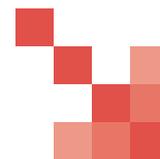


# Drafting an effective international arbitration agreement



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All too often the dispute resolution clause in a contract is the clause that receives the least attention. Pre-existing clauses are cut and pasted from existing agreements with little or no assessment made of the suitability of specific provisions, often late in the life of the drafting process. While any form of dispute resolution clause is rarely high on a party's list of priorities when the contract is drawn up, the terms of that clause may well be crucial in the event of a dispute.

This chapter considers:

- The essential requirements of a valid agreement to arbitrate.
- Core provisions of an arbitration clause.
- Further optional provisions to address specific requirements.
- The interaction with other forms of dispute resolution.

## THE ESSENTIAL REQUIREMENTS

The ability to arbitrate disputes can play an important role in a party's risk assessment when entering into cross-border contracts. A valid agreement to arbitrate can give a party access to a neutral venue with impartial arbitrators, and the ability to enforce the final award in a far greater number of countries than a court judgment.

If the arbitration clause fails to establish a binding agreement to arbitrate (such clauses are often termed "pathological clauses"), the party may well be left with no choice but to initiate court proceedings in the "home court" of its contractual counter-party, a prospect that may have given rise to the rationale behind proposing arbitration in the first place.

The test most commonly used to determine the core elements of a valid and enforceable agreement to arbitrate is that which would be applied by a state court that is asked to recognise the agreement to arbitrate under the UN Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958 (New York Convention). Those core elements are as follows:

- Parties have capacity to contract.
- Agreement valid under its governing law.
- Arbitrability.
- Written evidence of the parties' agreement to arbitrate.
- A clear agreement to submit the present or future dispute to arbitration.

## Parties have capacity to contract

While the classic bases of incapacity are less likely to present problems in international commercial contracts, capacity can still be an issue in certain circumstances. In recent years a number of countries have removed the capacity of some of their state-owned entities in key sectors (for example energy) to contract subject to arbitration clauses. This has been a feature in several natural resources-rich Latin American countries.

There are also a number of jurisdictions in which restrictions exist on the ability of nationals (whether natural persons or corporate entities) to submit disputes to determination in other countries without first securing court sanction. Liechtenstein is one example. Further issues of capacity can commonly arise in relation to contracts with state and/or state agencies.

## The agreement is valid under its governing law

There are also still a number of countries which require parties to reconfirm their agreement to arbitrate after the dispute has crystallised. Historically, before the widespread adoption of the UNCITRAL Model Law on International Commercial Arbitration 1985 (UNCITRAL Model Law), this requirement was a much more common feature of national laws. This was a factor in the International Chamber of Commerce (ICC)'s development of the Terms of Reference mechanism, under which parties are required to sign to confirm their agreement to submit a dispute to arbitration.

## Subject matter of the dispute is arbitrable

Many countries still view anti-trust/competition, and patent and trade mark-related disputes, as incapable of being arbitrated. The rationale behind this is that arbitration is essentially a mechanism for the private resolution of disputes between consenting parties, whereas anti-trust/competition and patent and trade mark disputes can impact on a wider group of parties. Many countries take the view that jurisdiction over such issues should be vested solely with courts.

Issues relating to the arbitrability of disputes over bribery or corruption in the procurement or performance of a contract raise interesting questions of public policy. Similarly, where a contract is illegal or otherwise not recognised by the court (for example gambling contracts in England and Wales), interesting issues can arise as to whether the arbitration clause is infected by the illegality. While in general terms there is a developing consensus that an allegation of bribery in relation to the contract is not of itself sufficient to make the agreement to arbitrate void (see the recent UK House of Lords decision in *Fiona Trust (Fiona Trust and Holding Corp v Privalov* [2007] UKHL 40), a different position has been taken in other jurisdictions.

### Written evidence of the parties' agreement to arbitrate

At one time, written evidence had to be in a single document. Now, written evidence can be found in more than one document, and with the increase in the use of electronic devices "written" and "document" can be more widely interpreted. While that broad approach is now widespread, again there are jurisdictions in which a more restrictive view is taken and it can be more difficult to establish satisfactory evidence of the parties' agreement to arbitrate.

### A clear agreement to submit the dispute to arbitration

Perhaps the greatest cause of a pathological clause is the requirement to establish a clear agreement to submit the dispute to arbitration. Difficulties commonly arise when drafters seek to reserve certain types of issue for resolution by a different dispute resolution mechanism (for example, completion account issues by expert determination), or fail to properly structure a multi-tier dispute resolution structure (for example, negotiation between principals before mediation before arbitration).

