1st Scenario*

International Business Contracts

ISSUES COVERED

Question 1: Contract Conclusion in International Business

Conclusion of Contracts in International Business – Offer and Acceptance – Pro Forma Invoice – Invitation to Offer/Binding Offer – Standard Forms – 'Battle of Forms' – Tacit Acceptance of Penalty Clause

Question 2: Confirmations of Order

Confirmation of Order – Binding Offer – Telephone Enquiry

Question 3: Efficiency and Speed in International Contract Drafting

Use of Standard Terms – Inclusion of Standard Terms – INCOTERMS – Meaning of EXW

Question 4: The Avoidance of Legal Advice at the Drafting Stage

Communication between Lawyers and Businessmen – Lawyers as 'Deal Breakers' – In-House Counsel – Proactive Conflict Management – Conflict Avoidance

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* For the Facts of this Scenario please refer to the Case Study.

ANSWERS

Question 1: Contract Conclusion in International Business

How was the contract negotiated and concluded between ALT and NedTrans?

A. One Document vs Exchange of Fax/Email Messages

1-1 Mr Stutz, Sales Director of ALT, the exporter from Zurich, Switzerland, and Mr Bakker, General Manager of NedTrans, the importer from the Netherlands, negotiated the contract by exchanging faxes in February and March 1997. In order to ascertain whether a legally binding sales contract was concluded between ALT and NedTrans, one has to go through the chronological order of events (⊘ 'Documents and Events') to find two matching declarations of the parties' common intention as to the essential elements of an agreement. This is the basis of every contract.

B. The Search for Offer and Acceptance

1. Non-binding Inquiry or Binding Offer?

1-2 The first formal[1] inquiry was made by Mr Bakker on behalf of NedTrans in his fax message of 25 February 1997 to Mr Stutz at ALT (⊘). As a response to this message, ALT sent its fax of 3 March 1997 entitled 'Confirmation of Order' (⊘). The purpose and legal significance to be attached to that message depends on how far the negotiations between the parties had proceeded.

2. Pro Forma Invoices/Invitation to Offer

1-3 If the parties have not been in business with each other before and have not discussed any details of the proposed transaction, the exporter will be reluctant to send a firm and binding offer as a response to the importer's first inquiry. In that case, the exporter's quotation or 'pro forma invoice', even though formulated in detailed terms and anticipating the contents of the contract, will contain language devoid of any appearance of a binding offer, such as 'SUBJECT TO OUR FINAL CONFIRMATION', or 'SUBJECT TO CONTRACT'.[2] From a legal perspective, the exporter's initial quotation has the purpose of motivating the recipient to make a binding offer. It can be characterized as a mere invitation to submit an offer ('*invitatio ad offerendum*').[3] Such a solicitation of offers cannot be accepted at all by

1. The informal telephone conversation on 24 February 1997 certainly did not contain legally binding declarations from either side.
2. See generally Berger, in CENTRAL (ed.), *Law and Practice of Export Trade*, 5, 11 *et seq.*
3. See, *e.g. Audio Visual Assoc., Inc. v. Sharp Electronics Corp.*, 210 F.3d 254 (4th Cir. 2000); Berger, *ibid.*; del Pilar Perales Viscasillas, in CENTRAL (ed.), *Law and Practice of Export Trade*, 98, 101.

the party to whom it is addressed. Like catalogues or advertisements, these declarations are meant to convey information about the goods, but do not imply the seller's intention to be legally bound. The contract is concluded through the congruity of the buyer's offer, made as a reaction to the seller's invitation, and the exporter's acceptance. This acceptance may be contained in a formal message to the importer or implied from the exporter's conduct, *e.g.* from his performance of the contract.[4]

These two ways of concluding a contract are reflected in Clause No. 4 of NedTrans' Import Conditions, to which NedTrans referred in its fax message of 6 March 1997 (⊘), which deals with the binding nature of the price agreed upon by the parties. **1-4**

3. Nature of Binding Offers

In our case, ALT and NedTrans have been doing business with each other since 1990 (Case Study No. 1-3). Furthermore, Mr Bakker and Mr Stutz had been in telephone contact with each other regarding the details of the sales transaction concerning the AX 100 Special prior to NedTrans' enquiry of 25 February 1997 (Case Study No. 1-3). Therefore, ALT's fax of 3 March 1997 did not contain language that could give rise to the assumption that the communication was intended to be non-binding. Since it contained all *essentialia* of the contract, it can be viewed as an offer, *i.e.* a legally binding declaration of ALT's intention to conclude a sales contract with NedTrans on the terms and conditions indicated in the message. In this case, the conclusion of the contract does not require a further exchange of communications between the parties, but rather mere acceptance of the offer. Such acceptance can be found in NedTrans' fax of 6 March 1997 (⊘). **1-5**

C. Inclusion of Standard Forms and Penalty Clause

There are, however, two issues which have not been considered so far, but which might have an impact on the question of whether a legally binding contract was concluded between ALT and NedTrans: **1-6**

- ALT's fax of 3 March 1997 contained a reference to the ECE General Conditions (⊘) while NedTrans, in its fax of 6 March 1997, referred to its Import Conditions (⊘) (No. 1-8);
- NedTrans' fax of 6 March 1997 which constitutes the acceptance of ALT's offer of 3 March 1997 contained a penalty clause (No. 1-9).

Both issues are closely related (No. 1-12). However, there is a basic difference between them.[5] While, with respect to the first issue, both parties made reference to **1-7**

4. See Art. 18(1) CISG (⊘), stating that a 'conduct of the offeree indicating assent to an offer is an acceptance'.
5. See generally Kröll and Hennecke, *RIW* (2001), 736.

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pre-formulated terms, which they generally used in all their export/import-contracts, the second issue involves a term which was drafted specifically for the contract between NedTrans and ALT. This is reflected by the fact that the penalty clause was not contained in NedTrans' Import Conditions, but in its fax of 6 March. To ensure a better understanding of this relationship, these issues will be discussed separately.

1. *The Standard Forms Problem*

1-8 The first issue, namely the respective references to different and potentially conflicting standard terms by both parties, is typical for domestic as well as international B2B contracts. In fact, it is fair to assume that this issue arises in a large number of cases since many, if not most, contracts concluded in international business are based in whole or in part on standard terms.[6] Usually, however, this does not prevent the conclusion of the contract. Rather, the issue here is, which of the clauses contained in the two sets of standard forms becomes part of the contract ('battle of forms').[7] In our case, the question of the 'battle of forms' is relevant for the determination of the validity of the arbitration agreement as the basis of the arbitral tribunal's jurisdiction. It will be dealt with in the 7th Scenario (No. 20-64). However, it does not affect the conclusion of the contract.

