Hastings International and Comparative Law Review

Volume 8
Number 2 *Winter 1985*

Article 5

1-1-1985

International Arbitration

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I. INTRODUCTION

Arbitration, like formal court proceedings, is a method of dispute resolution. The fundamental difference between arbitration and court proceedings is that the parties must agree to submit a dispute to arbitration, whereas one party can commence legal proceedings, even if the second party is strongly opposed. The parties may enter into an agreement to arbitrate prior to or during a dispute. The arbitration process is the same in both situations.

Proponents of arbitration claim it has several advantages over court proceedings. Arbitration is faster and less expensive. Unlike court proceedings, arbitration is private and arbitrators often have technical expertise which judges sometimes lack.

The following examples illustrate some of the advantages and disadvantages of arbitration. Arbitration is well suited to disputes in which the parties need an expert opinion. For example, customary practices have developed over centuries in the maritime industry and parties to a dispute may prefer to have it resolved by specialists. Disputes concerning the quality of goods are also suited for arbitration. For example, if a buyer seeks to purchase grain of a particular specification, and the seller delivers grain that the buyer believes does not meet this specification, the buyer and seller may agree to submit their differences to arbitration. The arbitrator, who in this case is probably an experienced grain dealer, inspects the grain and delivers an opinion. If the buyer and seller cannot agree to accept the opinion of a single arbitrator, they might agree to accept the majority opinion of a panel of three or more arbitrators. The dispute is therefore settled without resort to the courts. If such a case went to trial, each side would present experts to testify to the quality of the grain, and the court, which may have no expertise, would decide the issue.

In some classes of international transactions, however, an aggrieved

party prefers to rely on the courts rather than arbitration. For example, in an international banking transaction, a bank whose debtor defaults on a loan will frequently prefer court proceedings because the creditor bank has a legal right to recover if it simply establishes that the debtor is in default on a payment obligation. Furthermore, the creditor bank may wish to rely upon preliminary legal procedures to seize and preserve assets of the debtor. These procedures are not generally available in arbitration. In fact, the presence of an arbitration clause may complicate or preclude preservation of assets.

The banking example illustrates one weakness of arbitration. No matter how willing the parties may be to honor arbitration at the time they enter into an agreement, when one party becomes insolvent, the creditor wants to protect the assets of the debtor from other creditors. The legal process generally provides the best mechanism for this.

Construction contracts are routinely referred to arbitration. The construction process is complex and involves many stages and interrelated events. Determining liability in construction disputes is time-consuming and expensive, whether in court or arbitration. Nevertheless, a contractor may prefer to submit a dispute to an experienced arbitrator rather than to a judge, who may be unfamiliar with the construction process. While the advantages of speed and lower cost may not exist in the construction industry, the advantages of primary and technical expertise remain.

This Commentary will briefly discuss the following international arbitration topics in the context of international agreements: the choice between arbitration and court proceedings; arbitration clauses in contracts; initiation of arbitration after the dispute arises; appointment of arbitrators; preparation of the case; presentation of the case; and enforcement of the award. It is not the purpose of this Commentary to examine in depth the topics raised. There is no discussion of discovery, evidentiary rules, or strategy, all of which are of great importance, but which are beyond the scope of this paper.

II. THE CHOICE BETWEEN ARBITRATION AND COURT PROCEEDINGS

Factors that should be considered in deciding whether to arbitrate are:

(a) *The law that will apply if the contract does not include a valid choice-of-law provision.* For example, a United States contractor seeks to perform a construction contract for a private Indonesian company. The

contract is to be signed and performed in Indonesia. If the contract lacks a choice-of-law provision or if the provision is invalid, the law of Indonesia would govern disputes arising under the contract, based on conflict-of-laws rules.

(b) *The procedural rules in jurisdictions likely to be the forum.* For example, a court litigation in Kuwait can be time-consuming and expensive because all documents must be translated into Arabic and disputes are referred to an experts' department, which conducts exhaustive factual inquiries. A review of these procedures might lead a potential litigant to favor arbitration over litigation in a Kuwaiti court.

(c) *Substantive law of relevant jurisdictions.* If the substantive law of one of the relevant jurisdictions (a jurisdiction which is in some way related to the transaction) is unfavorable, the parties may avoid forum law and agree to arbitration or insert a choice-of-law clause in the contract. For example, a United States vendor sells equipment to a Kuwaiti purchaser who will install the equipment at a project in Dubai in the United Arab Emirates. Assume the Kuwaiti purchaser brings an action under the contract in Kuwait. Without a choice-of-law clause, a Kuwaiti judge would decide whether to apply the law of Kuwait, Dubai, or the United States. The parties may wish to eliminate this choice by agreeing on a choice-of-law clause at the time the contract is formed. Alternatively, the parties may choose arbitration as the form of dispute resolution.