Both of the above examples can be achieved by careful drafting. But poor drafting can cause uncertainty and therefore problems. The classic example is the clause that mandates mediation without allowing a party to "escalate" the dispute to arbitration after a set period if mediation does not result in a settlement. It can leave the parties locked in the mediation phase indefinitely.

## CORE PROVISIONS OF AN ARBITRATION CLAUSE

These are:

- Choice of the "seat" or legal place of the arbitration.
- Choice of arbitral institution to administer.
- Choice of institutional rules.
- Number and method of selection of arbitrator.
- Language of the arbitration.
- Confidentiality.

### Choice of the "seat" or legal place of arbitration

A prudent drafter will provide for the "seat" or legal place of the arbitration.

The "seat" need not necessarily be the venue for hearings. The arbitration law of many countries (including those that have adopted the UNCITRAL Model Law and the UK) permits the tribunal to conduct hearings outside the country of the seat without thereby changing the seat.

The true significance of choice of seat is that the seat determines the "curial law" of the arbitration. If London is prescribed as the seat, the English Arbitration Act 1996 governs all procedural questions and the English Commercial Court operates as the court. Key issues addressed under the curial law include:

- The default position in appointment, challenge and removal of arbitrators.
- Powers of the court in relation to an arbitration.

- Process for challenge to arbitral awards.

Perhaps more importantly, the choice of seat should be in a country that has joined the New York Convention, to increase the likelihood of successfully enforcing the award. Certain countries such as Libya have not acceded to the New York Convention; others such as Indonesia have acceded subject to exclusions for part of their territory; still others have acceded and ratified but still present enormous challenges in obtaining enforcement. For example, in Saudi Arabia there is still no reported instance of an enforcement of a foreign arbitral award, and see the problem of the "public policy" exclusion in the recent *Venture Global* case in India (*Venture Global Engineering, USA v Satyam Computer Services Limited, Supreme Court of India, Civil Appeal No.309 of 2008*).

### Choice of arbitral institution to administer

One of the big decisions when drafting an arbitration clause is whether to prescribe an administering institution and, if so, which one. There are an increasing number of institutions, for example:

- International Chamber of Commerce (ICC).
- London Court of International Arbitration (LCIA).
- Chartered Institute of Arbitrators (CIA).
- International Centre for Dispute Resolution (ICDR)/American Arbitration Association (AAA).
- Stockholm Chamber of Commerce (SCC).
- Singapore International Arbitration Centre (SIAC).
- Hong Kong International Arbitration Centre (HKIAC).
- China International Economic and Trade Arbitration Commission (CIETAC).
- Cairo Centre.
- Dubai International Arbitration Centre (DIAC).
- Santiago Chamber of Commerce (CAM Santiago).
- The Arbitration Centre of Mexico (CAM).
- Swiss Arbitration Association (ASA).

The functions performed by an institution include the following:

- Tribunal appointment.
- Administration of challenges to arbitrators.
- Administration of the deposit/advance on costs.
- Scrutiny of the award (currently unique to the ICC).

Different institutions charge for their services in different ways. The most common is by reference to the sums in dispute. This method is used in the ICC and the SCC, each of which has a "fees calculator" on their website for parties wishing to gain an impression of the likely costs. The LCIA, meanwhile, still charges hourly rates: GB£200 (about US\$398) per hour for the Registrar's time, and GB£100 (about US\$199) per hour for the Secretariat's time.

A number of pathological clauses result from drafters prescribing non-existent institutions. Care should be taken in both selecting and correctly naming the institution.

It is not essential to prescribe an institution. A very large number of arbitrations proceed on an ad hoc basis without involving any institution. The primary advantage is saving the fees of the administering institution, but the parties are then wholly reliant on seeking the assistance of the courts at the seat when one party wishes to form a tribunal in the face of a lack of co-operation from the other party, or a party seeks the removal of an arbitrator.

Parties used to arbitration often prescribe an institution and then vary their agreement to arbitrate by consent with their contracting party if, at the time a dispute crystallises, it is thought that there is an adequate residual relationship between the parties to dispense with the services of the administering institution.

### Choice of institutional rules

While most institutional rules are based on the UNCITRAL Rules, there are a host of subtle differences between different sets of rules (see box, *The role of "model clauses"*). Key differences include:

**Confidentiality.** The ICC makes no mention of confidentiality in its Rules, whereas the LCIA and ICDR both expressly provide for confidentiality in different ways.

