although the Code itself has been

7 See, M. Trajković, op.cit. p. 423; see, also, A. Jakšić, op.cit. p. 126.
8 European Convention, Article VII, para. 2.
9 Rules of Procedure, Applicable Law, Article 46, paragraph 4. This provision was first introduced to the FTA Rules in their first amendment made in 1958. It was then formulated as follows: Article 39 paras. 2 and 4: "Arbitrators evaluate facts according to their free conviction and render awards on the basis of applicable laws and regulations and trade usages.... Arbitrators may render an award holding exclusively to the principle of equity only if the parties have given them such authority".
replaced in 2004. The Arbitration Bill is pending before the Serbian Parliament since October 2005. According to the 1990 provisions, "arbitral tribunal may render an award on the basis of justice and equity only if the parties have vested it with such authority". The Arbitration Bill includes an equivalent provision.\(^{11}\)

Similarly, in Montenegro, the provisions pertaining to arbitration in the 2004 Code of Civil Procedure provide for the \textit{ex aequo et bono} decision-making in Article 493, para. 3, provided that the parties have expressly given the arbitral tribunal such authority.

The position of Serbia and Montenegro law on the contract which is submitted to non-state rules is more difficult to ascertain. It is widely accepted in domestic PIL theory that parties' choice is limited to choice of a national legal system. This limitation, however, does not necessarily derive from the wording of the 1982 PIL Code\(^{12}\) provision on party autonomy, which speaks only of law (\textit{pravo, droit, Recht}), and does not specify that it has to be the law of a State, like some other provisions of this Code (e.g. Arts. 21, 26, etc.).\(^{13}\) In other words, it could be argued that PIL Code permits a more lenient interpretation, which would include a choice of non-state rules.\(^{14}\) It is difficult to find advocates for this argument, however. The predominant view still is that any reference to a non-national system or rules (such as general conditions, model-laws, uniform rules, non-ratified conventions), should be construed only as a derogation from the directory rules of the otherwise applicable law. According to this view, the parties' choice of an a-national system of rules, should be treated as substantive autonomy, not conflictual. That would mean that, by making a choice of an a-national system of rules, the parties can replace directory rules of the otherwise applicable law.

\(^{10}\) The Code of Civil Procedure, 1976, as amended in 1990, article 479a,

\(^{11}\) Arbitration Bill, Article 49 para. 2.

\(^{12}\) The 1982 PIL Code, which was enacted in former Yugoslavia, still remains in force in Serbia and Montenegro, as the law of each of the two member states.

\(^{13}\) The PIL Code provides in Art 19: "Contract is governed by the law chosen by the parties, if not specified otherwise by this Code or by an international treaty."


applicable law only, while they cannot exclude the mandatory rules of the same law. The view was applied in a case before the Foreign Trade Court of Arbitration in Belgrade, where the parties have chosen the 1968 CMEA General conditions as applicable law. The choice was treated as substantive choice. The Czech law was determined as the applicable law but it was established that its rules on limitation of actions (3 years) were not mandatory. Since these rules were directory in nature, they could be replaced by the CMEA General conditions, which provided for a shorter limitation period (2 years).

The question of choice of the non-State rules is closely related to the question whether the parties are allowed to choose more than one State law to apply to their contract. If they are allowed to do the latter, then it would be difficult to justify why they should be prohibited from doing the former, since an amalgam of different State laws can, indeed, lead to a result that would not be provided under any of these laws individually. The possibility as well as desirability of depegage in general has been the object of some disagreement in the Serbian and Montenegrin PIL doctrine. Opinions are especially divided on whether the parties are free to choose more than one law for various aspects of their contract.17 The PIL Code is silent on this issue, although some authors have tried to justify their opposition to depegage by claiming that the cited provision of Article 19 of the PIL Code is restrictive, because it only speaks of 'law' and not of 'laws'.18

All observations on permissibility made so far should be confined to the proposition that the dispute is resolved by the competent state court in Serbia and Montenegro. One may assume that there will be obstacles to full recognition of the choice of non-state rules as the governing law of contract before State courts. Such choice would probably be recognized only as a choice of directory

rules and the chosen rules would be superseded by any mandatory rules of the objectively applicable law.

