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Causes and Consequences of Faulty Arbitration Clauses



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ABSTRACT

Taking into account the link between arbitration clauses and the process of arbitration, this article first aims to analyse arbitration clauses, why these clauses are sometimes unconscionable and what are the consequences of such deficiencies.

Companies have to consider that if the arbitration clause is drafted without a reasonable attention, this provision itself could be the cause of conflict. Furthermore, unconscionable, invalid and abusive clauses may lead to companies losing money and credibility.

To determine the reasons that prompt faulty arbitration clauses a multi-case study was applied to the research. This approach was chosen owing to the fact that with regard to law it is not possible to find two identical cases. There may be similarities, but the reasons for making the deal and the intention of the parties, can vary significantly from one contract to another.

During the research a particular comment was frequently encountered: "There is no perfect clause; it is impossible to find a perfect clause because every contract is executed according to different needs, circumstances and requirements."

Once the research was concluded, it was found that faulty arbitration clauses can be prompted by drafting mistakes and limitations particular to the arbitration itself. The consequences may vary depending on the magnitude of the error.

Key words: International commercial arbitration-arbitration clauses.



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Cláusulas de arbitramento defectuosas: sus causas y consecuencias

RESUMEN

En vista de la relación que existe entre la cláusula de arbitramento y el proceso arbitral, antes que todo, este artículo tiene como objeto analizar las cláusulas de arbitramento. Porqué razón estas cláusulas son a veces inaplicables y las consecuencias de las deficiencias en su redacción.

Para determinar las razones que generan cláusulas de arbitraje defectuosas un estudio casuístico fue aplicado a la investigación. Este método fue escogido debido a que en lo atinente a cuestiones legales no es posible encontrar dos casos idénticos, puede hallarse casos con similares circunstancias, pero las razones que llevaron a las partes para hacer el contrato y la intención, suelen variar significativamente de un contrato a otro.

A lo largo de la investigación es expresada frecuentemente una idea. Esta es en pocas palabras: “No hay cláusula perfecta, es casi imposible encontrar una cláusula aplicable a toda situación, puesto que cada contrato es firmado atendiendo a diferentes necesidades, circunstancias y requisitos.”

Una vez concluida la investigación, fue encontrado que las cláusulas de arbitraje inaplicables pueden ser causadas por errores de redacción o son derivadas de limitaciones propias del arbitramento, puesto que algunas veces simplemente no es el mecanismo idóneo para resolver cierta clase de conflictos. Las consecuencias varían dependiendo de la magnitud del error.

Palabras clave: arbitramento comercial internacional- cláusulas de arbitramento.

INTRODUCTION

This article presents an analysis of the reasons that prompt unenforceable or unconscionable arbitration agreement clauses, using a case study methodology. To do so, it will be analysed how flawed provisions can affect the outcome of what could had been a quick and fair award, therefore is an opportunity to explain to those who are not lawyers the concealed perils that the negligent drafting of arbitration clauses involve.

To provide a comprehensive perspective of the role played by the arbitration clause in the outcome of a commercial arbitration process

the second part of this document is dedicated to the international commercial arbitration. The third part deals with the arbitration clause, discussed shortly since with regards of the arbitration clause it is easier to mention what a drafter should never do than to enumerate the elements to include.

After this, in the fourth section we arrive to the core subject of the dissertation:

“The causes and consequences of mistakes made when drafting an arbitration clause within an international commercial contract”. This section will concentrate on the weaknesses in the arbitration clause. If they are rectified by the parties it can increase the odds of a satisfactory and enforceable award.

Finally, an important caveat must be stated. The present document will not study or analyse the causes and consequences of flaws related to the validity of the arbitration clause, in particular lack of capacity, doctrine of separability of validity between the contract and the clause, fraudulent inducement and illegality.

Thus, these issues will be addressed only when is strictly necessary to explain the problems faced by the parties when drafting an arbitration clause.

1. INTERNATIONAL COMMERCIAL ARBITRATION

1.1 Definition and characteristics of the international commercial arbitration

The International commercial arbitration has been described as “a means by which international disputes can be definitely resolved, pursuant to the parties’ agreement, by independent, non-governmental decision-makers”.¹

From the description given by Born it can be outlined the common characteristics of any commercial arbitration, be it domestic or international. These include the non-governmental origin of the award,



¹ Born, Gary. *International Commercial Arbitration* 2nd ed, Kluwer Law International, The Hague, 2001, p. 1.

its effectiveness which is reflected in its mandatory compliance, and finally, its almost universal use.

Another aspect is the consensual nature of the procedure. The bases of the arbitral process can be found usually either in an arbitration clause within a contract between the parties or in a submission agreement.² The normal procedure is that the parties agree to resolve any conflict before an arbitral tribunal when signing the contract or the agreement, being just a provision, in a stage in which no problem at all has arisen.

Although the definition mentioned above is fairly comprehensive, in the sense of capturing the essence of this mechanism, the international commercial arbitration is an institution that involves more attributes.

Within the features overlooked, firstly, we have the neutrality, a critical aspect of the international commercial arbitration.³ A valid premise as the objective of the parties, apart from celerity and low costs, is to find an autonomous evaluator of the case. Consequently, in most of the cases international commercial arbitration is deemed as a tool to reduce the distress caused by foreign courts, unstable environments and cultural differences.

A second characteristic omitted from the definition given by Born, is the adaptability. This attribute allows the international commercial arbitration to play an important role. In the words of Born, from a different book, arbitration “tends to be procedurally less formal and rigid than litigation in national courts. As a result, parties have greater freedom to agree on neutral and appropriate procedural rules, set realistic timetables, select technically expert and neutral decision-makers, involve corporate management in dispute resolution, and the like”.⁴

Finally, the expertise shown by the arbitrators is at any rate a feature that increases the likelihood of observance of the award.