2. *The Penalty Clause*

1-9 The situation is different with respect to the second issue. The penalty clause was not contained in NedTrans' standard forms. Instead, it was included in NedTrans' fax of 6 March 1997, in the form of a separate contractual clause. The inclusion of a new contractual term in a message that is supposed to constitute an acceptance of an offer bears directly on the question as to whether a contract was concluded between the parties. It is generally accepted in many domestic legal systems, and also in international contract law, that a reply to an offer which purports to be an acceptance but contains additions, limitations or modifications is a rejection of the offer and constitutes a counter-offer.[8]

1-10 This rule is reasonable in the way that it protects the offeror against contractual clauses to which he has not agreed. A provision such as Art. 19(3) CISG (🔗) reflects the general consensus that contractual clauses, such as the penalty clause included in NedTrans' fax of 6 March 1997, which relate to the extent of one party's liability to the other, convert the communication intending to be an acceptance into a

6. See Collins, *Regulatory Competition in International Trade: Transnational Regulation through Standard Form Contracts*, in: Eidenmüller (ed.), Regulatory Competition in Contract Law and Dispute Resolution, 2013, pp. 121, 122 *et seq.*
7. See generally del Pilar Perales Viscasillas, *Pace Int'l L. Rev.* (1998), 97, 106 *et seq.*; Kröll and Hennecke, *ibid.*, 737 *et seq.*; Schlechtriem, *Kollidierende Geschäftsbedingungen*, 36, 38 *et seq.*
8. Art. 2.11(1) UNIDROIT Principles of International Commercial Contracts (🔗 Art. 19(1) CISG (🔗)); s. 2:208(1) Lando Principles; s. 150(2) German Civil Code (*Bürgerliches Gesetzbuch*); see generally del Pilar Perales Viscasillas, in CENTRAL (ed.), *supra* note 3, 106.

counter-offer. In such a case, one has to examine the chronological order of events (🔗) and look for an acceptance of that counter-offer by ALT, in order to ascertain that a contractual consensus was reached. After 6 March 1997, there was no express consent to NedTrans' counter-offer by ALT, since the management at ALT was not even aware of the fact that its offer of 3 March was not validly accepted by NedTrans on 6 March. This is a typical scenario in B2B transactions. Very often, the parties do not notice these inconsistencies, and commence performance of the contract.[9]

1-11 This does not mean, however, that no contract is concluded between the parties in such cases. It was not necessary for ALT to give its consent in express terms. Typically, the other party's performance of the contract can be regarded as an expression of assent to the counter-offer.[10] In our case, ALT commenced production of the AX-100 Special ordered by NedTrans after receipt of NedTrans' message of 6 March. This must be regarded as consent to NedTrans' counter-offer of 6 March.

3. *The Connection between Standard Forms and Penalty Clause*

1-12 There is an important link between the issue of the inclusion of standard terms outlined above (No. 1-8) and the introduction of the penalty clause into the contract through NedTrans' message of 6 March (No. 1-9). If NedTrans' 6 March fax to ALT constituted a counter-offer, then ALT's fax to NedTrans of 3 March, which introduced the ECE General Conditions, has no legal effect. This does not mean, however, that these standard terms are to be disregarded in our case. In their telephone conversation of 20 January 1998, Mr Bakker clearly indicated to Mr Stutz that, whilst he 'accepted in principle the application of the ECE Conditions', he could not agree with Mr Stutz' view that the non-delivery by its South Korean supplier constituted a ground of *force majeure* (Case Study No. 2-8). This will be dealt with in more detail in 24th Scenario (No. 24-44).

If a contract has been concluded by exchange of (fax, phone, EDI or hardcopy) messages, legal analysis of contract conclusion has to follow the ***chronological order of events****. Standard forms introduced by both parties raise the problem of* ***'battle of forms'****. Special contract clauses introduced by one party may convert its acceptance into a* ***counter-offer*** *which requires acceptance by the other side.* ***Performance*** *by that party is usually an expression of assent to the counter-offer.*

9. Macaulay, Kidwell, Whiteford, Galanter, *Contracts*, 764.
10. See, *e.g.* s. 2-207(3) American Uniform Commercial Code, which states that '[c]onduct by both parties which recognizes the existence of a contract is sufficient to establish a contract for sale although the writings of the parties do not otherwise establish a contract'; see also Art. 18(1) 1st sentence CISG (🔗) stating that 'a statement made by or other conduct of the offeree indicating assent to an offer is an acceptance'.

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Question 2: Confirmations of Order

ALT's fax message to NedTrans of 3 March 1997 is entitled 'Confirmation of Order'. What is the function of a confirmation of order?

A. Significance of Seller's 'Confirmation of Order'

1-13 Very often, a 'Confirmation of Order' or 'Acknowledgement of Order' is used by parties intending to conclude a commercial contract. The legal effect of such an order depends on the circumstances under which the contract is negotiated.

1. Confirmation of Order as Binding Offer

1-14 If the seller's initial quotation is a mere *invitatio ad offerendum* (No. 1-3), the seller's confirmation of order sent as a response to the buyer's order (offer) constitutes an acceptance and brings about the contractual agreement between the parties.

2. Confirmation of Order as Writing in Confirmation

1-15 If, however, the seller's initial quotation can be qualified as a binding offer (No. 1-5), the contract is concluded by the buyer's order, which constitutes an acceptance of the seller's offer. In this case, the seller's subsequent confirmation of order does not bring about the contractual agreement between the parties. However, it may have the effect of varying the contents of the parties' contractual agreement if it falls under a relevant category such as *Kaufmännisches Bestätigungsschreiben* in German and Swiss commercial law,[11] *Orderbevestiging* in Dutch law, *lettre de confirmation* in French law,[12] written confirmations pursuant to § 2-207 of the American UCC, or similar concepts of writings in confirmation[13] of other legal systems which apply to the contract.

B. Significance for the ALT/NedTrans Contract

1-16 In our case, ALT's fax of 3 March which constituted a binding offer (No. 1-5), was entitled 'Confirmation of Order'. This was done perhaps because of Mr Bakker's

11. Esser, *Ga. J. Int'l & Comp. L.* (1988), 427 *et seq.*
12. Cass. Com., 13 March 2003, n° 00-21.555, Bull. civ. IV, n° 82; Cass. 2e civ., 6 July 1966, Bull. civ. II, n° 737; Chauvel, *Répertoire de Droit Civil*, Consentement, No. 203, 206.
13. See Art. 2.12 UNIDROIT Principles of International Commercial Contracts (🔗): 'If a writing which is sent within a reasonable time after the conclusion of the contract and which purports to be a confirmation of the contract contains additional or different terms, such terms become part of the contract, unless they materially alter the contract or the recipient, without undue delay, objects to the discrepancy.'; see generally Bonell, *An International Restatement of Contract Law*, 105 *et seq.*

previous telephone inquiry or simply due to standard commercial practice, without having any particular legal significance.

