

# **INTERNATIONAL ARBITRATION: THE FUNDAMENTALS**

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Arbitration is supposed to be a simple, user-friendly process. In fact, if an arbitration is well designed and competently handled, the process can indeed provide the benefits that its proponents claim for it: proceedings that are simpler, quicker and less costly than litigation; that are fair; and that produce final and enforceable decisions. There are pitfalls, however. Particularly in an international context, the rules and procedures that apply to a given arbitration may be complex. If these rules and procedures are not well understood, and if the arbitrations are not well designed, the process can be a difficult one.

This paper outlines the basic nuts and bolts of international arbitration, and the framework of laws, treaties and rules within which international arbitrations occur.

## **THE ARBITRATION PROCESS**

Arbitration is often categorized as a kind of Alternative Dispute Resolution process. In a broad sense, it is just that -- an alternative to the resolution of disputes in the courts. There is a fundamental difference, however, between arbitration and other forms of ADR. ADR procedures such as mediation, mini-trials, neutral evaluation or fact-finding and the like are intended to facilitate negotiations between disputing parties. They are designed to settle disputes by bringing the parties into agreement, generally through the intermediation of a neutral.

Arbitration has a different function. Arbitration resolves disputes when the parties cannot agree. Like litigation, it is a tiebreaker, to be used if, and only if, the parties cannot settle their differences by agreement.

Arbitration is increasingly the dispute resolution mechanism of choice in international transactions. Parties to trans-border contracts choose arbitration in part because of the inherent advantages of the arbitration process, and in part because each party wishes to avoid the risk of having to litigate in the other party's courts. Most contracts drafted today to govern international transactions contain clauses providing for the arbitration of disputes in a neutral forum.

A regrettable, but perhaps unavoidable, consequence of this increased reliance on arbitration to resolve major international commercial disputes is an increasing "judicialization" of the process. The current trend is away from the original model of arbitration as an informal means for the resolution of merchants' disputes by merchants, and toward proceedings that adopt many aspects of court litigation. There are pleadings, discovery (but generally less of it than in litigation), written evidence, hearings (less formal than judicial hearings, and with relaxed rules of evidence), examination of witnesses (generally cross-examination as well), and, at the end, a written, reasoned award that looks much like a judicial opinion.

The product of an arbitration is intended to be a final, judicially enforceable decision. Generally speaking, arbitrations yield this result. An arbitral award is less susceptible to being overturned on judicial review than a court judgment, and is often more easily enforceable outside the country where it was rendered.

## **THE FRAMEWORK**

International arbitration takes place within a six-part legal framework.

### 1. The Arbitration Agreement

Under most, if not all, relevant laws, the agreement to arbitrate must be in writing. Recognizing that the agreement of the parties to arbitrate is an essential element, and the first element, of any arbitration, whether local or international, we can state a first rule of arbitration:

#### *Rule 1. All arbitration is consensual.*

The rule is so obvious that perhaps it doesn't need stating. Not so obvious, however -- but of fundamental importance to parties and their counsel who contemplate the design of dispute resolution procedures -- are two corollaries to the rule:

#### *Corollary to Rule 1.*

The parties and their counsel can, and very definitely should, design arbitration procedures that are expeditious and appropriate to the circumstances.

Arbitration, particularly international arbitration, is "designer justice." Care must be taken in the design. Arbitration procedures should be designed when the parties are making the contract that may prove later to be the subject of dispute, and should be incorporated in an arbitration clause in the contract. It is much more difficult after a dispute has arisen for parties to agree to arbitration and to the terms of an arbitration clause. At that point, one party or the other may find it tactically advantageous not to agree to participate in effective and efficient dispute resolution proceedings.

#### *Second Corollary to Rule 1.*

If the parties do not agree to arbitration, they have elected to leave the resolution of any disputes that arise (if they cannot settle them by agreement) to litigation.

The parties may, of course, agree that disputes that cannot be settled by agreement will be settled by litigation in a designated forum, rather than by arbitration. If they do not agree to this much, however, they have tacitly agreed that their tiebreaker will be litigation -- in a forum that neither can predict in advance and that at least one may find uncongenial.

## 2. Statutes

Statutes -- national statutes and, in countries organized on federal lines, also the statutes of states or other political subdivisions -- are the second necessary element in the legal structure of both national and international arbitration.

Arbitration statutes serve two basic purposes. First, in many countries they supersede a substantial body of case law by providing that arbitration agreements are irrevocable and enforceable. Formerly, courts had often held such agreements to be unenforceable attempts to oust the jurisdiction of the courts. Arbitration statutes provide that, once the parties have agreed to arbitrate disputes that may arise under a contract, neither can change his or her mind. The statute will provide that the courts may not hear such disputes, but must refer the parties to arbitration.