² Wight, Robert. “Development in commercial arbitration”. In: Mackie, K. (ed.). *A Handbook of Dispute Resolution*. Routledge. London. 1997, p. 56.

³ Hill, Jonathan. *International Commercial Disputes*. 2nd Edition. LLP. London. 1998. p. 597.

⁴ Born, Gary. *International Arbitration and Forum Selection Agreements: planning, drafting, and enforcing*. Kluwer Law Internacional. The Hague. 1999. p. 70.

1.2 Types of arbitral procedures

The decision of choosing between ad-hoc and institutional arbitration is equally important to decide what kind of procedure will be followed to resolve a dispute. A wrong selection is likely to affect negatively the outcome, considering that these two types of arbitral procedures should not be applied indiscriminately to transnational commercial conflicts.

To begin with, a description of ad-hoc and institutional arbitration will be given. “An ad-hoc arbitration usually takes place when the arbitration clause in the original agreement between parties provides for arbitration without designing any arbitral institution and without referring to any particular set of institutional rules”, whereas that an institutional arbitration “is one that is administered by one of the many specialist arbitral institution under its own rules of arbitration”.⁵

Since the institutional arbitration is performed by an establishment, it can be deduced that the process will be more organized. Institutions, such as the International Chamber of Commerce in Paris, possess the necessary facilities and capable personnel to run arbitration in a fairly efficient way.

Before engaging in an institutional arbitration, parties must consider its disadvantages. An institutional arbitration process is quite expensive and delays will be present as a result of established bureaucratic stages.

In an ad-hoc arbitration the parties have more freedom, as they can give to the procedure a most fitting structure. To bypass any inconvenience the best alternative is to apply the United Nations Commission on International Trade’s –UNCITRAL- rules, since “the regulation include very detailed rules and offers thus a solution for many procedural problem”.⁶

In order to carry out a smooth process the ad-hoc arbitration needs full cooperation from the parties. Therefore, the dark side of the ad-



⁵ International Trade Centre UNCTAD/WTO. Arbitration and alternative dispute resolution: How to settle international business disputes. The Centre. Geneva. 2001. p. 44.

⁶ Herrmann, Gerold. The role of UNCITRAL. In: Fletcher, I. et al (ed.) Foundations and perspectives of international trade law. Sweet and Maxwell. London. 2001. p. 302.

hoc arbitration emerges when one of the opponents wants to delay the process.

2. THE ARBITRATION CLAUSE

2.1 The definition of arbitration clause

An arbitration clause could be defined as a provision in an underlying commercial contract, through which the parties involved in a particular transaction, agree to settle any conflict that arise from or related to the indenture by means of arbitration.

Usually, when the participants did not draft an arbitration clause within an international commercial contract nor a stand-alone pre-dispute arbitration agreement, there is no reason in requesting arbitration to resolve a dispute unless the parties accord to present the study of an existing disagreement before an arbitral tribunal. Such procedure is known as “submission agreement”.

Only in special circumstances, namely in arbitrations rule by international investor protection treaties,⁷ the State involved and the investor must solve their controversies using imperatively arbitration, even though the arbitration clause or submission agreement may be absent.

It is possible to draft international commercial arbitration clauses in many ways, because parties enjoy a significant leeway in the drafting of an arbitration agreement, hence when doing it this faculty is frequently applied.

This freedom is maybe because it is impossible to find a unique perfect arbitration clause to apply to every sort of situation; therefore, the parties can draft very short, very long or tailor-made arbitration clauses, always depending on their necessities and if the arbitration is institutional or ad-hoc.

At this stage it is noteworthy that the effectiveness of an arbitration clause does not depend on the length of the provision but on the clearness and concreteness. National courts have upheld arbitration clauses



⁷ Hirsch, Moshe. The arbitration mechanism of the International Centre for the Settlement of Investment Disputes. Martinus Nijhoff Publishers. Boston. 1993. p. 54-57.

that are as brief as “English law-arbitration, if any, London according ICC Rules.”⁸ On the other hand, long arbitration agreements sometimes are full of ambiguities and so imprecise that the validity and effectiveness of the clause are hampered.

So, the role of the lawyers and drafters in general does not consist in just choosing a pre-package arbitration clause, like the ones presented by the ICC, AAA, LCIA and UNCITRAL, among others. It could be a dangerous matter to select a clause randomly, because the institutional policies may not be suitable for the particular case.

Moreover, the participants in the making of the arbitration clause blueprint must have an in-depth understanding of the objectives of the contract, possible source of disagreements and flaws the arbitration clause may have.

Also, some decisions should be made about critical elements like the scope of the arbitration, the kind of arbitration and exclusivity as a means of settling a dispute.

Lastly, topics like the language, place in which arbitration is going to be held, punitive damages, applicable law, which if determined in advance might help to run a smooth and trouble-free arbitration process.

2.2 Scope of the arbitration clause

When drafting an arbitration clause, the characteristics of the transaction allow the parties and their advisors to foresee the most probable sources of conflict, making the appropriate adjustments to the content of the arbitration clause a manageable exercise. Despite this advantage frequent controversies may arise, caused by misunderstandings (cultural or linguistic), force majeure or unexpected circumstances.

To offset against the indeterminable sources of disagreements, many institutional arbitration clauses like the ICC and LCIA prescribe arbitration to solve any controversy and claims “arising out of or in connection with” the contract. The same intention is observed in the AAA’s and UNCITRAL’s clauses.



⁸ Arab African Energy Corp. Ltd v. Olieprodukten Nederland BV [1983] 2 Lloyd’s Rep.