Regardless of the legal effect of the order, the confirmation of order is usually made in various copies. These copies are intended to control the sales transaction within the seller's company. Some copies go to the seller's production and/or shipping department. Some go to the financial department so that the buyer will be billed on the basis of the price and payment terms contained in the confirmation of order.[14] **1-17**

> *A 'Confirmation of Order' has* ***many functions*** *in commercial practice. Lawyers must never accept the term that the parties have given a certain message at face value. Instead, they always have to look behind the wording of the message in order to ascertain its* ***true legal meaning****.*

Question 3: Efficiency and Speed in International Contract Drafting

How did the parties manage to keep their faxes so brief even though they have concluded a deal worth over USD 2 million?

A. Reference to Pre-formulated Texts

If the parties negotiate and conclude their contract in the way ALT and NedTrans have done in our case (Case Study No. 1-3), they are usually not interested in making their telephone, fax or EDI messages very long. The need for speed, resulting in more efficiency and economy in contract drafting, has always dominated international commercial transactions. **1-18**

1. Reference to Standard Terms

To achieve this efficiency and speed, ALT and NedTrans have followed standard commercial practice. In their respective faxes to the other side, they have made reference to different sets of standard terms. In commercial practice, standard terms are either formulated by one of the parties or, more frequently, by an international 'formulating agency' or trade association to which the party using the conditions belongs. **1-19**

In our case, the Swiss exporter, ALT, made reference to the 'ECE General Conditions for the Supply of Plant and Machinery for Export' in its offer of 3 March 1997 (🔗). This set of standard terms was prepared as early as 1953 by the Economic **1-20**

14. Macaulay, Kidwell, Whiteford, Galanter, *Contracts*, 767.

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Commission for Europe of the United Nations.[15] Since these conditions were formulated for the European exporters' trade, the ECE Conditions reflect a natural predisposition towards the exporting party. While the ECE Conditions might seem rather old and outdated at first sight, they are still being used by European exporters. The Annex of the ECE Conditions allows the parties to adapt them to the particulars of their transaction. Sometimes, the ECE Conditions are used together with a special Annex, which is prepared by the machine exporters' federation of the home country of that particular exporter. An example is the 'Annex attached to the General Conditions for the Supply of Plant and Machinery for Export by the German Metal-Working Industry' of July 1993 which supplies the figures provided for in the Appendix ('To be Completed by the Parties to the Contract') at the end of the ECE Conditions, 'as well as other supplementary stipulations between the Parties to the Contract'.

1-21 The Dutch importer, NedTrans, in its fax message to ALT of 6 March 1997, made reference to its own Import Conditions (⊘). It is obvious that these terms favour the position of the importer. Thus, No. 7 of NedTrans' Import Conditions contains detailed warranties relating to the quality of the goods. The ECE Conditions contain no such clauses on warranties. Instead, No. 10, in connection with No. 7.2 ECE Conditions, provides broad grounds for excusing the exporters' late or non-delivery.

2. Reference to INCOTERMS

1-22 In its fax of 3 March 1997, ALT used another way to achieve efficiency and speed in contract negotiations. With respect to the shipment of the sold goods, the message made reference to 'EXW Zurich'. Again, this reference to special trade terms, the meaning of which is well-known to all participants in the trade concerned, is part of standard practice in international trade. The most popular example of such terms are the INCOTERMS published by the International Chamber of Commerce (ICC) in Paris.[16] These three-letter terms, such as 'CIF', 'FOB' or 'FAS', provide an international code for the passing of the risk of loss and the responsibility for transport and insurance of the goods sold.[17] Instead of including lengthy clauses in their contract documents, the parties simply refer to the INCOTERMS and assume that the other party is aware of the meaning of the respective clause used. The meaning of these clauses can be regarded as forming part of the general trade usages which 'the parties

15. See United Nations Economic Commission for Europe Homepage www.unece.org.
16. ICC (ed.), INCOTERMS 2010: ICC Rules for the Use of Domestic and International Trade Terms, 2010, ICC Publication No. 715; see generally Ramberg, *ICC Guide to INCOTERMS 2010*, ICC Publication No. 720E; Ramberg, *Penn State International Law Rev* (2011), 415 *et seq.*; von Bernstorff, *Incoterms 2010 der internationalen Handelskammer (ICC)*; von Bernstorff, *RIW* (2010), 672 *et seq.*; see generally Morrissey and Graves, *International Sales Law and Arbitration*, 148 *et seq.*
17. 'CIF' means 'Cost, Insurance and Freight'; 'FOB' means 'Free On Board'; 'FAS' means 'Free Alongside Ship'; see generally Bredow and Seiffert, *ibid.*, 26 *et seq.*; Gabriel, *VJ* (2001), 41 *et seq.*; Nienaber, *ibid.*, 138 *et seq.*

know or ought to have known' (Art. 9 CISG,).[18] By determining the liability for the transportation costs, the INCOTERMS also form part of the price terms of the contract.

'EXW' means 'Ex Works'. It is the most exporter-friendly clause of the INCOTERMS, **1-23** in that it represents the minimum obligation for the seller and the maximum obligation for the buyer. Under the 'EXW' clause, ALT fulfils its obligation when it makes the AX-100 Special available at its factory or at another named place. The importer, here NedTrans, bears all the costs and risks involved in taking the goods from ALT's factory in Zurich to the desired destination in The Hague.

B. Increased Risks through Multiple Contract Documents

The consequence of this way of concluding international contracts is that the **1-24** contents of the contract are not contained in only one contract document, but in various ones: ALT's fax of 3 March, NedTrans' fax of 6 March, the ECE Conditions as ALT's Standard Terms and NedTrans' Import Conditions. The high number of contract documents increases the risk of contradictions and uncertainties with regard to the rules and provisions to which the parties have referred. Due to the different interests represented by export and import conditions, the parties' reference to different sets of standard terms almost always involves the problem of the 'battle of forms' described above (No. 1-8). In the event of a dispute, the judge or arbitrator has to determine, first, whether the standard terms have become part of the contract, and secondly, in the case of conflicting clauses that are relevant for the dispute at hand, which clause prevails or whether the conflicting clauses are superseded by the rules of the applicable domestic law. In our case, this may become relevant for the arbitration clauses contained in No. 10 of NedTrans' Import Conditions and No. 13.1 ECE Conditions used by ALT (No. 20-67).