**Terms of Reference.** This is uniquely a creature of the ICC Rules. The Terms of Reference are required to be drawn up following the initial exchange of the Request for Arbitration and the Answer. The Terms of Reference are intended to record the scope of the issues in dispute between the parties.

**Scrutiny of Awards.** Another unique feature of the ICC Rules is the ICC's review (termed "scrutiny") of any final award. On the one hand this is viewed by some as an advantage, in that it avoids typographic and other (often more significant) errors in awards, reducing their susceptibility to challenge before the courts of the seat, but it results in additional delay in the arbitral process, as scrutiny commonly takes between three and eight weeks.

**Timetabling.** The precise amount of time provided for individual steps in the arbitral procedure, including within what time period the parties should respond to Requests to Arbitrate and the subsequent sequence of submissions, differ between institutional rules.

### The number and method of selection of arbitrator(s)

While historically in some insurance and shipping contracts two arbitrators were prescribed (requiring unanimity), the choice is ordinarily between a sole arbitrator or a tribunal of three.

The most obvious factor influencing choice of the number of arbitrators is cost. While a tribunal of three does not treble the overall costs, it does tend to at least double the costs. The primary reason for selecting a tribunal of three is so that a party can select its own member of the tribunal (subject to institutional approval) and, through that party-nominated arbitrator, influence the selection of the chair. Many people view the opportunity to have input into the constitution of the tribunal as one of the strongest features of arbitration as a method of dispute resolution. The contrary argument is that in many arbitrations, the chair is the dominant figure, and so "wing men" are an unnecessary addition.

It is essential that provision is made for the method of appointment of the tribunal. The ICC in its recent task force report on *Saving Costs and Reducing Time* suggested that parties should devolve all responsibility to the ICC. There is something to be said for leaving open the choice as to whether one or three arbitrators should be selected and where three, to leave the appointment of all arbitrators to the appointing organisation. Chair selection is an important issue to prescribe.

Under several institutional rules in default of express provision, the institution selects the chair. If the parties wish to either select directly or select through their nominated arbitrators, express provision should be made. There should also be provision made for the default where no agreement can be reached.

### Language of the arbitration

Where the parties, relevant witnesses and key documentary evidence can be expected to be in different languages, the choice of the language of the arbitration can be important. Parties commonly link choice of language to the language of the contract, or the choice of seat, but there is in fact no fetter on the parties' freedom to select.

Factors to bear in mind include costs of translation and document transcription (which can be very substantial where parties have the potential to be involved in large disputes with many documents) and of course the impact on the available pool of arbitrators. While it is possible to select arbitrators who are not familiar with the language of the arbitration, many parties feel uncomfortable doing so.

### Confidentiality

While arbitration is a private method of dispute resolution, it does not necessarily follow that in the absence of express provision, the arbitration procedure and any documents created for or exchanged in connection with the arbitration will be confidential. The law is different as between different jurisdictions.

The position is also very different under different institutional rules as mentioned above.

## FURTHER OPTIONAL PROVISIONS TO ADDRESS SPECIFIC REQUIREMENTS

In addition to the core elements, parties often seek to add one or more of the following additional elements. Care should be taken when seeking to add additional provisions, because the more expansive the drafting and the further the clause extends beyond the basics, the greater the chance of the creation of a pathological clause. Possible additional requirements include:

- True procedural guidance (for example, the International Bar Association (IBA) Rules of evidence).
- Summary/expedited processes.
- Multiple parties/multiple contracts.
- Preliminary measures.

### Procedural guidance

In truth, none of the main institutional rules actually provides for the underlying procedure including, in particular, the manner in which evidence will be taken. This is by design. Arbitration is intended to be a flexible process whereby the parties (exercising party autonomy), in

## THE ROLE OF “MODEL CLAUSES”

Each of the main arbitral institutions prescribes a model form of wording. As can be seen from the examples below, they tend to be short:

### ICC

“All disputes arising out of or in connection with the present contract shall be finally settled under the Rules of Arbitration of the International Chamber of Commerce by [one or more]/[one]/[three] Arbitrator[s] appointed in accordance with the said Rules.”

### LCIA

“1. Any dispute arising out of or in connection with this contract, including any question regarding its existence, validity or termination, shall be referred to and finally resolved by arbitration under the LCIA Rules, which Rules are deemed to be incorporated by reference into this clause.

(a) the number of Arbitrators shall be [one/three];

(b) the seat, or legal place, of arbitration shall be [city and/or country];

(c) the language to be used in the arbitral proceedings shall be[ ].

2. The governing law of the contract shall be the substantive law of [ ].”

### ICDR

“Any controversy or claim arising out of or relating to this contract shall be determined by arbitration in accordance with the International Arbitration Rules of the International Centre for Dispute Resolution.”