And precisely, with regard to the UNCITRAL model clause, it is noteworthy that it refers to “any dispute, controversy or claim”. Additionally, the UNCITRAL clause mentions the disputes arising from the “breach, termination or validity”.⁹

The extremely cautious wording of the UNCITRAL seems to be related to the ad-hoc nature of the arbitrations that are meant to be ruled by this regulation. Perhaps to protect the willingness of the parties to settle their dispute by arbitration the UNCITRAL clause contemplates all conceivable scenarios.

If the parties decided to apply a clause that covers just the conflicts that “arise out the contract”, leaving outside of the context those “in connection with”, then, they would be omitting controversies originated in frauds and other tort claims.¹⁰

3. CAUSES AND CONSEQUENCES OF FAULTY ARBITRATION CLAUSES

3.1 The appropriate stage

After presenting what an effective arbitration clause should include we have arrived to the crucial topic of this document, the causes and consequences of faulty arbitration clauses. In other words, to the study of the reasons that take to the parties to sign unconscionable, unenforceable or even invalid arbitration clauses.

In order to find the afore-mentioned causes lets us place in a negotiation stage of an international deal. The corporate partners of each side are skilfully discussing the terms of the contract, which presumably are consonant with the interests of the parties. Nevertheless, from the number of cases found about arbitrations decided against a company for having draft a defective clause, it seems that corporate partners do not want to perturb the bliss of the moment of agreement by talking about how to proceed in case of a dispute .

Corporate negotiators should be more aware that it is precisely at this stage that business lawyers are meant to participate. After all, the



⁹ Friedland, Paul. Arbitration clauses for international contracts. Juris. New York. 2000. pp. 47-48.

¹⁰ Pennzoil Exploration and Production Co. v. Rumco Energy Ltd., 139 F. 3d 1061 (US 5th Cir. 1998).

reason why arbitrations are deemed as procedures in which intervene few lawyers at the beginning and a lot in the end is not fortuitous.

Consequently, the parties would do well in avoiding considering business lawyers as omen of controversy. As a matter of fact, the role of business lawyers consist in choosing the most suitable institutional arbitration clause, or, when is an ad-hoc arbitration, in drafting the arbitration clause in the most satisfactory way, including all essential and necessary elements to make it enforceable, according to foreseeable source of conflict; and, "if possible", suppress any deficiency.

It was stated "if possible" because within the international business environment things are complicated even with the expertise of a business lawyer. The fact that in cultures like the Anglo American the action of signing the contract symbolizes the intention of fulfil the stated terms, whereas in some Asiatic cultures, adjustments to the contract continue after signing it in response to environment changes, can help us to illustrate the high likelihood of misunderstandings in this field.¹¹

If managers and corporate partners in general take all this into account, they would choose the method the company use to settle its commercial dispute more carefully, because legal costs vary in a considerable amount depending on this.¹² Inadequately handled conflicts affect, eventually, the financial statements of companies, and, therefore, the trust and patience of the stakeholders.

Following, the causes and consequences of faulty arbitration clauses will be presented divided in the reasons of the most common failures. These mistakes are concreted in the form of "pathological clauses",¹³ which were wrongly drafted, whether by rush, or lack of both expertise and experience of the parties.

In general, depending on the magnitude of the mistake, a pathological clause could cause delays in the arbitral procedures, but will not necessarily be considered null, void or ineffective because international and domestic commercial arbitration legislation and practice try to



¹¹ Mead, Richard. *International Management-Cross Cultural Dimensions* 3rd Ed. Blackwell Publishing. Oxford. 2005. pp. 162-163.

¹² Glynn, John et al. *Accounting for managers*. 3rd ed. Thomson Learning. Surrey. 2003. p. 325.

¹³ Frederic Eisemann, former Secretary General of the ICC Court of Arbitration is considered to have created this expression.

apply these clauses to the largest extent possible by interpreting the will of those who sign the contract.¹⁴

3.2 Ambiguity

An arbitration clause is considered to be ambiguous when the parties do not express clearly that in case of conflict the method to use in order to settle the disagreements will be arbitration. Hence, parties are compelled to refrain from signing confusing agreements to arbitrate, because the general rule is that arbitration is prompted out of the contract, and if there is not an explicit arbitration clause within the contract it would not be an agreement to arbitrate.¹⁵

The clause shown below is a sample of an ambiguous clause where it is not possible to ascertain through which means will the dispute be solved:

Any controversy arising out of the performance of the present contract shall necessary be submitted to arbitration under the rules of...; in case of disagreement between the arbitrators chosen by the parties, it is agreed that the dispute shall be submitted to State Courts.¹⁶

What kind of disagreements between the arbitrators would dismiss the arbitral tribunal as the authority to settle the dispute?, in case of be three arbitrators would it be enough a disagreement between two of them to request the court intervention?, more important, are the parties providing for resort to an arbitral tribunal or to a State court?.

Generally, when the drafters make an ambiguous clause they squander the opportunity to arbitrate. In fact, this was the outcome of the case that involved the following arbitration clause:

In case of dispute, the parties undertake to submit to arbitration but in case of litigation the Tribunal de la Seine shall have exclusive jurisdiction.¹⁷

Arbitral tribunals can and should refuse to continue in such ambiguous situations, because although they allowed the making of an arbitral process, arbitrators cannot guarantee that the arbitral award be up-



¹⁴ Poudret, Jean-Francois and Besson, Sebastien. *Comparative Law of international arbitration*. 2nd ed. Thomson, Sweet and Maxwell. London. 2007. p. 128.

¹⁵ Townsend, John. "Arbitration clauses: Avoiding the seven deadly sins". *Dispute Resolution Journal*, February/April 2003 Vol. 58, Issue 1, p. 30.

¹⁶ International Trade Centre UNCTAD/WTO. *Arbitration and alternative dispute resolution: How to settle international business disputes*, The Centre, Geneva, 2001. p.151.