(d) *Enforceability of arbitration clauses in relevant jurisdictions.* For example, if the contract is enforced in a forum where arbitration clauses are not honored, the local party can go directly to court and have its case heard.

(e) *Procedures for arbitration in relevant jurisdictions.* The procedures governing an arbitration may have an impact on the outcome. Depending on the forum, an arbitration may be governed by the Rules of the International Chamber of Commerce or local procedures which may or may not be written. Some countries do not yet have any arbitration procedures.

(f) *Procedural rules for arbitration in third countries.* For example, in negotiating an arbitration clause, a United States party may wish to have the Rules of the American Arbitration Association apply. In response, a foreign party may seek to negotiate a clause which states that the rules of its country apply. If a deadlock is reached, the parties may suggest that the hearing take place in a third country pursuant to neutral rules. To make these suggestions, the parties should be familiar with arbitration rules in the third country.

(g) *The enforceability of arbitral awards.* The parties must know whether an arbitral award will be enforceable, and if so, under what circumstances. Some jurisdictions require a stipulation in the arbitration clause that the award will be binding upon performance of certain acts. Another requirement not found in every jurisdiction is that the arbitration set forth in writing findings of fact and legal reasoning behind the award.

If an award will be enforced in a country other than that in which the award was obtained, it is necessary to review pertinent multilateral or bilateral conventions, treaties, or agreements. The most prominent convention is the Convention on the Recognition and Enforcement of Foreign Arbitral Awards. Since its inception in 1958, approximately sixty countries have become parties to the Convention, including Australia, Chile, Egypt, Japan, Korea, Kuwait, Nigeria, the Philippines, and the United States. The purpose of the Convention is to provide a more reliable means of enforcing arbitration awards. Other agreements, such as the Japan-American Trade Arbitration Agreement of 1952, also encourage the use of arbitration as a means of dispute resolution.

III. ARBITRATION CLAUSES IN CONTRACTS

If the parties decide upon arbitration as the appropriate dispute resolution procedure, they must then negotiate the arbitration clause to be contained in an agreement. The consequences of carelessly drafting an arbitration clause can be serious, and substantial care must be taken in negotiations. It is imperative to consider not only what a particular arbitration clause provides for, but also what it does not provide for.

Gerald Aksen, former General Counsel of the American Arbitration Association, has suggested that an arbitration clause should specify twelve items: (a) arbitrable issues; (b) provisions for the enforcement of an award; (c) designation of rules and an arbitral institution; (d) method for selection of arbitrators; (e) number of arbitrators; (f) language in which the arbitration will be conducted; (g) governing law; (h) method for enforcing awards and entering judgment; (i) time limits; (j) costs; (k) locale of hearings; and (l) other miscellaneous provisions.

(a) *Arbitrable issues.* To avoid preliminary difficulties, the parties should agree that all disputes arising out of a specific transaction are subject to arbitration. If the parties attempt to define certain issues as arbitrable and leave others for the courts, problems of definition may arise.

(b) *Provisions for the enforcement of an award.* This factor will be discussed in conjunction with (h) below.

(c) *Designation of rules and the arbitral institution.* The parties should consider the characteristics of various procedural rules. The Rules of the International Chamber of Commerce (ICC) are based on civil-law procedure and require significant documentation at an early stage. These rules can lead to an expensive proceeding. On the other hand, the Rules of the London Court of Arbitration are based on common-law procedures and do not require as much documentation. Until recently, however, the London Court Rules had one significant drawback. When a question of law arose during the proceedings, either party could move for a "special case stated." The arbitrators would refer these questions to the courts and the arbitration would be suspended until the court ruled. The Arbitration Act of 1979, to a large extent, dispensed with the "case stated" procedure; however, former British colonies may have maintained it. Also popular are the Rules of the Swedish Court of Arbitration. The Swedish government is promoting Sweden as an attractive forum for arbitration and has promulgated a set of rules that seek to be equitable in their application.

(d) *Method for selection of arbitrators.* The method of selecting an arbitrator or panel of arbitrators should be specified in the arbitration clause or the rules chosen by the parties. Failure to provide for the selection of an arbitrator is a common problem in the arbitration process.

(e) *Number of arbitrators.* The number of arbitrators and their backgrounds should be considered. On a three-arbitrator panel, the parties may request three neutral arbitrators or two party-appointed and one neutral arbitrator. The availability of suitable persons is an important consideration.

(f) *The language in which the arbitration hearing will be conducted.* Unless the parties specify the language in which the hearing will be conducted, the parties may be obliged by local practices to arbitrate in an unexpected language.

