

## **CONSIDERATIONS ABOUT DRAFTING ARBITRATION CLAUSES**

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**Abstract:** *In this article we analyzed the necessary aspects on drafting an arbitration clause correctly. Thus, we identified and debated the major mistakes that can be made in drafting arbitration agreements, namely, equivocation, inattention, omission, over-specificity, unrealistic expectations, litigation envy, overreaching, and the items that cannot miss when drawing a arbitration agreement.*

**Keywords:** *International Arbitration; arbitration clauses; arbitration clauses.*

### **INTRODUCTION**

The arbitration agreement plays a capital role in the governance of arbitration. The parties have the freedom to draft the clauses of the arbitration agreement based on the universal principle of the contracting parties' autonomy, so, "freedom of contract, therefore, is at the very core of how the law regulates arbitration. What the contracting parties provide in their agreement generally becomes the controlling law" (Carbonneau, 2003, pp. 1.189–1.232.). Given the importance of the terms of the arbitration agreement, the parties or their attorneys must be cautious and wise in their writing.

The arbitration clause must fit to the circumstances of the parties' needs and not the clause that will solve the almost every problem inherent in arbitration. Why is so difficult to draft a universal arbitration clause who has the role to fit in any circumstances? Stephen R. Bond (1989, pp. 14-21), the general secretary of the International Court of Arbitration from Paris, answers to this question with three arguments: most drafting of this agreement is capital; second argument, "the other party may have very different ideas as to what constitutes an ideal clause", so will begin a negotiation of the arbitration clauses and the contracting party must know what is really important for her; the third and the final argument, "the all-purpose clause may not, in fact, be suitable for all situations", in this sense, there is no "miracle clause". So, I can conclude that a good drafted arbitration clause is the "miracle clause" for the contracting parties.

### **THE SEVEN DEADLY SINS by JOHN M. TOWNSEND**

An arbitration clause has to avoid the "seven deadly sins", as John M. Townsend (2003, p.1) states. He says that "while is so difficult to generalize about what will make a

“perfect” clause, it is not nearly as difficult to identify some of the features that make for a bad one.”

Townsend identifies seven deadly sins of an arbitration clause: equivocation, inattention, omission, over-specificity, unrealistic expectations, litigation envy, overreaching.

**The sin about equivocation** refers to the failure to state as clearly as possible that the parties agreed to solve their problems through arbitration. This clause is also called **pathological** and is found very frequently at the ICC International Court of Arbitration from Paris (Carbonneau, 2003, p. 1.190).

The UNCITRAL Model Law provides the writing requirement of the arbitral agreement in article 7 (2), “the arbitration agreement shall be in writing.”<sup>1</sup> The second article of New York Convention on Recognition and Enforcement of Foreign Arbitral Award states that the arbitral agreement has to be in writing and the parties have to undertake to submit to arbitration all or any differences which have arisen or which may arise between them in respect of a defined legal relationship, whether contractual or not, concerning a subject matter capable of settlement by arbitration. So, we cannot speak about arbitration in the absence of the contract.

The next clause is an example of an equivocation clause: “In case of dispute, the parties undertake to submit to arbitration, but in case of litigation the Court of Seine shall have exclusive jurisdiction” (Townsend, 2003, p. 1).

**The sin about inattention** is the next that can damage the arbitral agreement. This sin refers to the insufficient attention to the circumstances of the parties when the arbitral clause is drafted. Townsend states that the contracting parties or their attorneys should answer a few questions when the arbitral clauses are drafted: *What type of dispute resolution process is best in our circumstances? If arbitration is selected, we (the parties) understand that the arbitration clause will commit us to a binding process that involves certain trade-offs? Can we mediate or negotiate before we take the path of arbitration? We will want to enforce the award or a judgment based on the award?*

It is considered that the key in drafting a good clause is to pay sufficient attention to the underlying transactions so that the arbitration clause can be tailored to the contracting party’s special requirements and to possible difficulties that may judiciously anticipated (Townsend, 2003, pp. 3-5).

**Omission** is the sin that makes the arbitration clause incomplete, like the following statement: “Any disputes arising out of this Agreement will be finally resolved by binding arbitration” (Townsend, 2003, pp. 3-5). It is obvious that this clause is too weak in content and this fact will affect the parties’ interests. If the parties will not draft