¹⁷ Tribunal de la Grande Instance of Paris, 1 February 1979. *Rev Arb.* 97.

held.¹⁸ In effect, what the parties agreed in the clause just mentioned was to an utterly granted possibility to challenge the award.

In a recent New York case a mid level appeals court had to interpret this arbitration clause:

All disputes between the parties concerning the interpretation or enforcement of any rights or obligations under this agreement...may be resolved by final and binding arbitration pursuant to the voluntary arbitration rules of the AAA.

The plaintiff argued that the use of the phrase “may be resolved by final and binding arbitration” clearly made the arbitration optional and not mandatory; therefore, the parties could resolve the dispute in court. The New York Supreme Court disagreed and said that the use of “may be resolved” gave the parties an option not between court and arbitration but between going to arbitration and doing nothing at all.¹⁹

3.3 Negligence

The parties draft an arbitration clause negligently when they address improperly an institution in charge of administer the arbitration process, or one that has ceased its service, or named an institution correctly but relate it to a situs where it does not operate.²⁰

It was decided to name this error “negligence” since after choosing the suitable arbitral institution, the only thing parties must be careful about is that the name of such centre appears correctly in the arbitration clause.

Hence the fact that parties failed in something so straightforward seems to indicate that they did not put attention to detail when drafting the arbitration clause.

The parties have to take into consideration that they are bound to the agreement that is exhibited in a contract. The deal signed will be regarded by arbiters or judges as the landmarks to follow in order to interpret the will of the parties. In case of discrepancy between the content of an arbitra-



¹⁸ Ball, Michael. 1987. “Structuring the arbitration in advance-the arbitration clause in an international development agreement”. In: Lew, Julian (ed.). *Contemporary Problems in International Arbitration*. Martinus Nijhoff Publishers. Dordrecht. pp. 299.

¹⁹ Miletsky, Robert. “How to Make Sure Your Arbitration Clauses Do Exactly What You Want Them To Do”. *Contractor’s Business Management Report*. 2005. pp. 1, 6-7.

²⁰ Townsend, John. “Arbitration clauses: Avoiding the seven deadly sins”. *Dispute Resolution Journal*, February/April 2003, Vol. 58, Issue 1, p. 31.

tion clause included in a contract and the reality, then, time and money have to be wasted trying to find the real intention of the parties.

The necessity of avoiding making this kind of mistakes is particularly critical in international contracts, where the amounts at stake are significant. Therefore, the more accurate the parties are when consigning a standard institutional arbitration clause into the contract, the less they will need to clarify later.

It is also important to refer to the institution's arbitration rules and specify the relevant version of such rules, because from time to time institutions adjust their arbitration rules, and disputes may arise over which set of rules apply to a particular dispute.

The International Trade Centre cites the next one as a clause in which the mistake under analysis was made:

Any dispute or contravention to the present contract shall be submitted to the French Chamber of Commerce of Sao Paulo.²¹

This clause is considered pathological by the International Trade Centre, since it addresses a non-existing body as the arbitral institution to which the parties have to present possible controversies.

3.4 Exclusion of Essential or Necessary Elements

Any omission of an element necessary or essential to write an effective arbitration clause is likely to cause a disruption to the process.

When an arbitration clause is presented as just a plain agreement to arbitrate like this one:

All disputes arising out of the present contract shall be settled by way of arbitration.²²

Even though it is valid, it is a clause that will be difficult to apply in practice, especially with respect to the constitution of the arbitral tribunal. It does not contain any provision for the appointment of arbitrators or any mention of authority that may be called upon to appoint arbitrators in case of default of any of the parties. Furthermore, it does not have any provision on the place of arbitration.



²¹ International Trade Centre UNCTAD/WTO. 2001. Arbitration and alternative dispute resolution: How to settle international business disputes, The Centre, Geneva, p.150.

²² International Trade Centre UNCTAD/WTO. 2001. Arbitration and alternative dispute resolution: How to settle international business disputes, The Centre, Geneva, p. 150.

Let us turn now to ad-hoc arbitration, where it could be claimed correctly that the intervention of the courts is necessary to make important decisions to start the arbitration proceedings. So, “if the parties either say nothing or provide generally that an award can be enforced by any court of competent jurisdiction, then, the jurisdiction of an enforcing court will be determined by national law without regard to the parties’ silence on the subject.”²³

However, this situation is far from being the ideal approach, in which the parties draft an “effective clause” with the details concerning their arbitration without having to involve any court.

Another point to consider here is that even though usually the parties have in the national courts a cooperative and unconditional supporter of the arbitral process, there is a risk of designating retired municipal judges and practitioners as arbitrators without the proper international background. This situation worsens if the arbitration is held in a country which policy is hostile to this kind of mechanism of dispute settlement.

To emphasize the repercussions of omitting the recommended elements, two of them will be discussed: the place of arbitration and the substantive law applicable to the dispute.

Specify the place of arbitration in the arbitration clause is quite important. Firstly, because the award will have a great enforcement potential if the arbitration is performed in a state bound to the New York Convention. Secondly, it would be better if the parties choose a place with a favourable legislation to arbitration. Finally, as the place or arbitration is a determinant factor in the selection of arbitrators.²⁴

Regarding the applicable law to the substance of the dispute, it determines the extent of the parties’ respective rights and obligations and helps to fill gaps in contractual provisions. Thus, failure to include it within the wording of the clause leads to a dangerous uncertainty.

Before including the substantive law to apply to the dispute, the parties have to give a careful thought to this matter. It is normal that a party wants to choose their own national law, because it is the legislation the party is more familiar with. However, not always the own



²³ Friedland, Paul. Arbitration clauses for international contracts, Juris, New York, 2000, p. 79.