In terms of arbitrator appointment, possible wording importing the UNCITRAL List Procedure is as follows:

“The dispute will be resolved by a tribunal made up of three arbitrators (the “Tribunal”). The Tribunal will be selected in the following manner:

(a) Each party shall nominate one person to serve as a Party-nominated arbitrator:

(i) the Claimant shall include in its Request for Arbitration the Claimant’s nomination of the Claimant’s arbitrator.

(ii) the Respondent shall submit its nomination of its arbitrator at the time and in the manner required by the Rules.

(b) The third arbitrator, who shall serve as a Chair of the Tribunal, shall be selected as follows:

(i) within thirty (30) days after the first date on which both Party-nominated arbitrators are confirmed, the two Party-nominated arbitrators shall seek to agree on the identity of the Chair of the Tribunal.

(ii) if an agreement is reached on a person to be jointly nominated, the name of such joint nominee shall be submitted to the [ICC] for confirmation.

(iii) if an agreement is not reached within such thirty (30) day period, or if the ICC declines to confirm the joint nominee, [the ICC] shall utilise the list procedure set out in Article 6(3)(a) and (b) of the UNCITRAL Rules, save that “Chair” shall be substituted for “Sole Arbitrator”.

(iv) if for any reason the appointment of the Chair cannot be made according to this procedure, the [ICC Court] shall appoint the Chair under the Rules.”

In the event that it is proposed to expressly adopt the IBA Rules of Evidence, the following clause may be appropriate:

“The Parties and the Tribunal shall refer to the IBA Rules on the Taking of Evidence in International Commercial Arbitration (the “IBA Rules of Evidence”) for guidance on the evidence phase of the arbitration. As regards the presentation and reception of evidence, the IBA Rules of Evidence shall be used as guidance to the extent that the Tribunal deems them to be appropriate to the particular circumstances of the dispute.”

Further commonly encountered clauses include:

“Nothing in this clause shall:

(a) prevent either party from applying to court for interim relief pursuant to [section 44 of the Arbitration Act 1996] and such relief may be granted in circumstances not limited to the preservation of evidence or assets;

(b) override any provision of law which prohibits that such matter be dealt with other than in a court of law or other relevant tribunal.”

“Any arbitral award shall be binding and shall be enforceable in accordance with the rules of the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards. Judgement upon the award rendered may be entered into any court or other authority having jurisdiction or application may be made to said court or other authority for a judicial acceptance of the award and an order of enforcement, as the case may be.”

conjunction with the tribunal, formulate the procedure appropriate to the issues in dispute in the instant case. While that may be the theory, increasingly parties and their legal advisers are seeking to import more and more structure into arbitral procedure.

The more prescriptive the clause, the greater the scope to challenge an ultimate award, on the basis that the tribunal failed to comply with a mandatory requirement within the arbitration

clause. If the parties are anxious to be more prescriptive, particularly where the parties are from very different legal cultures, it may be felt appropriate to adopt as guidance, but not as strict rules, the IBA Rules on the Taking of Evidence in International Commercial Arbitration 1999. The IBA Rules are the product of work undertaken by lawyers drawn from right across the world spanning the common law/civil law spectrum, and many feel they represent a practical and sensible middle ground.

### Summary/expedited processes

While it is often tempting to seek to prescribe in the arbitration clause an expedited procedure, with short time limits for the completion of all necessary steps, care should be taken, as overly prescriptive clauses can lead to a pathological clause or create increased scope for one party to challenge the ultimate award for procedural unfairness or lack of jurisdiction.

There are numerous examples, especially in the area of shipping and commodity trading, where specific sets of rules establish an expedited procedure leading through to a dispositive hearing within three or six months from commencement of the arbitration. One of the most rapid procedures occurs under the rules of the Court for Arbitration in Sport, where in the context of drug infringement cases in major competitions such as the Olympics, arbitrations can be convened and resolved in a matter of days.

### Multiple parties/multiple contracts

Where, as is commonly the case with construction or large engineering projects, there are multiple parties and multiple contracts, the requirement for privity of contract between parties to a dispute, the limitations on the scope to join non-parties and/or to consolidate arbitrations and the need for equality in the tribunal appointment process can create many complex problems, which are beyond the scope of this chapter.

To facilitate joinder and/or consolidation of related arbitrations, all related contracts should be subject to the same arbitration clause, and where possible an umbrella contract between all parties specifically providing for the right to consolidate.