> *To achieve* ***efficiency of contract drafting****, standard terms and general trade terms, such as the* ***INCOTERMS*** *published by the International Chamber of Commerce (ICC), are regularly used in international commerce. While the former provokes the problem of the 'battle of forms' because different sets of standard terms are frequently used by both sides, the latter requires a* ***sound knowledge*** *of their precise meaning, which relates to the passing of risk and the costs of transport and insurance.*

18. See Berger, *The Creeping Codification of the Lex Mercatoria*, 199, 210.

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4th Scenario*

The Negotiations in The Hague: Morning Session

ISSUES COVERED

Question 1: A Basic Understanding of Negotiations

Negotiations as a Qualified Communication Process – Verbal and Non-Verbal Communication – 'Communication Dance'– Possible Contexts of Negotiations – Strategy and Tactics – Skills and Styles – Negotiation Theory

Question 2: Negotiation Theory

Negotiation Theories – Distributive Negotiations – Integrative Negotiations – Loss Aversion – Zero-Sum Thinking – Fixed-Pie Bias – Win/Win and Win/Lose Tactics – Soft and Hard Positional Bargainers – Creativity Techniques – 'Expanding the Pie' – Harvard Negotiation Project – Principled Negotiations

Question 3: The Lawyer's Pathological Perspective

Lawyers' Perspective of Disputes – Court Decision as 'Win/Lose' Ruling – Lawyers' Preference for Adversarial Model – Zero-Sum Thinking

Question 4: The Managers' Negotiation Tactics

Hard Positional Bargainer – Breaking Rapport – 'Hierarchy Game' – 'Stonewalling' – No-Negotiation Style – Use of Bluffs and Threats – 'Take-It-or-Leave-It Offer' – 'Tit-for-Tat Tactics' – Breakthrough Negotiation Strategy – 'Stepping onto the Balcony' – Use of Apologies – Personalizing the Bargaining Situation – Reframing

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* For the Facts of this Scenario please refer to the Case Study.

Question 5: Lawyers' Participation in Negotiations

Legal Know-How During Negotiations – Negotiation Table as 'Quasi-Courtroom' – Lawyers and Threat Potential – Lawyers' Adversarial Approach to Negotiations

ANSWERS

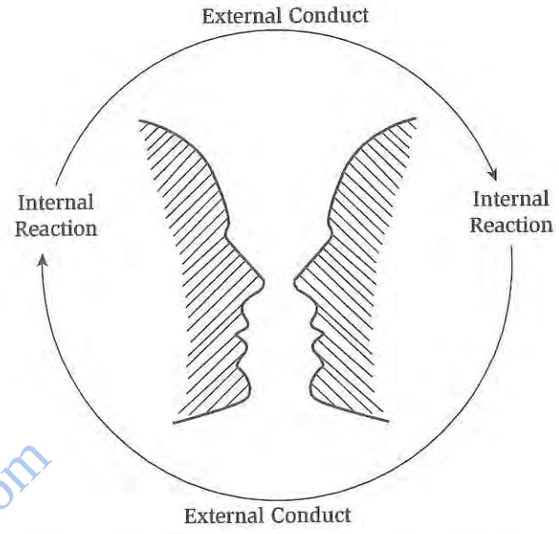
Question 1: A Basic Understanding of Negotiations

Look at the way Mr Bakker and Mr Stutz are discussing the dispute between their companies. Can you provide a definition of what 'negotiation' means? Try to single out its most essential elements.

A. The Meaning of 'Negotiations': A Qualified Communication Process

4-1 Negotiations are just as ubiquitous as the conflicts (No. 2-3) they are trying to resolve. The most common mistake of ineffective negotiators is a one-size-fits-all approach.[1] It is therefore extremely difficult to provide a generally acceptable and broad enough definition of the negotiation process. When we look at the discussion between Mr Stutz and Mr Bakker in The Hague on 28 February (Case Study No. 4-2), we realize that both men have entered into an intense communication process. Communication is a complex process. It consists of verbal and non-verbal[2] signals. Even if we do not speak, we communicate. It is therefore impossible *not* to communicate. Also, communication creates facts, *i.e.* a reaction by the other side. This means that a communication process is not static but dynamic. It is not one-sided but takes place between two or more people. Thus, a communication process is a cycle, a 'loop' or a 'communication dance' involving at least two persons. One person takes note of another person's (verbal and/or or non-verbal) conduct, reacts to it with his/her own thoughts and feelings and shows a corresponding verbal and/or non-verbal conduct *vis-à-vis* the other person. This indices in that person certain thoughts and feelings which in turn trigger a certain conduct, and so on.

1. Watkins, *Shaping the Game*, 15: 'In doing this, they exemplify the old adage: "To a person with a hammer, everything looks like a nail."'
2. Typically, non-verbal communication is effected through body language, *i.e.* posture, gestures, facial expression and eye contact.



O'Connor and Seymour, *Neurolinguistisches Programmieren: Gelungene Kommunikation und persönliche Entfaltung*, 44.

4-2 Efficient communicators act according to the principle: 'The significance of a message is revealed by the reaction which one receives'.[3]

4-3 Negotiation is a qualified communication process. It may be defined, in a nutshell, as 'communication for the purpose of persuasion'[4] or as 'a process of communicating back and forth for the purpose of reaching a joint decision'.[5] Since someone only needs to be persuaded to reach a decision if he has a different view than his opponent, negotiation can also be circumscribed as communication for the purpose of reconciling competing interests or as a way to 'communicate or confer with another so as to arrive at the settlement of some matter'.[6]

4-4 But more is involved in negotiations than just communication, *i.e.* the exchange of statements, views, or opinions. In negotiations, communication is not an end in itself. When we take a closer look at the discussions between Mr Bakker and Mr Stutz, we can observe that both men have reached a prior agreement to negotiate the dispute. We also observe that each side wants something from the other: Mr Bakker demands delivery of the AX-100 Special, while Mr Stutz tries to convince Mr Bakker

3. O'Connor and Seymour, *Neurolinguistisches Programmieren: Gelungene Kommunikation und persönliche Entfaltung*, 46.
4. Goldberg, Sander, Rogers, Cole, *Dispute Resolution*, 17.
5. Fisher, Ury, Patton, *Getting to Yes*, 32; Bühring-Uhle, Kirchhoff, Scherer, *Arbitration and Mediation in International Business*, 136; O'Connor and Seymour, *supra* note 3, 256.
6. Garner (ed.), *Black's Law Dictionary*, definition of 'Negotiate'.

