CHAPTER ONE

# Introduction to International Commercial Arbitration[1]

## A. PURPOSE

Arbitration is a private system of adjudication. Parties who arbitrate have decided to resolve their disputes outside of any judicial system. In most instances, arbitration involves a final and binding decision, producing an award that is enforceable in a national court. The decision-makers (the arbitrators), usually one or three, are generally chosen by the parties. Parties also decide whether the arbitration will be administered by an international arbitral institution, or will be ad hoc, which means no institution is involved. The rules that apply are the rules of the arbitral institution, or other rules chosen by the parties. In addition to choosing the arbitrators and the rules, parties can choose the place of arbitration and the language of arbitration.

Arbitration thus gives the parties substantial autonomy and control over the process that will be used to resolve their disputes. This is particularly important in international commercial arbitration because parties do not want to be subject to the jurisdiction of the other party's court system. Each party fears the other party's "home court advantage." Arbitration offers a more neutral forum, where each side believes it will have a fair hearing. Moreover, the flexibility of being able to tailor the dispute resolution process to the needs of the parties, and the opportunity to select arbitrators who are knowledgeable in the subject matter of the dispute, make arbitration particularly attractive. Today, international commercial arbitration has become the norm for dispute resolution in most international business transactions.

[1] This chapter presents a brief overview of some of the basic characteristics of arbitration and how it works. Specific points mentioned in this chapter will be developed in greater detail in subsequent chapters.

## B. DEFINING CHARACTERISTICS

### 1. Consent

The parties' consent provides the underpinning for the power of the arbitrators to decide the dispute. The parties' consent also limits an arbitrator's power because an arbitrator can only decide issues within the scope of the parties' agreement. Arbitrators are also expected to apply rules, procedures, and laws chosen by the parties. Normally, the parties express their consent to submit any future dispute to arbitration in a written agreement that is a clause in the commercial contract between them.[2] If they do not have an arbitration clause in their contract, however, they can still enter into an agreement after a dispute has arisen. This is known as a submission agreement.[3]

### 2. Non-Governmental Decision-Makers

Arbitrators are private citizens. They do not belong to any government hierarchy. Compared with judges, they will probably weigh less heavily any questions of public policy or public interest, since they see their primary responsibility as deciding the one dispute they were chosen by the parties to decide. Also, unlike some judges, arbitrators tend to be very thoughtful of the parties, and considerate in their interactions with them. Arbitrators are chosen by the parties, and, of course, they would like to be chosen again. It is in their interest to be perceived as even-tempered, thoughtful, fair-minded, and reasonable.

Arbitrators do not have to be lawyers. In some industries, the technical skills of architects and engineers cause them to be chosen as arbitrators. When there are three arbitrators, quite often each party will choose one arbitrator, and the third, who will be the chair, will be chosen by the two party-appointed arbitrators. International arbitrators are, however, all expected to be independent and impartial. They can be challenged, either before the arbitral institution or a court, if there is evidence that they are not independent and impartial.

### 3. A Final and Binding Award

One of the reasons parties choose to arbitrate is that arbitration results in a final and binding award that generally cannot be appealed to a higher-level court. Although there are occasional opportunities to appeal in some jurisdictions,[4] for the most part, a party can challenge an award only if there

[2] Sometimes this clause is referred to by the French term, "clause compromissoire," which is a clause agreeing to submit future contract disputes to arbitration.

[3] This agreement is sometimes referred to by the French term, "compromis," which is an agreement to submit an existing dispute to arbitration.

[4] Under the English Arbitration Act, for example, in certain limited circumstances, unless the parties have agreed otherwise, a party to an arbitral proceeding may appeal to the court on a question of law. English Arbitration Act of 1996, art. 69(1).

is some defect in the process. A party can try to vacate the award in the court of the country where the arbitration was held (the seat of the arbitration). However, under most arbitration laws, the only grounds for setting aside an award will be quite narrow, such as a defect in the procedure, or an instance where the arbitrators exceeded their powers and decided an issue that was not before them.

Once the arbitrators render an award, the losing party may voluntarily comply with the terms of the award. If it does not, the prevailing party will try to have the award recognized and enforced by a court in a jurisdiction where the losing party has assets. In the enforcing court, the losing party can also challenge the award, but again, only on very narrow grounds. Basically, the award cannot be challenged on the merits, that is, even if the arbitrators made mistakes of law or mistakes of fact, these are not grounds for non-enforcement, and the award will still be enforced. Once a party's award is recognized in the enforcing jurisdiction, it is generally considered to have the same legal effect as a court judgment, and can be enforced in the same way that a judgment would be enforced in that jurisdiction.