A more welcoming attitude to choice of non-state law may be observed in the new arbitration laws in both member states. The 2005 Arbitration Bill in Serbia clearly allows the internationalization of contract, with the following wording: "The arbitral tribunal in an international arbitration decides on the basis of law or rules of law as are chosen by the parties' agreement. If the parties have failed to designate the applicable law or rules of law, the arbitral tribunal shall apply the law determined by the conflict of law rules which it considers appropriate" (emphasis added). 19 The reference to "legal rules" in addition to "law" is the result of conviction of the drafters of the Bill that the parties in international commercial arbitration may have a legitimate interest in the choice of a non-state set of rules to govern their contract. Such interest may be expected to exist especially: in multi-party contracts, with parties coming from several different countries, where it is difficult to find a neutral national law; in unnamed contracts, which are not regulated or are sparsely regulated in national legal systems; in contracts which provide that the situs of arbitration will be in the place of business of the defendant, etc. 20 The same openness to internationalization of contracts submitted to arbitration may be seen in the wording of the Montenegrin Code of Civil Procedure, which states that "[t]he arbitral tribunal shall decide on the basis of rules of law chosen by the parties as applicable to the resolution of the dispute. Failing such choice, the Arbitral Tribunal shall decide in accordance with the law, which it considers to be the most closely connected to the dispute" (emphasis added). 21 The wording of the new arbitration laws in both Serbia and Montenegro indicates the change of attitude towards the nature of the parties' choice of non-state rules. It announces the acceptance of the conflictual nature of such choice.

19 The Arbitration Bill, Art. 50. paras. 1 and 3.
20 A. Jakšić, op. cit. p. 128.
21 The Code of Civil Procedure, Article 493, para 1. The distinction between rules of law, which may be the object of the parties' choice and the law, which may be applied by arbitrators in the absence of choice, made both in the Serbian Bill and in the Montenegrin law may be explained by the influence of the UNCITRAL Model Law on International Commercial Arbitration in the drafting process. The UNCITRAL model reserves for the parties the freedom to submit their contract to non-state rules.
Some other international sources of law that are in force in Serbia and Montenegro also indicate the willingness of the legislator to accept the application of a-national law as the governing law in the arbitration context. These are primarily multilateral and bilateral investment treaties. The former Yugoslavia was the member state of the ICSID convention, which provides in Article 42, that the "tribunal shall decide a dispute in accordance with such rules of law as may be agreed by the parties." Furthermore, Serbia and Montenegro is a party to more than 40 bilateral investment agreements. Most of these agreements include a provision on resolution of disputes between an investor of one contracting party and the other contracting party and some of them also contain a clause on the applicable law to such disputes. Although as a rule these disputes are non-contractual in nature, based on the breach of a treaty rather than contractual obligations, it is still interesting to see, that the applicable law to such disputes can be a-national law. The prevailing solution is the application of: a) the law of the Contracting Party in the territory of which the investment was made, including its provisions on the conflict of laws, b) provisions of the bilateral Agreement on protection and promotion of investments, and c) generally accepted principles of international law. None of the Agreements sets the order of priority of these rules. The Agreement with Greece is unique in that it provides for a full internationalization of the disputes between the host State and the investor based on breaches of obligations under the Agreement by the host state. Pursuant to its arbitration clause: "The arbitral tribunal shall decide the dispute in accordance with the provisions of this Agreement and the applicable rules and principles of international law."