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<sup>1</sup> UNCITRAL Model Law on International Commercial Arbitration adopted in 1985, with amendments as adopted in 2006. [http://www.uncitral.org/pdf/english/texts/arbitration/ml-arb/07-86998\\_Ebook.pdf](http://www.uncitral.org/pdf/english/texts/arbitration/ml-arb/07-86998_Ebook.pdf)  
See CLOUT case No. 44 - *William Company v. Chu Kong Agency Co. Ltd. and Guangzhou Ocean Shipping Company*, High Court-Court of First Instance, Hong Kong, 17 February 1993, <http://www.hklii.hk/eng/hk/cases/hkcfi/1993/215.html>; CLOUT case No. 365 - *Schiff Food Products Inc. v. Naber Seed & Grain Co. Ltd.*, Court of Queen’s Bench, Saskatchewan, Canada, 1 October 1996, <http://canlii.ca/t/1nsm0>; *Jiangxi Provincial Metal and Minerals Import and Export Corporation v. Sulanser Co. Ltd.*, High Court—Court of First Instance, Hong Kong, 6 April 1995, <http://www.hklii.hk/eng/hk/cases/hkcfi/1995/449.html>; *Great Offshore Ltd. v. Iranian Offshore Engineering & Construction Company*, Supreme Court, India, 25 August 2008, <http://www.indiankanoon.org/doc/394001/> (4.09.2015).

the details concerning their arbitration, the court will decide these details, but this will cost time and money.

If the sin of omission is over passed, the opposite of this – **the over-specificity**, is good to be also exceeded. This sin refers to the clauses that have too many details and becomes hard to put into practice. Townsend gives an example of this kind of clause: “The Arbitration shall be conducted by three arbitrators, each of whom shall be fluent in Hungarian and shall have twenty or more years of experience in the design of buggy whips, and one of whom, who shall act as chairman, shall be a expert on the law of the Hapsburg Empire.” All the details drafted in this arbitration clause are threatening the execution of this clause, so it’s widely not to add so many criterions that may became obstacle in the process of arbitration.

Townsend adds a companion sin to over-specificity, **the sin of unrealistic expectations**. This sin refers to tight time limits in the arbitration process. These limits can turn against those who have drafted them. A good example is the following: “The claimant will name its arbitrator when it commences the proceeding. The respondent will then name its arbitrator within ten days, and the two so named will name the third arbitrator, who will act as chair, within ten days of the selection of the second arbitrator. Hearings will commence within seventy days of the selection of the third arbitrator, and will conclude no more than five days later. The arbitrators will issue their award within ten days of the conclusion of the hearings.” I agree what Townsend says about these short limits of time that can “cripple the process before it gets started”, because if the arbitrator fails to meet the imposed deadline he will be deprived of arbitration jurisdiction.<sup>2</sup>

The last deadly sin that harms the arbitral agreement is **the sin of litigation envy**. In this case, the contracting parties want that their problems be solved through arbitration, but following the court rules. Townsend gives the following example: “The arbitration will be conducted in accordance with the Federal Rules of Civil Procedure applicable in the United States District Court for the Southern District of New York, and the arbitrators shall follow the Federal Rules of Evidence” or “The award of the arbitrators may be reviewed for errors of fact and law by the United States District Court for the District in which the arbitration is held” (Townsend, 2003, p. 4).

Regarding the United States, this clause creates procedural inaccuracies and, like Townsend (2003, p. 4) says: “The arbitrators had to decide whether and how to apply the local rules of the Southern District, whether a pre-trial order was required, whether the parties were obligated to make the mandatory disclosures required by the Federal Rules, and other controversies about discovery of the sort that people resort to arbitration to escape.”

În Europe’s case, most of the states used the Napoleon Codes as an inspiration source; this kind of clause affecting the speed and the costs of the arbitration, two of more advantages of this form of alternative dispute resolution.

### **3. “SINE QUA NON” OF AN ARBITRATION AGREEMENT**

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<sup>2</sup> See CLOUT case No. 101 *Private Company “Triple V” Inc. Ltd. v. Star (Universal) Co. Ltd. and Sky Jade Enterprises Group Ltd.*, 27 January 1995 - <http://interarb.com/clout/clout101.htm>. (4.09.2015)

Until now I analyzed what we have to do to avoid drafting an inoperative arbitration clause. But what this agreement should contain? What are the *sine qua non* clauses?

I join the opinion of other authors (Bond, 1989; Bishop, 2000; Carbonneau, 2003; Townsend, 2003; Smit, 2003) and I believe that the most essential and important clauses of an arbitration agreement are the following: **(1) the clause in which the arbitration is choosing to be the method to resolve the disputes between contracting parties; (2) the clause in which the parties choose between Ad-hoc or Institutional Arbitration; (3) the clause in which is defining the scope of arbitration; (4) the clause in which the parties desire that the arbitral award should be “final and binding” for them; (5) the clause in which the parties choose the place of arbitration; (6) the clause in which the parties choose the language of arbitration; (7) the clause in which the parties choose the composition of the Arbitral Tribunal; (8) the clause in which the parties choose the applicable law; and the last clause, applicable only for the United States, (9) the clause in which the parties choose to Entry of Judgment Stipulation.**

I believe that these nine clauses are the essential clauses of an arbitration agreement with the condition to be tailored by the parties' circumstances. The arbitral agreement cannot fail if it contains these essentials provisions. I will analyze these clauses one by one.