## C. ADVANTAGES OF ARBITRATION

The benefits of international commercial arbitration are substantial. An empirical study of why parties choose international arbitration to resolve disputes found that the two most significant reasons were (1) the neutrality of the forum (that is, being able to stay out of the other party's court) and (2) the likelihood of obtaining enforcement,[5] by virtue of the New York Convention, a treaty to which over 140 countries are parties.[6] An arbitration award is generally easier to enforce internationally than a national court judgment because under the New York Convention, courts are required to enforce an award unless there are serious procedural irregularities, or problems that go to the integrity of the process. The New York Convention is considered to have a pro-enforcement bias, and most courts will interpret the permissible grounds for non-enforcement quite narrowly, leading to the enforcement of the vast majority of awards.

Other advantages include the ability to keep the procedure and the resulting award confidential. Confidentiality is provided in some institutional rules, and can be expanded (to cover witnesses and experts, for example) by the parties' agreement to require those individuals to be bound by a

[5] *See* Christian Bühring-Uhle, *A Survey on Arbitration and Settlement in International Business Disputes*, in Christopher R. Drahozal & Richard W. Naimark, Towards a Science of International Arbitration, p. 31 (2005).

[6] United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 1958, UN DOC/E/CONF.26/8/Rev.1 ("New York Convention"). Available at www.uncitral.org. See also Appendix A. United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards.

confidentiality agreement. Many companies want confidential procedures because they do not want information disclosed about their company and its business operations, or the kinds of disputes it is engaged in, nor do they want a potentially negative outcome of a dispute to become public.

Parties also like being able to choose arbitrators with particular subject matter expertise. In addition, they like the fact that there is less discovery in arbitration, thereby generally resulting in a shorter process than in a full scale litigation, or at least shorter than is found in U.S.-style litigation. The lack of opportunity for multiple appeals of the decision on the merits is also an attractive aspect. For business people, there is great value in finishing a dispute so they can get on with their business.

While one advantage that has been touted in the past is that arbitration is less expensive than litigation, many companies today do not think that advantage actually exists.[7] As international arbitrations have grown in number and in the amount of money at stake,[8] parties have increasingly incorporated many litigation tactics into arbitration. These tactics tend to raise the costs, create delays, and increase the adversarial nature of the process. Nonetheless, even if the arbitration process has begun to resemble litigation in a number of ways, parties tend to find that arbitration is still worth the cost, because of the other advantages it provides.

## D. DISADVANTAGES OF ARBITRATION

To an extent, some of the disadvantages of arbitration are the same as the advantages, just viewed from a different perspective. For example, less discovery may be generally viewed as an advantage. Nonetheless, certain kinds of disputes, which typically involve extensive discovery, such as antitrust disputes, are increasingly arbitrated. These kinds of disputes often require the aggrieved party to prove a violation that it can only prove if it has sufficient access to documents under the control of the offending party. Less discovery in this kind of case means less of a chance for a claimant to meet its burden of proof.

Moreover, the lack of any right of appeal may be a benefit in terms of ending the dispute, but if an arbitrator has rendered a decision that is clearly wrong on the law or the facts, the lack of ability to bring an appeal can be frustrating to a party. For this reason, some parties in the United States

[7] *See* Bühring-Uhle, *supra* note 5, at 33 ("More than half (51%) of the respondents thought that the cost advantage did not exist. . . . ").

[8] For example, between April 2005 and April 2007, the top ten largest international arbitration awards ranged from U.S $133 million to U.S. $2.13 billion. *The American Lawyer/Focus Europe* Summer 2007. Available at www.law.com/jsp/article.jsp?id=1181639133576.

have written into their arbitration agreements a right to a judicial appeal on the merits of an arbitration award. The federal circuit courts are divided on whether this is permitted under the Federal Arbitration Act. The issue will be decided by the U.S. Supreme Court in the term beginning in October 2007.[9]

Another disadvantage is that arbitrators have no coercive powers – that is, they do not have the power to make someone do something by being able to penalize them if they do not. A court, for example, can impose a fine for contempt if someone does not comply with a court order. Arbitrators, on the other hand, cannot impose penalties, although they can draw adverse inferences if a party does not comply with an order of the tribunal. However, with respect to non-parties, arbitrators generally have no power at all. Thus, it may be necessary at times for the parties or the tribunal to seek court assistance when coercive powers are necessary to ensure compliance with the orders of the tribunal.

