4. Drafting arbitration clauses

1. Essential matters to include in an arbitration clause

In an arbitration clause, the parties should always:

- select a seat;
- consider whether they wish to select the rules of an arbitral institution or have an *ad hoc* arbitration;
- consider the number of arbitrators (and their appointment method); and
- choose the language of the arbitration.

In addition, although it is technically separate from the arbitration clause itself, the parties should always include provisions on governing law.

1.1 Governing law

All contracts should include a governing law clause. This determines the rights and obligations of the parties under that contract. If it is omitted, any subsequent contractual dispute may well begin with a lengthy and expensive argument over the appropriate applicable law.

Parties are generally free to choose which law should apply to a contract, subject to certain limitations. For instance, under the Rome I Regulation (EC) No 593/2008 on the law applicable to contractual obligations (the 'Rome I Regulation') – which applies in all EU member states (except Denmark) to all contracts concluded after December 17 2009 – the court must (in addition to the chosen governing law) apply any rules which cannot be derogated from by agreement under the laws of the country in which all elements relevant to the contract are located. Any overriding mandatory provisions of the forum must also be applied. Parties' freedom to choose which law should apply to a contract is also often restricted in relation to insurance, employment, consumer and passenger contracts.

It is also recommended that parties agree in advance on the governing law for non-contractual obligations. The Rome II Regulation (EC) No 864/2007 on the law applicable to non-contractual obligations (the 'Rome II Regulation') – which applies in all EU member states (except Denmark) since January 11 2009 – allows parties to agree the law governing certain non-contractual obligations subject to certain overriding rules. This agreement can be reached after a dispute arises, or beforehand if the agreement is "freely negotiated" and the parties are engaged in "commercial activity". Non-contractual obligations are widely defined and include tort and restitutionary claims, but not personal-type claims such as defamation.

TIP The following suggested clause sets out the parties' choice of law in respect of both contractual and non-contractual obligations: *"This Agreement [and any non-contractual obligations arising out of or in connection with it] will be governed by [ ] law."*

Choosing the governing law can be difficult. For contracts involving parties based in the same country and/or where the subject matter of the contract relates to a specific country, it is usual to start on the basis that the law of that country should apply. However, the parties may choose a law unrelated to any or all of the contracting parties. Laws that are frequently chosen include those of England and Wales, New York and Switzerland, since they are well developed and generally considered suitable for commercial transactions.

In addition, where arbitration is to be the chosen dispute resolution form, the parties can specify a non-state law, for example *Shariah* law, Jewish law or the law of a particular country supplemented by principles of international law, *lex mercatoria* and so on. They may also allow the arbitrator/tribunal to assume the powers of an '*amicable compositeur*' or to determine the dispute on an '*ex aequo et bono*' basis – both of these mean that the dispute is to be determined based on principles of fairness and equity, rather than any particular law. It should be borne in mind that specifying a non-state law or allowing the arbitral tribunal to assume the powers of an *amicable compositeur* remains controversial and in certain countries might not be enforceable. However, this practice is not uncommon in certain insurance-related arbitrations.

1.2 Legal seat

(a) What is the legal seat of the arbitration?

The 'seat' is where the arbitration is considered to be legally based. However, hearings may take place elsewhere if the parties agree. It is entirely separate and may well differ from the substantive governing law of the underlying contract. Parties often select a seat in a 'neutral' location where neither party is based.

As set out in Chapter 2, the New York Convention commits signatory states to enforcing arbitral awards made elsewhere. However, there are limited exceptions. One of these is that many signatory states have agreed that an award will be enforceable in their jurisdiction only if the seat of the arbitration is also in a New York Convention signatory state. It is therefore usually essential to choose a seat in a New York Convention contracting state.

TIP Popular choices of seat in New York Convention countries include London, Paris, Stockholm, New York, Geneva, Zurich, Brussels, The Hague, Dublin, the Dubai International Financial Centre, Singapore, Vienna and Hong Kong. These seats are popular because they are in arbitration-friendly jurisdictions; that is, they have adopted arbitration legislation that supports the arbitration process and restricts judicial interference as far as possible.