²⁴ Born, Gary. International arbitration and forum selection agreements : planning, drafting, and enforcing. Kluwer Law International. The Hague. 1999. pp. 57-61.

rules are the most advantageous, as the International Trade Centre UNCTAD/WTO has explained:

A party's own national law may favour them in certain ways, but not in others. French law, for instance, does not allow the "theory of unforeseen circumstances" which enables the contractual provisions to be adapted in the event that major changes occur to the circumstances as they prevail at the time the contract was concluded. Non-allowance of the "theory of unforeseen circumstances" may go against the seller's interest when the price of the good is rising as oppose to failing. A French seller therefore may be inclined to accept the law of the buyer's country.²⁵

For these reasons, the parties should not leave these issues to chance or add what they think is the best alternative without prudently deliberate about the consequences of each choice. The same reflection, *mutatis mutandis*, is relevant to the language of the arbitration, the law applicable to the procedure, the law applicable to the clause, the number of arbitrators and method of selection and the qualifications of the arbitrators.

3.5 Extremely elaborated

Before analysing the causes and consequences of extremely elaborated clauses a reference has to be made about the "escalation clause". That is for its complexity and, consequently, tendency to fall within the clauses considered as extremely elaborated.

Escalation clauses are those in which the parties agree that in case of conflict before beginning the arbitral process the parties must try to settle the disagreement through negotiation or mediation. If these preliminary steps to solve the conflict in a friendly way fail, then, it follows the arbitration stage.²⁶

Lately, escalation clauses have been used mainly in large-scale or long-term contracts, namely international construction and engineering contracts. It is maybe due to the convenience in keeping good relation during the length of these kinds of contracts, avoiding costly suspensions through the implementation of friendly methods.

A sample of an escalation clause use in a long-term cross border energy supply agreement is:



²⁵ International Trade Centre UNCTAD/WTO. Arbitration and alternative dispute resolution: How to settle international business disputes. The Centre, Geneva, 2001. p. 138.

²⁶ Berger, Klaus. "Law and practice of escalation clauses". Arbitration international, LCIA. 2006.Vol. 22, No. 1. p. 1.

- (1) Any dispute arising out of or in connection with this contract shall be settled in good faith through mutual discussions between the parties.
- (2) In the event that the parties are unable to resolve a dispute in accordance with section 1 above, then either party, in accordance with this Section 2, may refer the dispute to an expert for consideration of the dispute.
- (3) Any dispute arising out of or in connection with Agreement and not resolved following the procedures described in Sections 1 and 2 above shall, except as hereafter provided, be settled by arbitration in accordance with the Rules of procedure for Arbitration Proceedings.²⁷

A couple of important observations can be taken from the clause presented above. To begin with, by including the expression “shall” the parties wanted to make preliminary ADR methods a compulsory requirement before applying arbitration.

Another would be the effect when the drafter put e.g. “may refer” instead, because it means that the parties are just offering a possibility to solve things by preliminary ADR methods.

Secondly, the clause just mentioned appeals to the good faith of the parties and their willingness to resolve possible differences in a negotiated manner. Unfortunately, since it was not possible to get the complete contract it could not be identified how was determined a crucial matter which is the ending of the ADR stage and the beginning of the arbitral process.

Great caution has to be applied when dealing with this issue; otherwise, a ill-meant party might abuse of the confidence given and deliberately delay the arbitration process.²⁸

So, when the parties recur to a highly complicated provision as the escalation clause in order to maintain a conciliatory aptitude along with the performance of the contract they have to take into account that the more complex a clause is, the bigger is the chance of making mistakes.

Having warning the parties about the escalation clause which entails considerable risks when is extremely elaborated; now, it will be determined what happens when a clause is drafted with excessive and useless wording.

Two examples of extremely elaborated clauses have been brought:



²⁷ ICC Award No. 10256, 2003. ICC International Court of Arbitration Bulletin No. 82, printed in Figueres.

²⁸ Berger, Klaus. Law and practice of escalation clauses. Arbitration international, LCIA. 2006. Vol. 22, No. 1. p. 15.

Taken from Reisman,²⁹ the first extremely elaborated clause was drafted in this way:

The parties agree that God, in His Word, forbids Christians to bring lawsuits against other Christians in secular courts of law (1 Corinthians 6:1-8), and that God desires that Christians be reconciled to one another when disputes of any nature arise between them (Matthew 5:21-24 6:9-15; 18:5 -20). Because the parties hereto desire to honor (sic) and glorify the Lord Jesus Christ in their resolution of any disputes that my (sic) arise under this agreement, each party agrees that the provisions for mediation and arbitration set forth in this section shall be the sole and exclusive remedy for resolving any dispute between the parties arising out of or involving this agreement...

Until here even though containing strong religious expressions that might confuse somebody who is not erudite in catholic matters, the clause clearly indicates that the parties agree to be bound by an escalation clause (analyzed before).

The arbitrators shall apply the Law of God found in the Old and New Testaments in considering the facts and determining the conventions being arbitrated.³⁰

Here is where the parties will indeed have problems, firstly, due to the difficulties that a party will have to enforce an award based in an arbitration clause of this nature. Secondly, there is an uncertain outcome because it is unknown if the award is congruent with the governmental legislation of the place where it was issued.

Here there is another tangled clause:

All disputes in relation to the present contract shall be carried out by arbitrators appointed by the International Chamber of Commerce sitting in Geneva, in accordance with the arbitration procedure set forth in the Civil Code of France and the Civil Code of Venezuela, with due regard for the law of the place of arbitration."³¹

This is an arbitration clause, in which it seems that the parties with the intention to avoid participating in an arbitration ruled by a foreign law agreed to apply their own municipal laws. If the French and Venezuelan Civil Codes are congruent in the topic matter of dispute, then, the resulting award is likely to be understood and obeyed by the parties involved. On the other hand, the arbitrators will have a hard time trying to comply with the parties' agreement if both laws are different.