(g) *Governing law.* The law governing the contract is routinely set forth in the contract. While arbitrators in many jurisdictions need not comply in all respects with the chosen law, they generally attempt to do so, and one or more of the arbitrators on a multi-arbitrator panel may be trained in the law governing the arbitration. On occasion, the agreement requires the arbitrators to act as "*amiables compositeurs*" and do what is just and fair.

(h) *Enforcement of awards and entry of judgments.* The rules governing enforcement of awards and entry of judgments are generally set

forth in legislation in the jurisdiction where enforcement is sought. Frequently, a party is required to take the award to court within a specified period of time, and have it declared a judicial order. Problems may include translating the order into the language of the court and authentication by the proper authority.

(i) *Time limits.* Setting time limits on the conduct of arbitration is desirable and may even be required in some countries. In Kuwait, for example, an arbitration not completed in ninety days is automatically prosecuted in court.

(j) *Costs.* The apportionment of arbitration costs should be set forth in the arbitration clause. The clause may state that costs shall be apportioned among the parties in proportion to the award. For example, if a claim of one million dollars is made and the claimant is awarded only eight hundred thousand dollars, then, according to this method, the loser will bear eighty percent of the costs and the winner twenty percent. Alternatively, the agreement may state that the loser shall bear all the costs. If there is no explicit provision, the arbitrators may have discretion to apportion costs based on the agreement or applicable rules.

(k) *Locale of hearings.* The locale of arbitration is important because, if the rules selected by the parties do not cover a certain procedural point, local procedural rules may apply. Moreover, the locale must have available facilities and arbitrators.

(l) *Miscellaneous provisions.* It is advisable to insert a provision that arbitration may proceed to award, notwithstanding the failure of one party to participate in the proceedings. This may help enforce an *ex parte* award.

IV. INITIATING ARBITRATION AFTER THE DISPUTE ARISES

When a breach or a dispute over an alleged breach occurs, the contract should be reviewed to see if the dispute resolution procedure is activated. Some contracts provide for an informal review process before formal arbitration is initiated: for example, in construction contracts this review is made by the third party engineer.

A question which often arises with respect to contracts performed over a period of time is when arbitration should be initiated. Construction contracts sometimes provide that arbitration may proceed while performance continues. The general practice, however, is to reserve arbitration until performance is complete in the hope that a settlement will be reached. Even though arbitration is considered less adversarial

than litigation, arbitration which proceeds during performance can affect relations between the parties. It may be possible, however, to arbitrate during performance a limited dispute, such as whether supplied goods meet a particular specification, and indeed in such circumstances, arbitration may facilitate further performance.

The manner in which proceedings are initiated depends on the rules governing the arbitration. Under the American Arbitration Association Rules, for example, an arbitration is initiated by filing a one-page form. Under the International Chamber of Commerce Rules, the parties may have to submit a fully documented claim to an administrative tribunal. Regardless of the system of rules which the parties elect, a prevailing party must prove every fact alleged to the satisfaction of the tribunal.

V. APPOINTMENT OF ARBITRATORS

Arbitrators should be appointed according to procedures determined before a dispute arises. Once a dispute has arisen, the parties are unlikely to agree on the selection of arbitrators. Arbitrators can be nominated in the arbitration clause or by the body administering the arbitration. Parties choosing the latter course should ensure that the rules of the institution permit selection of arbitrators in the desired manner.

The following factors should be considered when selecting arbitrators: number of arbitrators; neutrality; qualifications and experience; nationality; and location of the hearing.

For small disputes, where arbitrators' fees are significant in relation to the claim, a single neutral arbitrator may be appropriate. For larger disputes, it is preferable to have a panel of at least three arbitrators who decide the outcome by majority vote. Because arbitral rules do not generally specify the number of arbitrators, the arbitration clause should state the desired number.

Typically large international arbitrations involve panels of three arbitrators, and two of the three arbitrators are often appointed by the parties. The distinction between party-appointed and neutral arbitrators is described in the Code of Ethics for Arbitrators in Commercial Disputes, drafted by a joint committee of the American Bar Association and the American Arbitration Association:

> For the purposes of this Code, an arbitrator appointed by one party who is not expected to observe all of the same standards as the third arbitrator is referred to as a "non neutral arbitrator."
>
> . . . [T]he two party-appointed arbitrators should be considered non-neutrals unless both parties inform the arbitrators that all three

> arbitrators are to be neutral, or unless the contract, the applicable arbitration rules, or any governing law requires that all three arbitrators are to be neutral.[1]