(b) Matters to consider when selecting the seat of the arbitration

The choice of seat is important, as it decides:

- which country's law governs the procedural aspects of the arbitration. This includes questions of day-to-day procedure in the absence of agreement between the parties (eg, where the arbitration rules that may have been selected by the parties are silent on specific issues – see below);
- the extent to which an award may be challenged or appealed (again, determined by the legislative framework of the seat of the arbitration). For instance, if the seat is in England and Wales, a limited right of appeal to the court on a point of substantive English law is available, but is usually excluded. Such right of appeal does not exist, however, in countries such as France or Switzerland. Indeed, if the seat of the arbitration is located in these countries it is, in certain circumstances, possible for the parties to fully waive the right to challenge arbitral awards;
- how far the local courts can assist or intervene in the arbitral proceedings. Some jurisdictions, such as England, are more prepared to intervene on issues such as allowing the parties to obtain interim relief from the local courts or determining questions of jurisdiction. Others, such as France or Switzerland, ordinarily require such issues to be determined by the tribunal (at least in the first instance); and
- the enforceability of any award. As mentioned above, an award will, in many cases, be enforceable under the New York Convention only if the seat of the arbitration is in a New York Convention contracting state.

1.3 Choosing institutional or *ad hoc* arbitration

(a) What is institutional arbitration?

Institutional arbitration does not mean choosing an institution to determine the dispute. It typically means choosing the rules of arbitration of an institution which will administer and support the arbitral process in accordance with those rules, regardless of the seat.

Many arbitral institutions (eg, ICC, LCIA) are well respected and their rules have been derived by arbitrators and users following many years of experience in handling arbitrations.

Cross-reference

A précis of each of the major arbitral institutions is set out in Chapter 2.

It should also be noted that choosing institutional arbitration (and subscribing to any set of rules) does not displace the legislative framework of the seat. Often they supplement it. Some rules may replace those in the legislation (to the extent that they can be excluded or varied) – for example, the LCIA rules automatically exclude the right to appeal on a question of law under the English Arbitration Act 1996 and set out a default timetable for written pleadings.

In some countries, such as China, *ad hoc* arbitration is not recognised, and so it is essential to choose institutional arbitration.

Advantages: The main advantage of institutional arbitration is the support of the institution if things go wrong. For instance, if the tribunal is not being responsive, the institution will be able to contact and put pressure on the arbitral tribunal.

Choosing institutional rules will, to a degree, prevent parties from engaging in certain delaying tactics. Examples include where a party refuses to appoint or seeks to challenge an arbitrator. In the former case, most institutional rules provide that the arbitrator will be appointed by the institution (eg, the ICC or the LCIA Court). Likewise, institutions usually deal promptly with challenges to arbitrators. Without institutional support, parties may have to refer to the local courts to deal with appointments or challenges, which may be time consuming and costly.

Most arbitral institutions will have a list of experienced arbitrators from which they will be able to draw if parties fail to agree on the identity of any of the arbitrators themselves.

Some institutions review awards before publishing them, ensuring award writing that is of a higher standard and procedurally compliant. An award from an institution will also benefit from the reputation and standing of that institution, which may help with its enforcement.

In an attempt to speed up the enforcement process, many institutional rules exclude appeals as much as possible.

Finally, the costs of institutional arbitration might be easier to predict than in *ad hoc* arbitration (see Chapter 13).

Disadvantages: There are few disadvantages to institutional arbitration. The main criticism is cost. Institutional arbitration is sometimes considered more expensive than *ad hoc* arbitration because the parties have to pay for the institution's administrative expenses. However, these are usually modest compared to the fees and expenses of the arbitrators and the parties' legal expenses (mainly lawyers' fees). The advantages of choosing institutional arbitration are generally considered to far outweigh the downside of this additional cost.