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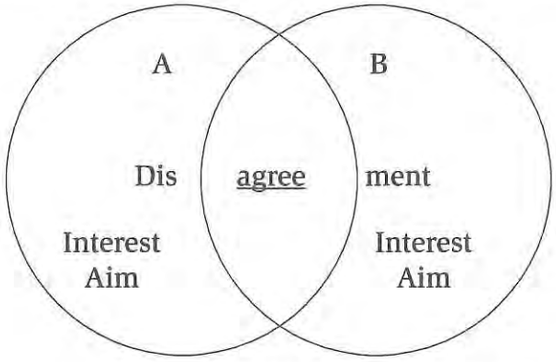

O'Connor and Seymour, *Neurolinguistisches Programmieren: Gelungene Kommunikation und persönliche Entfaltung*, 257.

to agree to a price increase. Moreover, the communication process between both men is related to the contract, *i.e.* to a business transaction that both companies concluded in March 1997. Based on these observations, and focusing on the function of the process, negotiation may be described as:

> 'a [voluntary communication] process whereby two or more parties seek an agreement to establish what each shall give or take, or perform and receive in a transaction between them'.[7]

4-5 In short, negotiation is a two- or multi-party communication process, by which two or more persons seek to advance their individual interests through joint action.[8] Negotiation is thus the basic form of all non-adjudicatory dispute resolution processes. This is why many regard negotiations as being outside the realm of ADR.

B. The Significance of the 'Environment'

4-6 There is a basic problem with all these definitions. They provide a rough idea of what this process is about, but they say nothing about the different contexts in which negotiations are conducted. The contexts are extremely varied, but they also have a considerable influence on the negotiation process. They range from private family life, such as communications between parents and their children, or between you as a private consumer and a seller from whom you have purchased a defective good, to serious foreign policy negotiations, such as the Middle East talks between President Carter, President Sadat and Prime Minister Begin in September 1978,[9] the famous 'round tables' in Poland and the former German Democratic Republic, or the

7. Saner, *The Expert Negotiator*, 15.
8. Salacuse, *The Global Negotiator*, 7.
9. See Carter, *Keeping Faith: Memoirs of a President*, 5 *et seq.*

negotiations concerning the former Yugoslavia or the talks between the two presidential candidates after the problematic presidential elections in the Ukraine in November 2004. Think about these different settings and you will quickly understand how the negotiation 'environment' affects the approach and style of the negotiators.

C. Three Essential Issues: Strategy, Psychology, Skills

The above definitions also say nothing about the three core problems, with which modern negotiation theory is mostly concerned: **4-7**

1. strategy and tactics;
2. psychology;
3. skills and styles.

Strategy and tactics both relate to the efficient planning of the negotiations and to the negotiation process itself. The choice of the right negotiation strategy serves to implement the objectives a party wants to achieve in the negotiations, which are based on an analysis of the reasons for the dispute and a definition of its needs. This choice depends primarily on the following factors: **4-8**

1. the power balance between the participants;
2. the importance of the negotiations for the party and the other side;
3. the level of information the party has;
4. the 'human factor' underlying the dispute, including the relationship the party has with the other side (friends, adversaries, strangers);
5. the shared interests (if any) that unite the party with the other side;
6. the negotiation theory followed by the party and the other side.[10]

The tactics are the weapons of negotiation.[11] They are the means by which a party pursues its chosen strategy.[12] We have seen already that some of these tactics, such as being in control of the choice of the location (No. 3-1) or of the agenda (No. 3-7), relate to the pre-negotiation phase and thus form an essential part of the planning stage. Others, with which we will deal when we observe Mr Stutz' and Mr Bakker's conduct and behaviour more closely, relate to the actual negotiation stage, the moment of truth when the parties sit at the negotiation table. Psychological aspects can have a substantial influence on the negotiation process. They relate both to the psychological make-up of the negotiators, including individual personality traits (self-esteem, personal drive, risk-taking propensities, aggressiveness, tolerance for ambiguity and confrontation and ethical flexibility), and to the emotions and **4-9**

10. Saner, *supra* note 7, 30; Brown and Marriott, *ADR Principles and Practice*, No. 4-066.
11. See generally Meltsner and Schrag, *Clearinghouse Review* (1973), 259 *et seq.*
12. Rubin, Pruitt, Kim, *Social Conflict: Escalation, Stalemate and Settlement*, 4.

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undercurrents affecting the particular issues that are at stake.[13] In fact, these psychological factors are the reason why the negotiations between Mr Bakker and Mr Stutz fail (No. 5-20). Negotiation skills and styles relate to the ability of a negotiator to present himself. They generally depend upon individual personality and attributes, such as personal authority, humour, flair and demeanour.[14] Look at the videos on the USB and try to find out for yourself how, in your view, the skills and styles of Mr Bakker and Mr Stutz affect their position in the negotiations. Whom would you trust more? Whom do you consider to be more powerful and convincing?

Negotiation is a qualified ***communication process****. It can be circumscribed as a voluntary communication process whereby two or more parties seek an agreement to establish what each shall give or take, or perform and receive in a transaction between them. Modern negotiation theory is mostly concerned* ***with strategy and tactics, psychology*** *the negotiation process,* ***skills and styles****.*

Question 2: Negotiation Theory

How would you characterize the negotiation styles of Mr Bakker and Mr Stutz? Can you think of other styles?

A. 'Distributive' vs 'Integrative' Negotiations

4-10 While the issues mentioned so far relate to the subjective side of every negotiation and negotiator, negotiation theory describes the objective principles inherent in any particular way of negotiation. Although abundant literature has been produced on this subject in the past decades, the virtually limitless variety of negotiation theories can be divided into two major groups: the 'distributive', 'competitive', 'positional' or 'share bargaining' approach on one side, and the 'integrative' or 'problem-solving' approach on the other.[15]

1. Distributive ('Positional' or 'Competitive') Bargaining

4-11 In the 'distributive' approach to negotiations, the parties regard themselves as adversaries. They assume that they are negotiating over the distribution of a rare and fixed good. The parties regard their negotiations as a contest, in which one party

13. Brown and Marriott, *supra* note 10, No. 4-085.
14. Brown and Marriott, *supra* note 10, No. 4-064.
15. See Bühring-Uhle, Kirchhoff, Scherer, *Arbitration and Mediation in International Business*, 138 ('One of the most important findings of negotiation theory').

wins and the other loses. Therefore, each party pursues its own interest(s) and tries to achieve maximum gain,[16] always at the expense of the other. Very often, parties use distributive bargaining techniques intuitively in order to pursue their own interests at the expense of the other side. The reasons for this intuitive bargaining behaviour are the phenomena of 'selective attention' and 'judgmental overconfidence', which parties assume once a conflict has arisen and which make them paint a 'black and white' picture of the dispute, where they represent the 'good guy' and the other side is 'bad' (No. 2-21). This approach causes parties to lose sight of the interests underlying their respective positions.[17] A party's position in negotiations is also frequently influenced by the intuitive fear of losing a good it possesses, which makes it demand extra compensation to overcome what it perceives as a loss ('loss aversion').[18]

4-12 Negotiations conducted by distributive parties are characterized by a 'fixed-pie bias':[19] each party pursues the goal of claiming value ('dividing the pie').[20] In game theory such an arrangement is called a 'zero-sum game' or 'fixed-sum game', because losses and gains always cancel one another out ('one for me is minus one for you'), *i.e.* they add up to zero.[21] Typically, the negotiators start with extreme positions and make small, infrequent and declining concessions (No. 5-8). The parties' struggle to slice up the pie, *i.e.* the distribution of bargaining power (No. 3-19) between them, is largely determined by the power parity. Frequently, parties tend to adopt 'zero-sum thinking' because they think that they can only win at the expense of the other side. This is one potential reason for the escalation of conflicts (No. 2-17).