Moreover, in multiparty disputes, an arbitral tribunal frequently does not have the power to join all relevant parties, even though all may be involved in some aspect of the same dispute. Because the tribunal's power derives from the consent of the parties, if a party has not agreed to arbitrate, usually it cannot be joined in the arbitration. A tribunal generally does not have the right to consolidate similar claims of different parties, even if it would be more efficient for all concerned to do so.

Finally, it could be viewed as a disadvantage that the pool of experienced international arbitrators lacks both gender and ethnic diversity. Although some institutions and a few individual members of this group have made efforts to broaden that pool, on the whole there has been little change.

## E. THE REGULATORY FRAMEWORK

The various laws, rules, and guidelines governing the arbitral process will be dealt with extensively in later chapters, but a brief overview is in order. One way to envision the regulatory framework of arbitration is in the form of an inverted pyramid. The point is facing down, and at that point is the arbitration agreement, which affects only the parties to it. This agreement is the underpinning for the regulatory framework governing the private

[9] *See* Hall Street Assoc. v. Mattel, Inc., 196 Fed. Appx. 476 (9th Cir. 2006), *cert. granted*, (U.S. May 29, 2007) (No. 06-989). Question presented: "Did the Ninth Circuit Court of Appeals err when it held, in conflict with several other federal Courts of Appeals, that the Federal Arbitration Act ("FAA") precludes a federal court from enforcing the parties' clearly expressed agreement providing for more expansive judicial review of an arbitration award than the narrow standard of review otherwise provided for in the FAA?"

dispute resolution process. If the arbitration agreement is not valid, then the framework becomes irrelevant, because there is no legal basis for arbitration.

On the pyramid above the arbitration agreement, the framework expands in terms of scope and applicability beyond the immediate parties. At one step above are the arbitration rules chosen by the parties. These rules, which apply to the arbitrations of all the parties who choose them, may be varied in a particular case by the arbitration agreement. Frequently, a rule will contain a provision that says, "unless otherwise agreed in writing by the parties." This means that the rule is not mandatory, but rather a default rule that will apply if the parties have not reached their own agreement on the particular topic.[10] Therefore, if the parties have agreed on a particular matter, their agreement will trump the arbitration rules, unless the particular rule is considered mandatory by the institution.

At the next level of the pyramid are the national laws. Both the arbitration law of the seat of the arbitration (the *lex arbitri*) and substantive laws will come into play, and they are likely to be different national laws. Many countries have adopted as their arbitration law the UNCITRAL Model Law on International Commercial Arbitration.[11] The Model Law is meant to work in conjunction with the various arbitration rules, not to conflict with them. Thus, the Model Law also has many provisions that are essentially default provisions: that is, they apply "unless the parties have agreed otherwise." If the parties have chosen arbitration rules that provide for a process or rule that is different from the Model Law, normally the arbitration rules will govern, because they represent the parties' choice of how to carry out the arbitration, that is, they indicate how the parties have "otherwise agreed."

[10] *See, e.g.*, LCIA Rules, art. 17.1 ("The initial language of the arbitration shall be the language of the Arbitration Agreement, unless the parties have agreed in writing otherwise. . . . ")

[11] UNCITRAL is the United Nations Commission on International Trade Law. Its mandate is to further the progressive harmonization and unification of the law of international trade. The following countries, territories, or states within the United States have adopted the UNCITRAL Model Law on International Commercial Arbitration: Australia, Austria, Azerbaijan, Bahrain, Bangladesh, Belarus, Bulgaria, Cambodia, Canada, Chile, in China: Hong Kong Special Administrative Region, Macau Special Administrative Region; Croatia, Cyprus, Denmark, Egypt, Germany, Greece, Guatemala, Hungary, India, Iran (Islamic Republic of), Ireland, Japan, Jordan, Kenya, Lithuania, Madagascar, Malta, Mexico, New Zealand, Nicaragua, Nigeria, Norway, Oman, Paraguay, Peru, the Philippines, Poland, Republic of Korea, Russian Federation, Singapore, Spain, Sri Lanka, Thailand, Tunisia, Turkey, Ukraine, within the United Kingdom of Great Britain and Northern Ireland: Scotland; in Bermuda, overseas territory of the United Kingdom of Great Britain and Northern Ireland; within the United States of America: California, Connecticut, Illinois, Louisiana, Oregon and Texas; Zambia, and Zimbabwe. Available at http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/1985Model_arbitration_status.html. *See* Appendix B for text of 1985 UNCITRAL Model Law.