Before providing for party-appointed arbitrators, therefore, the parties should ascertain whether applicable laws require three neutral arbitrators. The Code further states that party-appointed arbitrators may "be predisposed toward the party who appointed them but in all other respects are obligated to act in good faith and with integrity and fairness."[2] For example, arbitrators should not engage in delaying tactics or harass parties or witnesses and should not knowingly make untrue or misleading statements to the other arbitrators. Party-appointed arbitrators must also disclose their relationships with parties to the arbitration. In the United States, most party-appointed arbitrators act, within the foregoing guidelines, in the interest of the party appointing them. In practice this means that the arbitrator will ensure that the third, neutral arbitrator understands the arguments of the appointing party. It is beneficial to the parties appointing an arbitrator, therefore, to select a person with sufficient stature and knowledge to explain the details of the appointing party's case to the other arbitrators. Furthermore, a party-appointed arbitrator should have sufficient knowledge of the industry to distinguish material arguments and prevent the arbitration tribunal from focusing on issues that are not germane.

Typically, the arbitration clause will provide that each party appoint a non-neutral arbitrator when the dispute arises. The clause should set time limits for the appointment of arbitrators so that the procedure does not continue interminably. Often it is provided in an arbitration clause that the two party-appointed arbitrators shall agree on a neutral third arbitrator or the chairman of the arbitral tribunal. This is potentially slow and ineffective. More commonly, the third arbitrator is appointed by a neutral body, such as the International Chamber of Commerce, London Court of Arbitration, president of the local Bar Association, or some other authorized organization. Many of these organizations maintain lists of arbitrators, who are divided into groups based on their areas of specialization.

Even if the arbitration clause provides that the two party-appointed arbitrators appoint the third arbitrator, the arbitrators may be unable to agree. The clause, therefore, should contain a fallback provision empow-

1. CODE OF ETHICS FOR ARBITRATORS IN COMMERCIAL DISPUTES, *reprinted in* 33 BUS. LAW. 318 (1977).

2. *Id.* at 319.

ering a neutral body to appoint the third member of the tribunal. The arbitration clause may specify the qualifications of the third arbitrator, such as nationality, language ability, or expertise in a particular industry.

Any arbitrator may be challenged by either party at any time. A successful challenge must demonstrate that the arbitrator is not qualified to accept the appointment; for example, a challenge could be based on a conflict of interest. Failure to disclose a conflict of interest compromises the proceeding and may be grounds for vacating an award.

The American Arbitration Association has its own method of appointing arbitrators. When the Association receives a demand for arbitration, it prepares a list of potential arbitrators. That list, containing approximately twelve names, is sent to each of the parties, with instructions to select several arbitrators and assign them a priority. The lists are then resubmitted to the Arbitration Association which selects, from the names remaining on the list, a panel of three arbitrators. A tribunal assembled in this way is usually neutral and independent. This independence is further enhanced by the American Arbitration Association Rules, which strictly prohibit the parties from communicating directly with arbitrators. All communications are directed through the Association.

VI. PREPARATION OF THE CASE

The preparation of a case for arbitration, like preparation for trial, is time-consuming and laborious. The fundamental guideline for preparing a case is that every fact alleged must be supported by evidence. The rules of evidence, however, are not rigidly applied in arbitration. Evidence usually takes the form of direct testimony or documents such as contracts, drawings, schedules, correspondence, and site notes. Because large international transactions generate volumes of documents, assembling and reviewing the evidence take considerable time.

VII. PRESENTATION OF THE CASE

Presentation of a complex case requires careful planning and simplification of the issues. The parties begin with an opening statement that should summarize the transaction and explain the evidence and legal arguments on which each aspect of the claim is based.

The procedural rules governing presentation of a case may differ according to the arbitration rules. Where the governing rules do not pro-

vide for a specific procedure, the rules of the forum will generally apply; therefore, knowledge of the forum rules is important.

In civil-law jurisdictions, the arbitrators typically take an active, inquisitorial role and draw out the parties' cases. In common-law jurisdictions, arbitrators follow United States procedure and allow the parties, through direct and cross-examinations, to develop their own cases.

VIII. ENFORCEMENT OF AWARDS

An award that cannot be enforced is worthless. Fortunately the Convention on the Recognition and Enforcement of Foreign Arbitral Awards is widely accepted and reduces the difficulty of enforcing awards. Nevertheless, problems continue to arise. For example, assets may be moved, consumed, or otherwise disposed of during the arbitration process. Furthermore, many countries which do not have a history of enforcing awards have been slow to adapt to the procedures of the Convention.

IX. CONCLUSION

This Commentary has focused on the legal consultant's view of arbitration rather than on the litigator's view. It has not, therefore, dealt with litigation questions, such as strategy, discovery, and admissibility of evidence. Instead, it has raised complex questions concerning international arbitration with which the international legal consultant should be familiar and has offered some suggestions as to the manner in which such questions may be approached.