Cross-reference *More on how fees and expenses are dealt with in institutional arbitrations can be found in Chapter 13.*

(b) What is ad hoc *arbitration?*

'*Ad hoc*' arbitration does not subscribe to any institution. It may subscribe to a set of rules, for example UNCITRAL, or it may rely on the legislative framework of the seat of the arbitration, enabling the parties to determine their own rules, usually together with the arbitral tribunal. This does not mean, however, that parties cannot later choose to apply a set of rules, or that an institutional arbitration is inflexible. If the parties to an *ad hoc* arbitration require support during the proceedings they will need to apply to the tribunal and/or the local courts.

Some sectors – such as shipping (LMAA), construction (CIMAR) and commodities (FOSFA, LME) – have adapted *ad hoc* procedures that are commonly used and are preferable in those areas to institutional rules. These are not institutional but are backed by trade association bodies.

Advantages: The main perceived advantage of *ad hoc* arbitration is cost. Because the parties are not appointing an institution to administer the arbitration, they can save the cost of paying its administrative charges.

Ad hoc arbitration can be a very efficient way to resolve disputes, provided that:

- the arbitration agreement is well drafted – for example, it states where the seat will be located, includes an appointing authority (see below), and sets out the arbitration procedure or refers to a set of rules designed for *ad hoc* arbitration, the most famous being the UNCITRAL Rules;
- the parties cooperate during the arbitration and do not use delaying tactics (see below); and
- an experienced arbitral tribunal is appointed, whose members are used to dealing with arbitration proceedings.

However, there are a number of potential disadvantages to *ad hoc* arbitration.

Disadvantages: The main disadvantage is the lack of institutional support. If the parties are unable to agree on the appointment of the arbitral tribunal, they will have to rely on the local courts to do this. This can be costly and time consuming. Local courts will also not have the same knowledge and experience in the selection of arbitrators as an arbitral institution, meaning that the individual(s) selected might not be suitable to the dispute (eg, due to a lack of relevant skills or experience). To avoid this problem, parties often nominate an 'appointing authority' in their arbitration agreement. If the arbitration is governed by the UNCITRAL Rules, for example, the appointing authority will be the Secretary-General of the Permanent Court of Arbitration at The Hague, unless the parties select otherwise.

TIP

Including an appointing authority in an *ad hoc* arbitration clause can help to reduce the time and costs involved in the event of a disagreement between the parties on the appointment of the tribunal, because the appointing authority will resolve such disputes and thus avoid the need for the parties to apply to the local courts.

In an *ad hoc* arbitration a recalcitrant party may use delaying tactics such as challenging one or more members of the arbitral tribunal. As stated above, such challenges are usually dealt with quickly by an arbitral institution. Bringing the challenge before the local courts wastes more time and money than if the challenge had been dealt with by an efficient and experienced arbitration institution. Again, choosing an appointing authority can help to avoid these problems.

While *ad hoc* arbitration is sometimes considered cheaper than institutional arbitration, it may in fact end up more costly. As detailed above, a recalcitrant party is more likely to be able to use delaying tactics such as challenging the arbitral tribunal or refusing to appoint or agree to an arbitrator. Furthermore, an institutional arbitration usually fixes the fees and expenses of the arbitral tribunal according to the rules of the institution. In *ad hoc* arbitration, the tribunal fixes its own costs, making them less predictable.

Finally, awards made in *ad hoc* arbitration will not be scrutinised by an institution, thereby increasing the risk of them being poorly drafted and thus susceptible to being set aside.

1.4 Choosing arbitral rules

As stated above, the major arbitral institutions that are generally recommended include the ICC, LCIA, Swiss Rules, SIAC, HKIAC Administered Rules, Stockholm Chamber of Commerce and DIFC. Their rules are frequently revised to take into account developments in international arbitration practice. SIAC, for example, revised its rules in 2010, and the ICC's new arbitration rules came into force on January 1 2012. The CIETAC Rules and Swiss Rules have also been updated in 2012. These rules have been modified to reflect current arbitral practices, to respond to developments in international arbitration and to adapt to the changing needs of the international business community.