4-13 Because of its competitive character, which emphasizes the goal of victory, the distributive approach tends to create a hostile and confrontational atmosphere between the parties. The parties' desire to hide information, while at the same time getting as much information as possible from the other side (*e.g.* about the other side's 'walk-away price', No. 3-15) through the use of negotiation tactics has lead some to characterize the distributive approach to negotiations as 'informational bargaining'.[22] Due to the prevalence of these techniques, business life has been characterized as 'war'.[23] The parties tend to focus more on manipulation, manoeuvring, fooling, bluffing, commitment tactics and threats *vis-à-vis* the other side, than on trying to understand the issues and interests of the other side sufficiently to find a mutually acceptable solution:

16. See Haft, in Haft and von Schlieffen (eds), *Handbuch Mediation*, §2, No. 17: 'Positions are nothing but wishful thinking for the future' (translation by the author); Frenkel and Stark, *The Practice of Mediation*, 27 *et seq.*
17. See Duve, Eidenmüller, Hacke (eds), *Mediation in der Wirtschaft*, 43 *et seq.*
18. Rau, Sherman, Peppet, *Processes of Dispute Resolution*, 169 referring to the 'endowment effect' which leads people to overvalue items they own as compared to items they don't.
19. Birke and Fox, *Harvard Neg. L. Rev.* (1999), 1, 49.
20. Bühring-Uhle, Kirchhoff, Scherer, *supra* note 15, 139.
21. See Binmore, *Fun and Games*, 237.
22. Frenkel and Stark, *supra* note 16, 29 *et seq.*
23. See Duve, Eidenmüller, Hacke (eds), *supra* note 17, 49 ('business is war').

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> 'When two Win/Lose people get together – that is, when two determined, stubborn, ego-invested individualists interact – the result will be Lose/Lose. Both will lose. Both will become vindictive and want to "get back" or "get even," blind for the fact that murder is suicide, that revenge is a two-edged sword.'[24]

4-14 Moreover, a competitive negotiator expects similar behaviour from his opponent and therefore mistrusts him. The absence of transparency as to the interests and goals of the parties might create the appearance that the parties are farther apart than they really are. Parties who have not enjoyed training in negotiations usually adopt this approach intuitively. It does not require much intellectual effort, and each party has a chance to maximize the gain it intends to derive out of the negotiations. However, there is also the risk that a party is confronted with a better competitive negotiator.

4-15 The following are some of the tactics used in distributive negotiations to pressure one's opponent to submit:

- Take-it-or-leave-it offers (No. 4-30).
- Exaggerated first offer, followed by small, slow concessions (No. 5-4).
- Requiring the other side to make the first offer (No. 5-3).
- Limited disclosure of information regarding facts and one's own preferences (No. 3-9).
- Delays (No. 4-29).
- Bluffing and lying (No. 4-30).
- Personal insults.
- Threats (No. 4-32).
- Belittling the other side's alternatives.
- Making false concessions to coax someone into reciprocating.
- Drawing artificial bottom lines.
- Playing good guy/bad guy (No. 5-11).
- False authority limits (No. 13-2).[25]

4-16 Because they are caught up in a tension of hostility and in taking positions that do not allow them to communicate with or trust one another easily, the parties 'leave value on the table' by settling on less than optimal solutions.[26] They tend to focus more on differences, *i.e.* their respective positions, rather than on connections or common interests and values. The problems connected with this approach to negotiation are best exemplified by contrasting the styles of a 'soft' and a 'hard' positional bargainer:

24. Covey, *The 7 Habits of Highly Effective People*, 210: Covey defines 'Win/Lose people' as people who 'are prone to use position, power, credentials, possessions, or personality to get their way', *ibid.*, 207.
25. See Mnookin, Peppet, Tulumello, *Beyond Winning: Negotiating to Create Value in Deals and Disputes*, 24 *et seq.*; Volkema, *The Negotiation Toolkit*, 78 *et seq.*; Gifford, *Ohio St. L. J.* (1985), 41, 49; Waddell, *Dispute Resolution: A Survey*, 81; Katz, *Principles of Negotiating International Business*, 111 *et seq.*
26. See Raiffa, *Negotiation Analysis: The Science and Art of Collaborative Decision Making*, 139 *et seq.*

Positional Bargaining: Which Game Should You Play?

Soft	*Hard*
Participants are friends	Participants are adversaries
The goal is agreement	The goal is victory
Make concessions to cultivate the relationship	Demand concessions as a condition of the relationship
Be soft on the people and the problem	Be hard on the problem and the people
Trust others	Distrust others
Change your position easily	Dig in to your position
Make offers	Make threats
Disclose your bottom line	Mislead as to your bottom line
Accept one-sided losses to reach agreement	Demand one-sided gains as the price of agreement
Search for the single answer: the one *they* will accept	Search for the single answer: the one *you* will accept
Insist on agreement	Insist on your position
Try to avoid a contest of will	Try to win a contest of will
Yield to pressure	Apply pressure

Reproduced from Fisher, Ury, Patton, *Getting to Yes*, 9.

4-17 The chart shows two things. First, a competitive negotiator can reach his goals through hard or soft negotiation techniques. Secondly, while both approaches are used to achieve the same goal, *i.e.* to 'win' the negotiation battle, they are inherently different in nature. 'Hard' distributive negotiations are characterized by a lack of mutual trust, even though such trust would have enabled the parties to work towards achieving mutual gains. The negotiator's dilemma (No. 3-17) leads parties to adopt 'hard' instead of 'soft' positional bargaining strategies. The reason why 'soft' strategies are not adopted is that every side fears that it might 'lose the contest'.[27]

4-18 The problem with this distributive negotiation theory is that the parties only very rarely end up with an optimal, interest-oriented resolution of their dispute. The distributive approach is built on the 'judgmental overconfidence' of the parties, which stands in the way of a more creative and cooperative dispute resolution process (No. 2-20). In addition, the all-or-nothing attitude of the parties puts a considerable burden on their business relationship and makes non-settlement more likely:

27. Brown and Marriott, *ADR Principles and Practice*, Nos 4-029, 4-032.

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'competitive/adversarial advocates generate far more nonsettlements than their cooperative/problem solving cohorts. The extreme positions taken by competitive/adversarial bargainers and their frequent use of manipulative and disruptive tactics make it easier for their opponents to accept the consequences associated with nonsettlements.'[28]