The first clause, in which the arbitration is choosing to be **the method to resolve the disputes between contracting parties**, requires from the parties the clearly and expressly intend that they do agree resolving their problems through arbitration. It's so important to do so because there are other methods of dispute resolutions, like mediation, conciliation, expert determination. This agreement can be a clause into another contract between parties, clause compromissoire or a separate agreement, compromis; it is a must to be in writing, like I discuss at the beginning of this article, in the paragraph of the equivocation sin.

The second clause, **the clause in which is defining the scope of arbitration** is very important too because “the words make the difference”. The parties should be aware about what they are drafting - what types of disputes they want to be arbitrated: all potential disputes, including tort claims, fraud-in-the-inducement claims, statutory claims and any others types that arise from their contractual relationship or only the disputes regarding the contract. The parties should express their desire clearly, avoiding misinterpretation of the clause.

The standard clause of ICC is simple and clear, contains all the ingredients to be an effective arbitral clause: “**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 arbitrators appointed in accordance with the said Rules.” This one can be a good model to start drafting a similar clause.**

The third clause, **the clause in which the parties desire that the arbitral award should be “final and binding” for them, meaning** : “that issues joined and resolved in

the arbitration may not be tried de novo in any court,” like United States courts held.<sup>3</sup> This is one of the advantages of arbitration, issuing arbitration procedure and its outcome, the arbitration award, the court interference, which here cannot review its substance.

The leading arbitral organizations provide a clause in this meaning: the International Chamber of Commerce and the London Court of International Arbitration Rules state in art.29 (1), respectively in art.29 (2), that any award shall be binding for the parties and the parties should waive the right to any recourse, the American Arbitration Association Rules provide in art.30 (1) that the award is final and binding for the parties and they will carry it out without delay.

The following clause is the clause in which the parties choose between Ad-hoc and Institutional Arbitration. Many authors (Bond, 1989; Bishop, 2000) believe that this is a fundamental clause because the parties have to agree on what kind of arbitration – ad-hoc or institutional, will be administer their disputes.

If the parties choose ad-hoc arbitration, they will avoid the administrative fees charged by arbitral institutions, but the parties have to handle with the administrative part of arbitration. Bishop agrees that in the case of ad-hoc arbitration “there is no quality review by an institution like ICC”, “in the absence of a administrator, the parties may have to apply to the courts to resolve procedural problems on which they cannot agree” and “ad hoc awards do not receive the same deference as institutional awards when they are presented to courts for enforcement” (Bishop, 2000, p.31).

The choice of an institutional arbitration will cost parties more money, but instead the arbitration institution will resolve the most of administrative problems of arbitration, will provide quality control. There are many arbitral institutions worldwide: the International Chamber of Commerce (Paris) and the London Court of International Arbitration, the American Arbitration Association, the International Centre for the Settlement of Investment Disputes, the Stockholm Chamber of Commerce, the Inter-American Commercial Arbitration Commission, the Arbitration Court of the World Intellectual Property Organization and many more.

Stephen R. Bond argues that “in international arbitration, the arbitration clause should provide for institutional arbitration. You pay an administrative charge, but with good institution you get value for the money” (Bond, 1989, p.68).

One of the essential clauses is the clause in which **the parties choose the place of arbitration**. Why is this clause so important? Bishop gives seven arguments related to the importance of the place of arbitration: first argument is that it is especially important to select a forum whose arbitral awards will be enforceable in other countries like a country that has ratified the New York or Panama Conventions recognizing arbitral awards); the following argument is that it is important for the forum's law to recognize the agreement to arbitrate as valid. We should have in minded that in Article V (1) (a) of the New York Convention, the validity of an arbitration agreement may be determined by

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<sup>3</sup> See *M&C Corp. v. Erwin Behr, GmbH & Co.*, United States Court of Appeals, No. 04-1557, April 28 2005. <https://bulk.resource.org/courts.gov/c/F3/411/411.F3d.749.04-1557.html> (4.09.2015);

*Iran Aircraft Industries v. Avco Corp.*, United States Court of Appeals, September 29 1992.