Second, arbitration statutes require that arbitral awards made in the jurisdictions to which the statutes apply be enforced by the courts in that jurisdiction. Courts may set aside awards on certain limited grounds, such as lack of fair arbitral proceedings or because the arbitrators exceeded their mandate. Under most statutes, however, the courts have no power to set aside awards for errors of law or fact. Except in limited instances, therefore, arbitral awards are final, binding and enforceable in the courts of the jurisdiction where the award was made.

Arbitration statutes typically provide the courts with certain powers to assist the arbitral process. Courts may be given a role, for example, in appointing arbitrators when the parties have not agreed on a method of appointment, or in hearing challenges to arbitrators on grounds of interest or bias. Courts may have the power to issue orders for the appearance of witnesses or the discovery of documentary evidence. They may be empowered by statute (or, as in the United States, by judicial decision) to issue attachments of property, injunctions or other interim relief while an arbitration is pending.

Most commercial nations have national arbitration laws. Over the past two decades a number of countries that are recognized as international arbitration centers have competed to attract international arbitration business. "Modern" arbitration statutes have been enacted in France (1981), the Netherlands (1986), Switzerland (1987) and England (most recently in 1996). These newer statutes are intended to facilitate and support arbitration, and to enhance the attractiveness of the nations that enacted them as centers for international arbitration.

Nearly all national arbitration laws perform the same basic functions and contain the same or similar basic rules. From the consumer's point of view, all of the principal arbitration laws are satisfactory. There are differences from country to country, however. These can be traps for the unwary, requiring special care in the drafting of arbitration clauses and special terms in those clauses. Some unusual features of the principal laws governing domestic and international arbitration are noted below.

### United States

In the United States, the controlling statute is the Federal Arbitration Act (the “FAA”), which was first enacted in 1925, and which has been subject to only a small number of ad hoc amendments in the 76 years following. Although the statute, viewed from today’s perspective, contains omissions and internal inconsistencies, these have been managed reasonably well by the courts. Now there is a large body of U.S. court decisions that interpret and implement the Act.

The active and frequent interventions of the U.S. courts have not only settled issues, but in some cases have raised new ones. A current issue on which the courts are divided is whether, by agreement, parties can expand the grounds on which courts may set aside awards to go beyond the grounds set out in the FAA, and to empower courts to set aside awards for errors of law or unsupported findings of fact.

### Switzerland

It is possible in arbitration in Switzerland to preclude by agreement any review, on any ground, by the Swiss courts. This is possible only if none of the parties to the arbitration has a domicile or place of business in Switzerland.

### Netherlands

Under Dutch law the courts have the power, on application of a party, to order the consolidation of separate arbitrations that involve common parties or common questions of law or fact. Except for a small number of state laws in the United States,<sup>[1]</sup> the Netherlands statute is unique in abandoning the generally prevailing principle that, unless all parties otherwise agree, arbitrations under separate arbitration agreements must be conducted separately, even if they produce conflicting results.

### England

The English Arbitration Act of 1996 consolidates and clarifies rules from earlier statutes in a comprehensive and logical fashion, intended to be comprehensible to people who are not English lawyers. The Act states certain governing general principles that are in accord with current international thinking on the jurisprudence of arbitration, but seldom expressed in statutes. The principles include the autonomy of the parties -- their right to decide most questions of arbitral procedure by agreement -- and a recognition that the object of arbitration is the “fair resolution of disputes” without unnecessary cost or delay. The 1996 Act identifies (if it does not always answer) a few significant questions that most arbitration laws gloss over, such as statutes of limitation; the consolidation of related

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<sup>[1]</sup> The Massachusetts, Georgia and Florida statutes provide for consolidation, each in a different way.

arbitral proceedings; and the remedies that arbitrators may provide, including the award of pre-award interest.

A significant and unusual provision of the English Act is the right it gives parties to go to the High Court for interlocutory rulings on points of law, and to appeal arbitral awards to the courts on questions of law. The parties also have the power, however, to make legally effective “exclusion agreements” that preclude such requests to the Court. The parties have no power to preclude judicial review on grounds of lack of a fair hearing or lack of arbitrator jurisdiction.

### France

Under French law, it is possible to enforce a foreign arbitral award in the French courts even though the award has been set aside by a court of the country where the award was rendered.