Cambridge University Press
978-0-521-86666-8 - The Principles and Practice of International Commercial Arbitration
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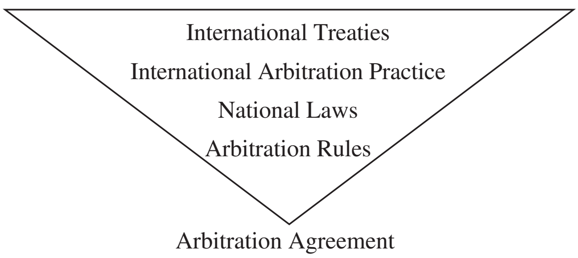
The substantive law chosen by the parties is the national law that will be used to interpret the contract, to determine the merits of the dispute, and to decide any other substantive issues. If the parties have not chosen a substantive law, then the tribunal will determine the applicable substantive law.

At the next step above the national laws in the regulatory pyramid is international arbitration practice, which tends to be utilized to various degrees in all arbitrations. This includes various practices that have developed in international arbitration, some of which have been codified as additional rules or guidelines. There are for example, rules that have been developed by the International Bar Association on the Taking of Evidence (see Appendix E), and on Rules of Ethics (see Appendix F). The IBA has also produced Guidelines on Conflicts of Interest in International Arbitration (see Appendix G). The American Arbitration Association and the American Bar Association have also produced a Code of Ethics for Arbitrators (see Appendix H). UNCITRAL has produced Notes on Organizing Arbitral Proceedings, "to assist arbitration practitioners by providing an annotated list of matters on which an arbitral tribunal may wish to formulate decisions during the course of arbitral proceedings. . . . "[12] Although the Notes do not impose any obligation on the parties or the tribunal, they potentially contribute to harmonizing arbitration practice.

Arbitrators and parties may agree that some of these international practices will be followed, or arbitrators may simply use them as guidelines. International arbitrators are a relatively small group, and international practices – both those that are codified by various international organizations and those that are merely known and shared in the arbitration community as good practices – tend to create a relatively coherent system of procedures.

Finally, at the top of the inverted pyramid are any pertinent international treaties.




For most international commercial arbitrations, the New York Convention will be the relevant treaty because it governs the enforcement of both arbitration agreements and awards, and because so many countries are parties to the Convention.[13] In addition to the New York Convention, three other

[12] Available at www.uncitral.org.
[13] *See supra*, text accompanying note 6.

important conventions are the Inter-American Convention on International Commercial Arbitration (the Panama Convention),[14] the European Convention on International Commercial Arbitration,[15] and the Convention on the Settlement of Investment Disputes between States and Nationals of other States (the "Washington Convention" or the "ICSID Convention").[16]

The Panama Convention, which has been ratified or adopted by fourteen South or Central American countries and by the United States and Mexico, is similar in intent and effect to the New York Convention. It has been influential in making arbitration much more acceptable in Latin American countries.

The European Convention supplements the New York Convention in the contracting states. It provides for a number of general issues concerning party's rights in arbitration, and also provides specific limited reasons for when the setting aside of an award under the national law of one Contracting State can constitute a ground for refusing to recognize or enforce an award in another Contracting State.[17] The European Convention's effect on awards that have been set aside will be discussed more fully in Chapter 10.[18]

The Washington Convention on the Settlement of Investment Disputes between States and Nationals of other States is also known as the ICSID Convention because the Convention created the International Center for the Settlement of Investment Disputes (ICSID). The ICSID Convention was promoted by the World Bank, which wanted to encourage investors to make investments in developing countries. Historically, investors could not bring any kind of action against a government, and had to depend upon their own government to take up their cases against a foreign government. The ICSID Convention provides the opportunity for the country and the investor to arbitrate any dispute directly, either pursuant to an arbitration agreement in a state contract, or by virtue of a bilateral investment treaty that includes a clause whereby the state consents to arbitrate with investors covered by the treaty. The ICSID Convention, and treaty arbitrations generally, will be discussed more fully in Chapter 11.

Thus, as seen above, the regulatory framework for international commercial arbitration includes private agreements, agreed-upon rules, and international practice, as well as national laws and international conventions. Although parties have substantial autonomy to control the arbitration

[14] O.A.S. Ser. A20 (S.E.P.E.F.), 14 I. L. M. 336 (1975).
[15] 484 U.N.T.S. 349 (1961).
[16] 575 U.N.T.S. 159, T.I.A.S. 6090, 17 U.S.T.1270 (1965).
[17] European Convention on International Commercial Arbitration (1961), 484 U.N.T.S. 349, art. IX. Not all EU countries are parties to the Convention, and some distinctly non-European countries are parties, such as Cuba and Burkina Faso. List of countries available at http://untreaty.un.org/sample/EnglishInternetBible/partI/chapterXXII/treaty2.htm.
[18] *See infra*, Chapter 10, Section 10(D)(5)(f).

process, the supplementation and reinforcement of the process by both national and international laws help ensure that the process functions in a fair and effective manner. The regulatory framework also gives parties confidence that they will have a reasonable method of recourse when problems develop in their international business transactions.