²⁹ Reisman, Merton. et al, *International Commercial Arbitration-Cases, material and notes on the resolution of international business disputes*, the Foundation Press Inc., New York, pp. 165-166, 169.

³⁰ This clause has been included in the present paper with all due respect of the catholic religious believing, and just to analyse the legal meaning.

³¹ Paris, ICC case 2321/1974.

Altogether, the last two causes of faulty arbitration agreements make think that the parties are compelled to find a balance in the drafting of an arbitration clause, so they will not be bound to an over-drafted or a plain clause.

The consequence of both mistakes is almost the same: The courts will have to intervene, along the process and in deciding and enforcing the award; or the arbitrators may conclude that they are before an unconscionable clause. To elude this dangerous territory, many expert refrain from formulate tailor made clauses and just use the most suitable of the institutional or the UNCTRAL (when the parties choose ad hoc arbitration), these have been used for a while and have yielded good results.

3.6 Lack of legal harmonization about crucial matters

Due to the ever variable conditions in which arbitration clauses are meant to be applied; namely, commercial transactions, legal and cultural backgrounds, the implementation of a single set of rules over the international commercial arbitration has proved to be a cumbersome task.

To expose the degree of discrepancy between the different international regulations about key aspects of arbitration and its consequences, the topic of the “writing requirement” is going to be presented.

An inconsistency exists between the UNCITRAL and the New York Convention on the meaning of “writing”. There are differences between the writing requirements of the UNCITRAL Model Law (Article 7 (2))³² and the New York Convention (Article II(2)).³³ This discordance generates problems related to the validity and enforceability of the arbitration clauses.

The UNCITRAL in the mentioned article allows to means of telecommunication which provide a record of the agreement, or in an exchange of statements of claim and defence in which the existence



³² Art 7(2): “The arbitration agreement shall be in writing. An agreement is in writing if it contained in a document signed by the parties or in an exchange of letters, telex, telegrams or other means of telecommunication which provide a record of the agreement, or in an exchange of statements of claim and defence in which the existence of an agreement is alleged by one party and not denied by another. The reference in a contract to a document containing an arbitration clause constitutes an arbitration agreement provided that the contract is in writing and the reference is such as to make that clause part of the contract.”

³³ Article II (2): The term “agreement in writing” shall include an arbitral clause in a contract or an arbitration agreement, sign by the parties or contained in an exchange of letter or telegrams.

of an agreement is alleged by one party and not denied by another". When comparing both regulations this institution has a more flexible view of the writing requirement than the New York Convention. So, in principle an arbitration clause that observes the UNCITRAL directives may be a valid one.

In spite of this, when the award is rendered it may be challenged for not complying the writing requirements of the New York Convention, which is more strict. Hence, in a nutshell, an arbitration clause is deemed as valid if it follows the parameters signalled by the UNCITRAL, nonetheless, the award provided from that clause could be not enforceable, if it does not satisfies the condition of the New York Convention.

In view of the explicit writing requirements in the Model Law (UNCITRAL) and the New York Convention have not been applied in a regular manner, drafters need to consider at least three things: how are the requirements interpreted by the country where the arbitration is held, how the requirements will be regarded in a country where a stay of legal proceedings might be sought would view them and how the country of enforcement would upheld the award.³⁴

3.7 Unrealistic expectations

Unrealistic expectations are agreed in the drafting of an arbitration clause when the proceeding is divided in a series of steps which are allotted a short period of time to be performed. This is a double troubling matter, on the one hand it is the time, and on the other the specific stages.³⁵

With regards to the time, as stated in the chapter related to the characteristics of the international commercial arbitration, this method of dispute settlement is considered to be faster than litigation. However, it does not mean that the parties will get an immediate resolution of their dispute. Only before special circumstances like when provisional measures are needed to protect goods or intellectual right, and to avoid delays in construction projects narrow time limits are acceptable.



³⁴ Garnett, Richard. et al. *A Practical Guide to International Commercial Arbitration*. Oceana Publications Inc., New York., 2000, p. 45.

³⁵ Townsend, John. "Arbitration clauses: Avoiding the seven deadly sins". *Dispute Resolution Journal*. Vol.

⁵⁸ Issue 1. February/April 2003. pp. 32-33.

In respect of those arbitration agreements that impose specific stages to be applied to the potential arbitration process, namely those with a strict schedule to present the requirement for arbitration, the written submissions, ways of conduct the presentation of documents, hearings, et cetera; this is deemed to be counterproductive. It would mean that the arbitrators will not be allowed to use their discretion while directing the process.³⁶

The following is a sample of an arbitration clause with unrealistic expectations:

The claimant will name its arbitrator when it commences the proceeding. The respondent will then name its arbitrator within seven (7) days, and the two so named will name the third arbitrator, who will act as chair, within seven (7) days of the selection of the second arbitrator. Hearings will commence within fifteen (15) days of the selection of the third arbitrator, and will conclude no more than three days later. The arbitrator will issue their award within seven (7) days of the conclusion of the hearings.³⁷

As a consequence both, the parties and their lawyers when drafting the arbitration clause should consider that a fairly expeditious process is not advisable, and after the arbitrators fail in conduct it according to the parties will, then, they will have to resort to litigation.

3.8 Copy of court proceedings

If litigation is conducted within a determined country, the normal situation is that the language and rules of the proceeding will be imposed to the parties, with the caveat that one of the parties may be playing as local, which is an advantage when the law favours the local party. Whereas, if the same matter is presented to be settled through arbitration, parties enjoy more freedom to choose the place of arbitration, language, procedural rules, who will be the arbitrators and the like.³⁸

Litigation and arbitration are different not just in this respect but also in the speed, cost, international recognition, finality, specialized competence, an almost exclusive follow up, flexibility and confidentiality.