2. *Integrative Bargaining*

4-19 In an 'integrative' negotiation approach there are no losers. Because they produce the highest joint outcome for both sides, these types of problem-solving approaches are regarded as the most desirable by conflict researchers.[29] In this scenario, the negotiators look beyond the aspirations and positions stated by the parties and try to figure out, assess and reconcile their underlying needs or preferences in order to reach an amicable settlement. If one negotiates with a counterpart that uses an integrative, cooperative negotiation style, one can expect the other side to:

- begin with realistic opening positions;
- try to maximize the disclosure of information;
- rely on objective criteria to guide the discussions and seek to reason with the other side;
- rarely resort to threats;
- seek to maximize the joint returns of both sides.[30]

4-20 By enhancing disclosure of information and using various creativity techniques, the parties transform ('integrate') the issues and interests that are involved in the dispute into negotiable packages. This enables them to develop 'win/win' solutions by creating new values in an integrative bargaining process through reciprocal give and take, instead of simply distributing the existing values between the parties.[31] To be able to find the trades, it is essential for each party not only to know its own interests, preferences and priorities, but also to try to estimate the other side's (No. 3-9). In fact, information sharing is at the heart of the problem-solving approach to negotiation, and increased information exchange leads to improved negotiation performance.[32] This can be done through brainstorming techniques (No. 12-11) or by asking questions instead of maintaining one's position:

'So, one should always ask the journalist's basic questions of every matter: 1) *What* (What is at stake? What is the "res" of the dispute? Can it be changed, expanded or traded?); 2) *When* (Must one resolve this now? Are instalments

28. Craver, *Effective Legal Negotiation and Settlement*, §2.02[2][b].
29. Rubin, Pruitt, Kim, *Social Conflict: Escalation, Stalemate and Settlement*, 171 *et seq.*
30. Craver, *The Intelligent Negotiator*, 7; Frenkel and Stark, *supra* note 16, 34 *et seq.*
31. Saner, *The Expert Negotiator*, 79 *et seq.*
32. Rau, Sherman, Peppet, *supra* note 18, 131; Thompson, Peterson, Brodt, *Journal of Personality and Social Psychology* (1996), 66 *et seq.*

possible? Are there any tax consequences or contingency arrangements? What risk allocation and sharing is involved?); 3) *Where* (Where can something be moved or transferred? Can a change or forum or process be affected?); 4) *Who* (Who are all the relevant parties here? Can one add some people or entities with resources and the power to do things?); 5) *How* (What means may be used to solve the problem: money, land or an apology?); and finally [and most important!] 6) *Why* (Why are the parties here? What are the underlying reasons, motivations or interests in this matter? Can one reconstruct the reasons for being here and look for new ways to resolve the issues?)'[33]

Through this value-creating negotiation techniques, the parties 'expand the pie' instead of just 'slicing it up' by creating more imaginative, 'synergized' solutions.[34] **4-21**

There is also an important aspect at the interpersonal level connected with this approach. Skilled negotiators using integrative bargaining techniques realize that people tend to work most diligently to satisfy the needs of opponents they like personally (No. 2-29). Overtly competitive negotiators are rarely perceived as likable, while integrative bargainers appear to be seeking results that benefit both sides.[35] **4-22**

It must be noted that this integrative technique works only with those disputes that have a number of issues to be integrated. The more issues there are, the greater is the chance for integration. Furthermore, it must be stressed that a party who tries to negotiate in an integrative manner may find itself in the 'negotiator's dilemma' (No. 3-17), which prevents it from sharing the information needed to detect trades and expand the pie. **4-23**

3. *'Principled Negotiations'*

At the Programme on Negotiation at Harvard Law School,[36] a special integrative negotiation method was developed in the early 1980s. It is called 'Principled Negotiation', or 'Negotiation on the Merits', and is based on the following four basic guidelines: **4-24**

33. Menkel-Meadow, *Hofstra L. Rev.* (2000), 905, 915 *et seq.* (emphasis and underlining added); see also Fisher, Ury, Patton, *Getting to Yes*, 44 *et seq.*; Rubin, Pruitt, Kim, *supra* note 29, 182 *et seq.*
34. The standard example for this technique is the proverbial quarrel between two children over an orange. In a distributive bargaining context, one child would get the orange, the other child would get nothing ('win/lose'). An integrative negotiator would ask why the children want to have the orange. The child who wants the fruit to make orange juice would then get the fruit while the other child would get the peel to use it for baking a cake ('win/win'), see Rubin, Pruitt, Kim, *supra* note 29, 171; Fisher, Ury, Patton, *ibid.*, 57: 'Too many negotiations end up with half an orange for each side instead of the whole fruit for one and the whole peel for the other'.
35. See Craver, *supra* note 28, §2.02[2][d].
36. See for more information on this programme www.pon.harvard.edu.

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16th Scenario*

The Commencement of the Arbitration

ISSUES COVERED

Question 1: Conflicting Arbitration Clauses

Drafting of Dispute Resolution Clauses – Drafting Negligence – Pathological Arbitration Clause

Question 2: The Nature and History of Arbitration

Definition of Arbitration – Nature of Arbitration – History of Arbitration – Advantages of Arbitration – Arbitration Agreement – Consensual Character of Arbitration – Rights vs Interest Arbitration – Dispute as Prerequisite for Arbitration – Gap Filling and Adaptation through Arbitration – The Primacy of Party Autonomy – Judicial Character of Arbitration – Arbitral Due Process – Effects of Arbitral Award – Judicialization of Arbitration – Challenges for Arbitration

Question 3: Use, Benefits and Dangers of Best Practices

Meaning of 'Best Practices' – IBA Rules on the Taking of Evidence – IBA Guidelines on Conflict of Interest – Non-Statutory Nature of Best Practices – Best Practices and Arbitral Discretion – Advantages and Disadvantages of Best Practices

Question 4: 'Ad Hoc' versus 'Institutional' Arbitration

'Ad Hoc' Arbitration – Institutional Arbitration – German Institution of Arbitration (DIS) – DIS Arbitration Rules – Fast-Track Arbitration – DIS Supplementary Rules for Expedited Proceedings

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* For the Facts of this Scenario please refer to the Case Study.