## F. INSTITUTIONAL ARBITRATION V. AD HOC ARBITRATION

One of the choices parties must make when they decide to arbitrate is whether they want their arbitration to be administered by an arbitral institution, or whether they want the arbitration to be ad hoc.[19] There are advantages and disadvantages for each choice. With an institutional arbitration, the advantages are that the institution performs important administrative functions. It makes sure the arbitrators are appointed in a timely way, that the arbitration moves along in a reasonable manner, and that fees and expenses are paid in advance. From the arbitrators' point of view, it is an advantage not to have to deal with the parties about fees, because that subject is handled by the arbitral institution. Moreover, the arbitration rules of the institution are time-tested and are usually quite effective to deal with most situations that arise. Another advantage is that an award rendered under the auspices of a well-known institution may have more credibility in the international community and the courts. This may encourage the losing party not to challenge an award.

With an ad hoc arbitration, there is no administering institution. One advantage, therefore, is that the parties are not paying the fees and expenses of the administering institution. The parties also have more opportunity to craft a procedure that is very carefully tailored to the particular kind of dispute. They may draft their own rules, or they may choose to use the UNCITRAL Arbitration Rules, which are frequently used in ad hoc arbitrations.[20] (UNCITRAL itself does not administer arbitrations and is not an arbitral institution.) Ad hoc arbitrations are sometimes particularly useful when one of the parties is a state, and there may be a need for more flexibility in the proceedings. It can be decided, for example, that neither party is the respondent, since both sides have claims against each other. Then each party will simply have the burden of proof of the claims it raises against the other party. An ad hoc proceeding can be disadvantageous, however, if either of the parties engages in deliberate obstruction of the process. In that

[19] Ad hoc arbitration is not an option in China. *See* Jingzhou Tao & Clarisse von Wunschheim, *Article 16 and 18 of the PRC Arbitration Law – The Great Wall of China for Foreign Arbitration Institutions*, 23 Arb. Int. 309, 324 (2007).
[20] Available at www.uncitral.org/pdf/english/texts/arbitration/arb-rules/arb-rules.pdf.

situation, without an administering institution, the parties may have to seek the assistance of the court to move the arbitration forward.

## G. ARBITRAL INSTITUTIONS

As international commercial arbitration has grown and expanded with the growth of international business,[21] arbitral institutions have also grown and changed. The American Arbitration Association, for example, has created an international division – the International Centre for Dispute Resolution (ICDR) – just to deal with international disputes. Many arbitral institutions have updated their rules to present an international arbitration-friendly format, and to improve their ability to deal with certain issues, so that court assistance will not be needed as often. For example, the ICDR has added a rule that improves the institution's ability to respond promptly to a claimant's need for emergency relief, which may occur even before the tribunal has been formed.[22] If emergency relief is not available in some form at an early stage, a party has no choice but to seek relief from a court.

Institutions vary in cost and quality of administration. Many companies prefer to work with the older, better established institutions, even if the cost may be somewhat higher. Parties are concerned that if they go with a brand new arbitral institution, that institution might not be in business a few years down the road when a dispute might arise. Listed below is a brief description of a few of the major international arbitration institutions.

### 1. The International Chamber of Commerce (ICC) International Court of Arbitration

The ICC International Court of Arbitration is one of the better-known and most prestigious arbitral institutions. The International Court of Arbitration is not a court in the ordinary sense of the word; it is not part of any judicial system. Rather, the Court of Arbitration is the administrative body that is responsible for overseeing the arbitration process. Its members consist of legal professionals from all over the world. In addition, the ICC has a Secretariat, which is a permanent, professional administrative staff.

A few features distinguish the ICC as an arbitral institution. First, every ICC arbitral award is scrutinized by the Court of Arbitration, meaning the

[21] The international caseload of major arbitral institutions nearly doubled between 1993 and 2003, and, during the same period, more than tripled before the American Arbitration Association and its International Centre for Dispute Resolution. *See* Christopher R. Drahozal & Richard W. Naimark, Towards a Science of International Arbitration: Collected Empirical Research, 341, app.1 (2005).

[22] *See* ICDR Rules of Arbitration, Article 37, *Emergency Measures of Protection*. Available at www.adr.org/sp.asp?id=28144.