### State Laws

In federal systems, such as the United States, Canada and Switzerland, the states, provinces or cantons are also likely to have arbitration statutes. Nearly all of the states in the United States have adopted the Uniform Arbitration Act. A more comprehensive model state law, the Revised Uniform Arbitration Act, was recently proposed. The new act has been adopted by two states (New Mexico and Hawaii) and is currently under consideration by the legislatures of six other states.

Some states in the United States have enacted special laws governing international arbitrations. California and Florida, for example, have detailed international arbitration statutes that are highly supportive of arbitration and that ought to be consulted by anyone planning to place an international arbitration in either state. Other states with international arbitration statutes include Texas, Hawaii, Georgia, Connecticut, Oregon and Ohio.

In the United States, state statutes apply only to the extent they are not inconsistent with federal law. Typically, when one elects to arbitrate an interstate or international dispute in any of the states of the United States, he or she can expect that the arbitration’s procedures will be governed by the Federal Arbitration Act and by any provisions of the state’s arbitration laws that are not inconsistent with the FAA and the court decisions interpreting it.

### UNCITRAL Model Law

A Model Law, first promulgated by the United Nations Commission on International Trade Law (UNCITRAL) in 1985, has been highly influential in the drafting of arbitration laws in recent decades. This excellent and comprehensive statute has been adopted (often with variations) by no fewer

than 45 countries,<sup>[2]</sup> as well as by a number of states in the United States and provinces in Canada. In addition, its terms strongly influence the drafting of virtually all new arbitration statutes. Its influence is apparent in the 1996 English Arbitration Act.

### 3. Courts

National and state courts are the third element in the framework of international arbitration. It is, of course, the courts at the place of arbitration that interpret the arbitration statutes that govern there. Judicial attitudes toward arbitration may vary. Courts exhibit different degrees of willingness to compel arbitration, to assist the arbitration process, and to enforce or review arbitral awards.

The courts of most major arbitration jurisdictions tend to be supportive of arbitration. U.S. courts consistently hold that the FAA establishes a strong pro-arbitration bias under U.S. law. This bias is particularly pronounced with respect to international arbitrations. The U.S. Supreme Court has referred to arbitration as “an almost indispensable precondition” to the orderly transaction of international business.

The categories of international disputes that are held to be arbitrable under the FAA continue to expand. The U.S. Supreme Court has held that international disputes under both U.S. securities and antitrust laws are arbitrable. Within the past several years, the Supreme Court has held that disputes under the Age Discrimination in Employment Act (“ADEA”) and the Carriage of Goods by Sea Act (“COGSA”) are arbitrable notwithstanding the availability of judicial remedies under those statutes. The classes of statutory claims that are arbitrable under the FAA are still being marked out by the lower courts on a case by case basis.

Wherever an arbitration is held, the national law of the place of arbitration, and any applicable state law, as applied by the courts, will determine, among other things:

- What kinds of disputes are arbitrable. As noted above, a wide range of disputes, including private disputes under the antitrust and securities laws, have been held arbitrable under the FAA. Courts in other countries may take a narrower view.
- Whether arbitration agreements will be enforced.
- How arbitrators are appointed. Most arbitration statutes give the courts the power to make appointments, to the extent the parties and party-appointed arbitrators have not done so.

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<sup>[2]</sup> Australia, Azerbaijan, Bahrain, Bangladesh, Belarus, Bermuda, Bulgaria, Canada, Chile, Croatia, Cyprus, Egypt, Germany, Greece, Guatemala, Hong Kong, Hungary, India, Iran, Ireland, Japan, Jordan, Kenya, Korea, Lithuania, Macau, Madagascar, Malta, Mexico, New Zealand, Nigeria, Oman, Paraguay, Peru, Philippines, Russian Federation, Scotland, Singapore, Spain, Sri Lanka, Thailand, Tunisia, Ukraine, Zambia, and Zimbabwe.

- Whether courts will grant injunctions and other interim relief in support of arbitration. There are marked disparities among different jurisdictions, and even among federal judicial circuits in the United States.
- The degree to which courts will enforce awards or review them and set them aside on appeal.

In light of the importance of national law in the conduct of international arbitrations, one may state a second rule of international arbitration:

*Rule 2. All international arbitration is national arbitration.*

Every arbitration is subject to a *lex arbitri*. Every arbitration, in other words, is subject to the arbitration law (generally the arbitration statute and related judicial decisions) of the place where the arbitration is held.

This broad rule does not apply in every case, however.

*Exception to Rule 2*

Certain kinds of arbitration, including proceedings before special arbitral tribunals set up by treaties or other international agreements, may not be subject to national laws or the control of national courts.