[http://www.leagle.com/xmlResult.aspx?page=6&xmldoc=19921121980F2d141\\_11101.xml&docbase=CSLWAR2-1986-2006&SizeDisp=7](http://www.leagle.com/xmlResult.aspx?page=6&xmldoc=19921121980F2d141_11101.xml&docbase=CSLWAR2-1986-2006&SizeDisp=7) (4.09.2015).

the law of the country where the award was made, so compliance with local laws is important. The third argument takes into account that the place of arbitration is usually the country whose courts will hear an action to vacate an award, so it is important to consider the scope of awards' review available in that country. The next argument focuses on the interference of national courts, so Bishop says that the national courts of the arbitration place should not unnecessarily interfere in ongoing arbitral proceedings, thereby creating an incentive for dilatory tactics and expensive procedural disputes. In the fifth argument he agrees that the forum's courts should, however, assist the proceedings when necessary. In the last two arguments, Bishop argues that the host country should allow non-nationals to appear as counsel in international arbitration proceedings and the situs should not unduly restrict the choice of arbitrators (Bishop, 2000, p.31).

The studies on arbitration clauses provide that the clause that involves the arbitration place, is, along with the choice of applicable law, the element most often added to the basic ICC arbitration rules (Bond, 1989, p.18).

The following important clause of an arbitral agreement is **the clause in which the parties choose the composition of the Arbitral Tribunal**: how many arbitrators will compose the Arbitral Tribunal, how should they be selected, what qualifications should they have. This clause is linked to clause in which the parties choose between the institutional and ad-hoc arbitration.

In ad-hoc arbitration, the parties have to provide the procedure by which will be appointed the arbitrators. Most often, each party appoint an arbitrator and these two arbitrators will choose the third one. The parties have to be cautious and provide a supplementary mechanism if eventually things go wrong: one of the parties does not appoint the arbitrator or the two arbitrators cannot appoint the third one. There is the possibility that the parties may choose an authority with powers to appoint the missing arbitrator. It is wisely recommended for the parties to agree on the number of the arbitrators, the qualifications and the requirements to be met by them, avoiding so future problems that need to be solved.

In institutional arbitration, these tasks also belongs to the parties, but can be successfully substituted by arbitration institution chosen. The Rules of the Arbitration Institution generally contain provisions that are applied if the parties have not been agreeing to the contrary.

Stephen R. Bond (1989, p.18) argues that "the ICC's experience has been that parties from developing countries and Eastern European countries have a strong preference for three-person arbitral tribunals. They seem to believe that even though coarbitrators must be independent of the party proposing them, pursuant to the ICC Rules, a coarbitrator of the same nationality can explain to his fellow arbitrators the legal, economic and business context within which the party operates."

The following essential clause of an arbitral agreement is **the clause in which the parties choose the language of arbitration**. It is very important that the parties agree on the language of arbitration because through this agreement they will avoid expensive and time-consuming translation of documents, interpretation at hearings.

If the parties do not agree on the language of arbitration, in the case of an ad-hoc arbitration, the arbitral tribunal will resolve this problem and, in the case of an

institutional arbitration, the institution choice will provide the solution of this lack of agreement.

**The clause in which the parties choose the applicable law** is very important for the parties because once they have decide on the law applicable to the contract, they don't have to face any "surprises", like the decision of the arbitral tribunal in this matter, that cannot reconcile both sides. One more argument for drafting this clause is related to money and time; the parties will have to wait until the arbitral tribunal will decide in this situation.

Stephen R. Bond (1989, p. 19) says that this clause is the element most often added to the contract, often drafted directly in the arbitration clause.

The last essential clause is applicable only for United States - **the clause in which the parties choose to Entry of Judgment Stipulation**. In the United States, the Second Circuit Court of Appeals held in the cases *Varley vs. Tarrytown Ass., Inc.* (1973), *Splosna Plovba of Piran vs. Agrelak Steamship Corp.* (1974) that, in the absence of a clause in the meaning that a court may enter judgment on an arbitral award, courts may not do so. Few years later, courts changed their opinion and held that the conduct of the parties can authorize the entire judgment of a court on an arbitral award (Bishop, 2000, p. 31).

It is important to say that the model clause of the American Arbitration Association provides that judgment may be entered upon the award in any court or competent jurisdiction. This clause is essential if enforcement may be required in the United States.

#### **4. CONCLUSIONS**

In conclusion, I can say that an universal arbitration clause as a solution for every problems does not exist, but there are some essential ingredients, "key clause" of an arbitral agreement that may avoid spending a lot of money and time in the arbitral process: the clause in which the arbitration is choose to be the method to resolve the disputes between contracting parties; the clause in which the parties choose between Ad-hoc or Institutional Arbitration; the clause in which is being defining the scope of arbitration; the clause in which the parties desire that the arbitral award be "final and binding" form them; the clause in which the parties choose the place of arbitration; the clause in which the parties choose the language of arbitration; the clause in which the parties choose the composition of the Arbitral Tribunal; the clause in which the parties choose the applicable law and the last clause, applicable only for United States, the clause in which the parties choose to Entry of Judgment Stipulation.

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