22 Succession to this Convention has not been recognized. Serbia and Montenegro signed the Convention in 2002, but has not ratified it.
23 These are the Agreements with China (Art. 9 para 7), Spain (Art 11), para. 3, Albania (Art XI), Kuwait (Article 9, para 6) and Greece (Art 9, para 4), and India (Article 9, para. 3 (v)(iii).
24 The Agreement with Kuwait, in addition to the above stated options, mentions the party autonomy as the primary principle for the designation of the applicable law.
25 It should be added that the Agreement with India refers solely to the application of the provisions of the Agreement.
While there is readiness in domestic legislation and legal theory to accept the application of non-national rules, there is a different attitude towards the situation in which the parties have tried to cover all possible issues in their contract (a self-sufficient contract) and have stated their intention that the provisions of their contract should supersede any contrary provisions of any national law. The prevailing scholarly view is that the concept of contract defined in such manner cannot be theoretically or legally sustained. There must be some supporting legal rules, either national or transnational, that uphold the validity of contract and its binding nature, but also set the limits to the parties' autonomy.

b. The formulation of choice
The choice of non-state rules should not be easily presumed or implied from the wording of the contract - it should be express. The theory mentions the following possibilities as far as parties' choice of the non-state rules as applicable law is concerned: the choice of international law, the choice of general principles of law or lex mercatoria, the reference to simultaneous application the national law and general principles of law, the choice of principles and rules common to several State legal systems, etc.28 Domestic parties are not encouraged to make any such choices, however. On the contrary they are warned that, according to the opinion of prominent legal scholars,29 there is a considerable uncertainty implied in such choice. A reference to simultaneous application of several legal systems may also complicate and prolong the resolution of the dispute and make it more expensive. The recommended course is to choose a national law.

27 According to M. Trajković, in an analysis of ICC cases in 1987 in which the parties have chosen the applicable law, it was found that among some 270 contracts, there was only one, arbitral clause which provided for internationalization of the contract. This was the arbitral clause in a contract between a Yugoslav and Kenyan party, which directed the arbitrators to bring the decision on the basis of "international law". See, M. Trajković, op.cit. p. 415, citing S. Bord, Howe to Draft an Arbitratio Clause, Journal of International Arbitration, June 1989.
On the contrary, the choice of a particular set of rules, such as Geneva general conditions, ICC customs and rules, FIDIC rules etc. has been encouraged and fully recognized in judicial and arbitral practice so far. However, such choice was generally not treated as a choice of applicable law, but as a substantive choice, replacing the directory rules, as previously explained.

Statements of general principles of international contract law by UNIDROIT and by the Commission for European Contract Law in the preceding decade have been noted as a novelty by the domestic legal theory. The Principles have been translated to Serbian and discussed by legal scholars. Their significance for the future development of international contract law is by no means underestimated. However, they are recognized primarily as an academic effort and are not truly considered as part of lex mercatoria. They are not considered as possibly applicable by judges or arbitrators, unless expressly chosen by the parties. If a contractual clause would determine any of these sets of rules as the applicable rules to the particular contract, one could expect the arbitrators to recognize such choice as valid and to give it effect in an arbitral proceeding taking place in the territory of Serbia and Montenegro. Considering the wording of the new arbitration laws and the comprehensive nature of the Principles, it may be expected that the choice of such rules would in future be treated as equivalent to the choice of an applicable (national) law.

c. The limitations on the choice of Non-State rules

The starting principle is that arbitrators are bound to respect the parties' choice of the applicable rules of law. This duty is not absolute, however. The necessary limits on the choice of any legal system, including a set of non-state rules, as the

---


applicable law, should be found in the ordre public exception, which may be used by judges and by arbitrators alike, when resolving a dispute with an international element. Although the arbitration laws of member states, which include provisions on the governing law, fail to mention the ordre public exception, it may nevertheless be supposed that the arbitrators sitting in Serbia and Montenegro, could rely on the general provision of the PIL Code. Pursuant to Article 4 of the PIL Code, the law of a foreign State shall not be applied if its effect would be contrary to the fundamentals of the social system as embodied in the Constitution. Although the provision speaks of the law of a foreign State, it could be applied by analogy in case of choice of non-state rules that fail to comply with fundamental domestic legal values. It is also added by arbitration scholars that the parties' will cannot prevail if the rules chosen prove to be against international public policy.32

Should a choice of non-state rules be considered by a State judge, the limits are likely to be even stricter. As previously indicated, judges might give effect to such a clause, but they would surely treat it as a substantive choice (incorporation), meaning that the applicable law would be ascertained anyway, and its mandatory provisions, that cannot be derogated from by contract (even if they are not mandatory in the international sense), would have priority over any chosen non-state rules.