Where there are multiple parties to the same contract, it is necessary to provide a mechanism by which parties are designated as claimant or respondent for the purposes of selection of arbitrators and pleading. The alternative would be an overly cumbersome procedure with each party nominating its own arbitrator.

### Preliminary measures

Parties commonly make express provision for the entitlement of the parties to petition a court to secure protective measures. Strictly, under most arbitration laws, such a requirement is unnecessary, as the underlying arbitration law facilitates application to secure relief in aid of/support of an ongoing arbitration.

The UNCITRAL Model Law has recently been amended to empower arbitrators to grant injunctive relief. This provision needs to be adopted into national law and as yet few countries have done so. Even where such a power exists, the parties must wait for a tribunal to be convened before applying for provisional measures. This delay can be unsatisfactory and can lead parties to have recourse to the national courts.

## INTERACTION WITH OTHER FORMS OF DISPUTE RESOLUTION

Multi-tiered dispute resolution clauses are another common cause of pathological clauses. It is essential when seeking to either carve out specific types of dispute which will be resolved by a specific mechanism or creating phases (for example negotiation moving to mediation before arbitration) that the drafters do not leave the parties incapable of progressing to the next stage in the process. This can happen where mediation is mandatory but one party fails to enter into the mediation process and there is no

### CHECKLIST OF DO'S AND DON'TS

Do:

- Keep it simple - ambitious drafting can more easily lead to pathological clauses.
- Select the seat or legal place of the arbitration with care to ensure a non-interventionist but supportive judicial system to underpin the arbitral process.
- Select an arbitral institution able to administer the arbitration and deal with challenges to arbitrators and appointment in default agreement.
- Scrutinise any institutional rules with care - they are not all the same.
- Select an odd number of arbitrators - provide for three unless you know for certain that the sums in the dispute will not justify it - you can always agree later to opt for a sole arbitrator.
- Think about adopting the IBA Rules of Evidence, particularly if your counterparty is from a different legal culture and so may have very different expectations about the approach to evidence and arbitral procedure.
- Ensure that your contract provides for the governing law of the contract (preferably separate from the arbitration clause itself).
- If the "seat" and governing law of the contract differ, expressly provide for the law of the agreement to arbitrate.
- Take care with multi-level dispute resolution clauses so as not to create preconditions to arbitration which may be incapable of being satisfied.

Do not:

- Name a specific arbitrator, as they may be unavailable or no longer alive by the time a dispute arises.
- Select a seat or legal place of the arbitration and applicable law without reviewing the implications - it is unwise simply to trade with one party specifying the law and the other the seat.
- Be overly prescriptive about the qualifications or experience required by an arbitrator - this can unduly reduce the pool of candidates qualified to be appointed.

opportunity to escalate the dispute at the option of either party (see box, *Checklist of do's and don'ts*). This section considers:

- Time-limited direct negotiation.
- ADR/mediation.
- Expert determination.
- Dispute Review Boards (DRBs).

**Time-limited direct negotiation**

It is often advantageous to expressly provide that the parties will negotiate in good faith. In complex projects, provision is often made for the elevation of the dispute through internal layers to senior individuals within each organisation, who have no personal connection with the underlying contract or project.

Clauses also sometimes provide for information exchanges at the negotiation phase on the basis that informed discussions more frequently lead through to compromise. It is also often advantageous to set a time period after which the parties are entitled to escalate the dispute or to provide the right to bypass the phase in certain prescribed circumstances.

**ADR/mediation**

In certain cultures mediation has gathered significant momentum as an alternative method of resolving disputes. It is possible for parties to prescribe a mandatory mediation phase before the parties are entitled to elevate the dispute to arbitration. It is prudent to provide for escalation options to avoid mediation operating as a condition precedent, potentially locking a party out of its entitlement to commence an arbitration (*see above, Interaction with other forms of dispute resolution*).

**Expert determination**

Care needs to be taken in drafting any carve-out provisions which require defined categories of dispute to be resolved by a different form of dispute resolution. It is not uncommon for completion account or other forms of valuation dispute to be resolved by expert determination, with the balance of disputes arising under a contract to be resolved by way of arbitration. Care needs to be taken to ensure that the boundaries between different forms of dispute are clearly defined and understood to avoid the development of a pathological clause.

**Dispute Review Boards (DRBs)**

DRBs have gained considerable support in complex construction and engineering projects in recent years. DRB's are beyond the scope of this chapter. In essence, the DRBs establish a mechanism for the interim resolution of ongoing disputes during the life of a project, with those interim decisions subject to a later review in the context of an arbitration or court proceedings. The value is in preventing a dispute from derailing the overall project.

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