³⁶ Born, Gary. *International arbitration and forum selection agreements: planning, drafting, and enforcing*. Kluwer Law International. The Hague. 1999. p. 84.

³⁷ Townsend, John. "Arbitration clauses: Avoiding the seven deadly sins". *Dispute Resolution Journal*. February/April 2003, Vol. 58, issue 1, p. 32.

³⁸ Redfern, Alan. *Law and practice of international commercial arbitration*. Sweet and Maxwell. London. 2004. p. 281.

When drafters of arbitration clause want to apply to arbitration rules that are proper of court proceedings or they provide an expanded review of the arbitration award, they are exposing the arbitration to a phenomenon called “litigation envy”.³⁹

Take the following clause:

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.

The problem with copying court proceedings is that it can cause uncertainty and misspending of company resources, due to arbitration is a proceeding that attends a different nature. Unfortunately, this is a problem that is found in ad-hoc and institutional arbitration.

In many AAA’s arbitrations, for example, although resolving disputes fairly, they occasionally take too much time in doing so and also with high costs.

The main reason for Ed Gluklick, a journalist specialized in dispute resolution, is the AAA’s policy to employ familiar, time-consuming techniques of litigation, namely introduction of voluminous exhibits, repeatedly questioning witnesses about the same subject, asking leading questions, and making “for-the-record” objections.⁴⁰

Consequently, the arbitration clauses that are designed is to copy litigation are likely to be ineffective. Furthermore, it would not have sense to draft in an arbitration clause a would-be litigation process, because it could go against the core characteristics of the arbitration, which are the neutrality and the international recognition.

3.9 Abusive clauses

At its simplest, an abusive clause is one that has been drafted manifestly favouring the interest of one of the parties. Generally, the benefited is the strongest economic party, which imposes unfair conditions through contracts of adhesion, or by reference. Sometimes these stipulations are so unequal that the courts refrain from enforce them.



³⁹ Townsend, John. “Arbitration clauses: Avoiding the seven deadly sins”. *Dispute Resolution Journal*. February/April 2003, Vol. 58, issue 1, p. 33.

⁴⁰ Gluklick, Ed. May-Jul 2003. “Stick With the AAA Arbitration Clause”: The Best Chance for a Fair Resolution that Saves Time and Money. *Dispute Resolution Journal*, Vol. 58, Issue 2, p. 46.

A notorious example could be this clause:

This contract is subject to the Nevada arbitration rules governed under Nevada revised statute chapter 38 and the Federal Arbitration Law.⁴¹

The Nevada Supreme Court upheld the district court decision declaring the unconscionable clause. According to the Nevada Supreme Court, this provision was deemed implausible because it did not inform to the buying party that they were consenting to waive legal rights vital to the preservation of their interest.⁴²

Drafting this kind of provision is not advisable at all. Nowadays, in developed countries like the United Kingdom, France, Germany, and above all, the United States, vigorous measures have been enacted to protect consumers from these practices.⁴³ In addition, it can generate the distrust of clients who may even question the ethics of the company.

3.10 Incapacity of arbitration to deal with multiparty arbitration

According to Friedland,⁴⁴ the problems face by drafters of arbitration clauses in multi-party contracts are four. Firstly, the majority of arbitration clauses and institutional rules are designed for only two parties. Secondly, it is not possible to estimate the number and which party will participate in the arbitration. Thirdly, in any case it cannot be determined beforehand if more than two parties will be part of the arbitration process. Finally, if the arbitration clause included every conceivable event, it would be very long.

Multiparty arbitrations can pose a real challenge to the drafting of an arbitration clause where pragmatism and agreement are advisable.

Even though doctrine and arbitral institutions have tried to find an answer to these problems, few acceptable solutions have been presented to deal with a matter that municipal courts usually resolve without trouble.



⁴¹ D.R. Horton, Inc. v. Green, 96 P. 3d 1159 (Nev. Sept 13, 2004) (per curiam)

⁴² Review of Court decisions. Dispute Resolution Journal. November 2004/January 2005. p. 90.

⁴³ Howells, Geraint. Consumer protection law. Aldershot. Ashgate. 2005. p. 47.

⁴⁴ Friedland, Paul. Arbitration clauses for international contracts. Juris, New York, 2000, pp. 87-88.

It is important to take into account that even after recurring to institutional arbitration, the parties are not saved from the difficulties presented by multiparty arbitrations. Despite multiple efforts during the 1990s in the revision of their rules, the ICC, LCIA and AAA, have limited the changes to the nomination of arbitrators in multiparty conflicts.

With reference to these adjustments, Yves Derains and Eric Schwartz have been particularly critical of the measures adopted by the ICC to confront multiparty problems.

In their opinion: "...the New Rules do not address many of the issues that may arise in a multi-party context, such as, for example, with respect of the joinder of parties not named in the request for arbitration or the filing of a cross-claim by one respondent against another... However, as discussed further with respect to Article 4 (6), in the absence of appropriate provision in the Rules, parties wishing to do so must be able to agree on the procedures to be followed or run the risk that the ICC Court will require separate arbitrations to be instituted in respect of the various disputes involved".⁴⁵

This situation represents a significant setback to the ICC. Parties will rather use other methods to settle their disputes instead of afford the likelihood of uncertainty that conflicting decisions may bring.

With regards to ad hoc arbitrations if a party is implicated after the deadline established in the agreement it may cripple the process.

Finally, the *First Options of Chicago Inc. v. Kaplan*⁴⁶ case below was added to demonstrate that the problems prompted by multiparty arbitrations have innumerable causes. Often, the reasons that generate difficulties are not related to the drafting of the arbitration clause.