3. Designation of non-State rules as the applicable law by judges or arbitrators

There is no likelihood that a State judge would decide to submit a contract with an international element in which the parties have not made their choice to the application of non-state rules. Judges, according to Constitution, adjudicate on the basis of the Constitution, statute and other general legal acts. The PIL Act directs them to recognize party autonomy in contracts with an international element, and in the absence of choice, to apply the law of the State designated by the provisions of this Act (this will usually be the law of the State of the

_____________________

characteristic performance, unless circumstances of the case point to the application of some other law).

An arbitral tribunal having its place of arbitration in Serbia and Montenegro would also be unlikely to designate non-state rules as applicable to a contract, unless this would be expressly provided by the parties' agreement. The legislators in both member states have restricted the arbitrator's freedom in the absence of parties' choice, to designation of a State law as the governing law.

Nevertheless, there is some room for internationalization of contract by arbitrators in both member states on the basis of provisions which direct the arbitral tribunal to always take into consideration (trade) usages.\(^\text{33}\) The expression "usages" is usually understood restrictively, as a customary business practice in the specific business sector to which the parties in the dispute belong. The expression could be interpreted more broadly, however, to encompass general principles of law or \textit{lex mercatoria}.\(^\text{34}\) In such case, general principles could act as a supplement of the applicable State law. On the other hand, reliance on these principles as a corrective of "substandard" national law, or as a way for the arbitrators to avoid the express choice of the applicable State law is firmly rejected by domestic scholars.\(^\text{35}\)

4. Recognition of foreign judgments and arbitral awards based on the application of non-State rules as substantive law

The substantive limits to recognition of foreign judgments and arbitral awards are defined by the content of domestic ordre public. The case for testing whether the domestic ordre public is against the application of non-state rules as a sole source of decision in contractual disputes has not arisen in practice of domestic courts as of yet. It is a majority view in the doctrine that domestic courts should not deny recognition of a foreign award or judgment solely because the decision

\(^{33}\) See, the Arbitration Bill, Article 50 para 4 in Serbia and the Code of Civil Procedure, Article 493, para. 4 in Montenegro. See also, the Foreign Trade Court of Arbitration in Belgrade, Rules of Procedure Applicable Law, Article 46, paragraph 3.

\(^{34}\) For argument in favor of such interpretation, see M. Trajković, p. 427; against, see, A. Jakšić, p. 127.

\(^{35}\) Ibidem.
was based on non-state substantive rules if the non-state rules were agreed upon by the parties to the dispute. This view follows from the fact that the parties would be allowed to make such choice before domestic arbitral tribunals, too. There should be something more to cause denial of recognition - i.e. the substantive result reached by the application of the non-state rules to the particular case would have to be contrary to domestic public policy.

More stringent scrutiny is to be recommended in cases when the arbitral tribunal or foreign court applied the non-state rules on its own initiative, without express authorization from the parties, or even against the parties' express wishes. Caution and reserve would be necessary in such cases, because determination of non-state rules as the applicable law by arbitrators in the absence of parties' choice is not recognized by domestic arbitration law and is not widely accepted internationally either. The determination of applicable law in that manner could be automatically considered as against domestic public policy.

5.Conclusion

The parties to an international commercial transaction may choose to subject their contract to application of non-state rules or to withdraw their contract from application of any legal rules altogether. If they wish to ensure that such choice will be effective they should combine the choice-of law clause with an arbitration clause. An arbitral tribunal sitting in Serbia and Montenegro is likely to give effect to such choice. According to new arbitration law, if non-state rules were chosen, such choice will be given effect as the choice of governing law, rather than incorporation. The non-State rules will be applied as rules of decision, with the possible limitation of *ordre public* exception. Foreign awards applying non-state rules or awards based on principles of justice and equity are likely to be recognized by domestic courts provided that the designation of the applicable rules of decision or the equitable decision-making was based on the parties' express choice.