The International Centre for the Settlement of Investment Disputes (“ICSID”), a World Bank affiliate, is such a tribunal. ICSID jurisdiction derives from the ICSID Convention and in some cases from Bilateral Investment Treaties, the North American Free Trade Agreement (“NAFTA”) or other treaties. ICSID arbitrations are truly international. They are conducted within a framework established by an international convention and are not subject to any nation’s arbitration laws. The Iran-United States Claims Tribunal at The Hague should probably be classified as another such supra-national arbitral tribunal.

It is also argued that a private arbitration may be so structured as to be subject to no national law, so that the award produced in the arbitration is “a-national.”

4. International Conventions

Over-arching these national laws, and creating a single system of international arbitration, are international treaties that provide for the enforcement of foreign arbitral awards. The principal international convention is the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (1958), to which 135 nations have subscribed. This convention requires the courts of signatory countries (1) to enforce arbitration agreements made in other countries, and (2) to recognize and enforce arbitral awards rendered in the territories of other countries (generally only other signatory countries). The Convention provides, however, that an award need not be enforced if it was unfairly or irregularly procured or if it covered a question outside the scope of the

parties' arbitration agreement. A court may also refuse enforcement if enforcement would violate the public policy or standards of arbitrability of the enforcing state. The Convention's standards for refusal to enforce a foreign award are narrowly construed in the United States and most other countries.

The Inter-American Convention on International Commercial Arbitration (1975) is a comparable treaty to which the United States and 15 Latin American countries are parties. In addition, bilateral agreements and certain other regional agreements provide for reciprocal recognition of arbitral awards.

Significantly, there are no multilateral treaties to which the United States is a party that provide for the international recognition and enforcement of court judgments, as do the Brussels and Lugano Conventions. In the absence of a treaty, foreign judgments are scrutinized and enforced by the courts pursuant to principles of comity prevailing in the jurisdictions where enforcement is sought.

## 5. Arbitration Rules

The fifth part of the framework of international arbitration consists of the detailed rules that govern arbitration procedures. The parties are free to select the rules that will govern an arbitration, or to write their own rules. The rules used most frequently in international arbitration include those of the International Chamber of Commerce ("ICC"), the American Arbitration Association ("AAA"), the United Nations Commission on International Trade Law ("UNCITRAL"), the London Court of International Arbitration ("LCIA"), the CPR Institute for Dispute Resolution, and (in "East-West" transactions) the Stockholm Chamber of Commerce.

Although the rules listed above vary in many particulars, all are well tested and workable. Furthermore, most provisions of most rules may be varied by agreement of the parties.

The UNCITRAL Rules and variants of those rules have been adopted by many newly established arbitration centers. The Cairo, Vancouver, Kuala Lumpur and Hong Kong centers, among others, either base their rules on the UNCITRAL Rules, or will apply those rules if the parties so choose. The International Arbitration Rules of the AAA (2003) also borrow from concepts in the UNCITRAL Rules.

Rules and variations on the rules apply because the parties have agreed that they apply. Again, the parties have an opportunity to design their dispute resolution procedures — first, in their choice of arbitral rules and, second, in their fine-tuning of the rules.

## 6. Arbitral Institutions

Arbitral institutions are the sixth and final part of the framework. The parties may elect to have their arbitrations administered by the ICC, the AAA, the LCIA, the Stockholm Chamber or any of at least a dozen other

local or national institutions. These institutions assist with the logistics of arbitration. They also perform the important functions of appointing arbitrators if the parties have not otherwise provided for their appointment, and of hearing challenges to arbitrators based on alleged bias or interest. The institutions charge fees for their services, some on the basis of time devoted to a proceeding, some on the basis of the amount in dispute. These fees can be substantial.

It is also possible for parties to choose “ad hoc” arbitration, in which the arbitrators and the parties handle administrative tasks without the aid of an arbitral institution. The UNCITRAL rules and the CPR Institute’s International Rules are well drafted and effective ad hoc rules, and are gaining in popularity.

## **CONCLUSION**

All six parts of the framework of international arbitration -- the parties’ agreement, statutes, courts, conventions, rules and arbitral institutions -- are variables that one must keep in mind in designing arbitration procedures for a given transaction. The parties’ agreement is the most important variable, for their agreement largely determines what laws, rules and institutions are relevant and, to some extent, what role each will play. The choices are significant, notwithstanding a gradually emerging trend toward uniformity in laws, rules, arbitral procedures and judicial attitudes in international arbitration. International arbitration is still largely national arbitration. It is still “designer justice.”

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