For *ad hoc* arbitration, the most famous rules are those designed by UNCITRAL. Like the institutional rules mentioned above, the UNCITRAL Rules have been revised to respond to developments in international arbitration. They were last revised in 2010 and are under constant review.

1.5 How many arbitrators?

An arbitral tribunal will usually consist of one or three arbitrators, depending on what the parties have agreed.

Most arbitration rules and legislation provide for a default position in case the parties have not made a choice in this respect. Thus, under Article 12(2) of the 2012 ICC Rules, where the parties have not agreed upon the number of arbitrators, the ICC Court of Arbitration will appoint a sole arbitrator "save where it appears to the [ICC] Court that the dispute is such as to warrant the appointment of three arbitrators". Likewise, under Article 5(4) of the LCIA rules, a sole arbitrator will be appointed unless the LCIA Court determines that a three-member tribunal is appropriate. In contrast, Article 7.1 of the UNCITRAL Rules provides that if the parties have not agreed that there will be only one arbitrator, three will be appointed.

TIP The current practice in the ICC is that one arbitrator will generally be appointed for any dispute worth US$20 million or less, and three for disputes over US$20 million or other complex disputes. This is worth bearing in mind if you are making submissions to argue for the appointment of either one or three arbitrators based on the complexity of the issue at hand.

Appointing a sole arbitrator minimises the costs of the arbitration, as only one arbitrator's fees must be paid. It also tends to reduce the length of an arbitration as it does not require three people all to be available at the same time and come to a decision between them. Where a short timetable may be needed, the amount at stake is unlikely to be large or the issues not complex, it may be advisable to provide for the appointment of a sole arbitrator.

However, the general trend in international arbitration is to appoint three

arbitrators, except where the sum in issue does not justify it. Generally, each party appoints one arbitrator and either those two arbitrators choose the presiding arbitrator or an institution may do so, depending on the parties' decision set out in the arbitration agreement or any particular institutional rules to which the parties have chosen to subscribe. If each party has appointed an arbitrator, this will contribute to a feeling of confidence in the tribunal. Where there are more than two parties, they will be divided into two sides – claimant and respondent – for the purpose of nominating one arbitrator for each side. Where this fails (eg, because two different sides cannot be identified or the members of the different sides are unable to agree upon a common choice of arbitrators), the arbitral institution will usually nominate all three arbitrators. In an international arbitration, each of the parties and the members of the tribunal may come from different legal backgrounds and cultures, and even speak different languages. A party-appointed arbitrator, while remaining impartial, should be able to ensure that his or her appointing party's position is properly understood by the other members of the tribunal.

Cross-reference

More on how to choose an appropriate arbitrator is set out in Chapter 7.

1.6 Language of the arbitration

Unless the parties are based in the same country or come from countries where the same language is spoken, choosing the language of the arbitration in the arbitration clause can be crucial. This will often be the same as the language of the contract. The language of the arbitration will be essential in determining who can or cannot be selected as an arbitrator, as it is highly desirable for him or her to be fluent in that language. The choice of language(s) will normally apply to the various statements of case, written submissions and written statements filed during the proceedings, as well as any oral hearings that may take place.

Most arbitral institutions include a provision regarding the language of the arbitration in their recommended clauses. Where the language of the arbitration has not previously been selected, most arbitration rules allow the tribunal to choose it.

If during the proceedings a document is submitted which is expressed in a language other than that of the arbitration, the arbitral tribunal will usually have the power to order for a translation to be provided. Some arbitration rules expressly provide for this, including the LCIA Rules (Article 17.4), the AAA International Rules (Article 14) and the UNCITRAL Rules (Article 19.2).

2. Optional matters to include in an arbitration clause

Parties often use the model arbitration clauses recommended by well-known arbitration institutions such as the ICC or the LCIA. These clauses have been drafted carefully by arbitration specialists with considerable experience in international arbitration matters. They may even have been tried and tested before national courts. This means that they are likely to be valid in most countries. However, this 'one size fits all' approach does not necessarily suit all parties, which may wish to adapt the recommended clauses to their needs.