Facts:

- The case is about various interconnected disputes between, First Options of Chicago, Inc., a firm that clears stock trade on the Philadelphia Stock Exchange, and, three parties: Manual Kaplan; his wife Carol Kaplan; and his wholly owned investment company, MK Investment, Inc. (MKI).



⁴⁵ Derains, Yves. and Schwartz, Eric. A guide to the ICC rules of arbitration. Kluwer Law International. The Hague. 2005. p. 325.

⁴⁶ 514 U.S. 938 (U.S. Supreme Court 1995)

- First Option cleared the trading account of MKI.
- The agreement governed the “working out” of debts to First Options that MKI and Kaplan incurred, was embodied in various contracts.
- In 1989, after entering into the agreement, MKI lost US\$1.5 million. First Options decided to liquidate, certain MKI assets; demanded immediate payment of the entire MKI debt; and insisted that the Kaplans personally pay any deficiency. When its requirements were not met by the Kaplans, First Options sought arbitration.

Legal problem:

MKI having signed the only workout document that contained an arbitration clause, accepted arbitration. The Kaplans, who had not personally signed that document, denied that their conflict with First Option was arbitrable.

Decisions taken:

The arbitrators decided that they that the power to rule on the merits of the parties’ dispute, and did so in favour of First Options. The Federal District Court conformed to the award. Nonetheless, on appeal the Court of Appeals for the Third Circuit agreed with the Kaplans that their dispute was not arbitrable; and it reserved the District Court’s conformation to the award against them.

Considerations of the District Court:

The position of the court can be summarized in that the party who has not agreed to arbitrate will normally has a right to a courts decision about the merits of its dispute. But, where the party has agreed to arbitrate, then it has relinquished much of that right’s practical value. The party still can ask a court to review the arbitrators’ decision, but the court will set that decision aside only in very unusual circumstances.

Conclusions:

Basically, the decision of the court is supported in that arbitration is based on the consent of the parties. For this reason, it would be considered as a bizarre approach to authorize arbitrators to pronounce judgements on matters where one of the parties that have not expressly agreed to arbitrate.

In this case four were the contracts signed between First Options and the KMI, but not all of them were signed subscribe by the Kaplans. When this happen the best option would be to draft special provisions into each contract, binding to all party to a multiparty arbitration.

4. FINAL CONSIDERATIONS

4.1 Analysis

The drafting of an effective arbitration clause is a stage deemed to be of supreme significance due that, as a general rule, the arbitration process is underpinned by the arbitration clause or the submission agreement. Therefore especial attention has to be employed when drafting these provisions, otherwise, they may be regarded as unconscionable or prompt an unenforceable award.

There are cases in which the drafters of the arbitration clause are the ones to be blamed when problems arise during the arbitration process or in the compliance of an award. Moreover, although the bibliography about presenting the drafting guidelines of an arbitration clause is abundant (Alan Friedland, Gary Born and Paul Friedland, among others cited in the present document), unreasonable mistakes are still found currently on international transactions.

The case presented by the International Trade Centre UNCTAD/WTO, in which the parties agreed to submit the disputes to an arbitral centre that did not even exist is clear evidence that the drafters sometimes do not have the slightest concern about the arbitration clause and the consequences of the mistakes.

Furthermore, it seems that the drafters (experts, beginners, lawyers or corporate partners) in occasions forget that the enforcement or validity of an arbitration clause does not depend on the extent of the clause, but on the capacity of concretization and simplicity.

The case Arab African Energy Corp. Ltd v. *Olieprodukten Nederland BV*. 2 Lloyd's Rep, although decided more that 20 ago is still cited since the court in England validated its laconic arbitration clause: "English law-arbitration, if any, London according ICC Rules."

In this way, when the drafters do not consider too much the wording of the clause, then they can expose the provision to be considered as

ambiguous, abusive, copy of a litigation process, impracticable for the short terms, negligently drafted, excessively ornamented or be excluding an essential or necessary element.

However, the evidence found shows that it would be unfair to attribute all the flaws of the arbitrations clauses only to the drafters.

To start with, it happens that in cases like the multiparty arbitration the international institutions are struggling to design an arbitration rule to apply in these situations, but so far, as Yves Derains and Eric Schwartz explained, when dealing with multiparty arbitration the deficiency of the ICC rules in this respect generate uncertainty, because the ICC Court would require separate arbitrations.

In the second place, another threat to the enforceability of the international arbitration clauses is the disparity between the New York Convention and the UNCITRAL in critical topics like the documents considered to bear a writing agreement to arbitrate. This is another factor of international uncertainty that does not have anything to do with the parties' drafting skills.

Lastly, it was found that the effectiveness of some institutional arbitration clauses is affected by the institution's procedure itself. Arbitral process like the applied for the AAA's make the parties lose money and time due to the reproduction of stages associated with litigation. A weakness highly criticized by journalists specialized in dispute resolution.

4.2 Conclusion

Taken all the arguments presented here, the causes of unenforceability, invalidity and other lamentable consequences can be derived from mistakes either attributable to the drafters or to the arbitration shortfalls. In consequence, it is strongly recommended to the drafters to look for a clause of a well known arbitration centre (institutional) or follow the UNCITRAL rules (ad-hoc).

This is due to the fact that these models have been tested in arbitration and courts internationally during years and they are most likely to be effective. That is, to produce an enforceable award without the intervention of the courts during the arbitral process, to rectify those complications caused by mistakes in the drafting of the arbitration clause.

Finally, in the search for the fittest arbitration clause, the drafters most take into account that there is not a clause applicable to any kind of situation or circumstances. Hence, if he or she want to submit an effective clause a throughout analysis is indispensable. Always evaluating the suitability of a particular institutional or an ad hoc clause for each specific contract, the arbitrability of the matter, the capacity of the parties, the language and place in which the arbitration will be held, the procedural law to govern the arbitration, specify the number of arbitrator and the method to select them.

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