Question 5: Laws, Rules, and Procedural Discretion

Hierarchy of Rules – The Proactive Arbitrator – Judge-Like Approach to the Conduct of an Arbitration – Party Agreements on Procedural Issues – The Tribunal's Procedural Discretion – Consultation with Parties

Question 6: Effects of a Valid Arbitration Agreement

Arbitration Agreement as Source of Procedural Powers of Arbitrators – Arbitration Agreement as Bar to Dispute Settlement before Domestic Courts – Anti-Suit Injunctions in Aid of Arbitration – Invalidity of Arbitration Agreement

Question 7: Confidentiality in Arbitration

Confidentiality and Privacy – Confidentiality as Implied Term of Arbitration Agreement – Public Interest Exception – Publication of Awards – Confidentiality Agreement

Question 8: Arbitrability

Objective Arbitrability – Contractual Arbitrability – Law Applicable to Arbitrability Issue – Substantive Rules – Claims Involving an Economic Interest – Antitrust Law – Public Policy – Setting Aside of Award – Subjective Arbitrability – Law Applicable to Parties' Representation

Question 9: The Place of Arbitration

Significance of Seat – Territorial Theory – Seat as Legal Nexus to 'Lex Loci Arbitri' – Mandatory Character of Territorial Theory – Choice of Seat as Choice of Law – Nationality of the Award – Distinction between Seat and Place of Hearing and of Taking of Evidence

Question 10: The Party-Appointed Arbitrator

Number of Arbitrators – Nomination of Party-Appointed Arbitrator – Significance of Choice of Arbitrator – Qualifications and Qualities – Favourable Disposition to a Party's Case – Role of Party-Appointed Arbitrator – Psychologies in the Tribunal – 'Ex Parte' Communications with Party-Appointed Arbitrator – The Arbitrator's Duty to Disclose

Question 11: Selecting a Candidate for Party-Appointed Arbitrator

Timing of Nomination of Party-Appointed Arbitrator – Information about Suitable Candidates – Assistance by Arbitral Institution

Question 12: Request for Arbitration/Statement of Claim

Request for Arbitration – Statement of Claim – Early or Late Submission of Facts and Law – Tactics Involved – Extension of Time Limits

Question 13: Request for Arbitration and Statutory Limitation Periods

'Lis Arbitri Pendens' – Interruption of Statutory Periods of Limitation – Influence of Arbitration Rules – Need for Legal Certainty

Question 14: Written Advocacy in International Arbitration

Purpose of Legal Briefs – Statement of Facts, Law and Defences – Requirements Imposed by Arbitration Rules

Question 15: Filing of Statement of Claim

Submission of Statement of Claim – Requirements Imposed by Arbitration Rules

ANSWERS

Question 1: Conflicting Arbitration Clauses

Look at the arbitration clauses contained in No. 13.1 ECE Conditions (No. 1-4) attached to ALT's fax of 3 March 1997 and No. 10 of NedTrans' Import Conditions (No. 1-7) referred to in NedTrans' fax of 6 March. Do you think the parties were aware of the different wordings during the contract negotiations?

A. *Negligent Drafting of Arbitration Clauses*

It is commonly the case in international commercial practice that little, if any, attention is paid to the drafting of the dispute resolution clause. Typically, these clauses, together with the choice of law provision, are located at the end of the lengthy contract document. Consequently, forum selection and arbitration clauses are often 'midnight' or 'champagne' clauses, inserted into the contract at the very last minute of the contract negotiations, when the managers want to close the transaction and celebrate their deal, instead of having to think about potential future disputes between their companies.[1] Often, contract drafters have little or no experience in arbitration. Sometimes, they do not follow the wise advice to include the model clause of a leading arbitral institution into their contract.[2] Instead, they concoct their own clause, or manipulate the 'tried and tested' model clauses published by arbitral institution.[3] This poses serious problems if a dispute arises **16-1**

1. Finizio and Speller, *A Practical Guide to International Commercial Arbitration: Assessment, Planning and Strategy*, para. 2.1.
2. The traditional advice for the drafting of arbitration clauses is 'KISS', *i.e.* 'keep it short and simple' (and keep it institutional!); see also Born, *International Commercial Arbitration*, 210: 'In the overwhelming majority of cases … international arbitration agreements are straightforward exercises, adopting either entirely or principally the model, time-tested clauses of leading arbitral institutions. Although pedestrian, this course is almost always the wisest one'.
3. See, *e.g.* the *Insigma* judgment of the Singapore High Court which dealt with an arbitration clause in which the parties had agreed to 'arbitration before the Singapore International Arbitration Centre in accordance with the Rules of Arbitration of the International Chamber of Commerce', *Insigma Technology Co. Ltd v Alstom Technology Ltd* [2008] SGHC 134 (Singapore), aff'd. [2009] SGCA 24 (the High Court qualified the clause as an agreement on *ad hoc* arbitration under the ICC Arbitration Rules!); see Kirby, *Arb. Int'l* (2009), 319 *et seq.*; because of that and other decisions, Art. 1(2) of the 2012 ICC Arbitration Rules provides that '[t]he [ICC] Court is the only body authorized to administer arbitrations under the Rules …'; that Article, however, which is not a mandatory statutory provision, but part of a set of private rules, cannot prevent parties from

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between the parties. It is for these reasons that the IBA has published its IBA Guidelines for Drafting International Arbitration Clauses. They have been developed in order to assist not only arbitration specialists but, particularly, in-house counsel and business lawyers ordinarily involved in contract drafting but unfamiliar with the complexities of arbitration.[4]

16-2 In our case, the problem is aggravated by the fact that the arbitration clauses are contained in the standard forms used by ALT and NedTrans. Managers like Mr Stutz and Mr Bakker do not usually read general contract conditions attached to a party's letter or fax, let alone review the dispute resolution clause located at the end of these conditions or in the final clause of a lengthy contract document. They want to conclude their deal instead of anticipating future dispute scenarios. They focus on the commercial aspects of the deal (price, goods, payment terms, delivery date, etc.). For the rest, they 'just hope for the best'.[5]

B. The Price for Negligent Drafting

16-3 In most cases, the effects of a loose drafting approach are not felt at the drafting stage. Mr Bakker and Mr Stutz were happy with what they negotiated for their companies in early March 1997. Their perspectives changed, however, when the dispute over ALT's non-performance arose in 1998 (Case Study No. 2-1). It was only then that the legal department of NedTrans realized that the arbitration clauses contained in both sets of standard forms were not identical (Case Study No. 16-1). More often than not, it is at this time, namely when arbitral tribunals and/or domestic courts decide that the parties have drafted a 'pathological' arbitration clause[6] which does not operate in practice, that the parties in international trade have to pay for their negligence at the drafting stage (No. 1-27). In a worst-case scenario, neither a domestic court nor an arbitral tribunal will decide the parties' dispute, because the court considers the arbitration clause to be valid and refers the dispute to arbitration, while the arbitral tribunal regards the arbitration clause as invalid and refers the parties to the domestic courts. In this case, the parties are confronted with a denial of justice instead of an efficient and interest-oriented mechanism of dispute resolution. We

agreeing on arbitration under the ICC Arbitration Rules to be administered by another arbitral institution. The *Insigma* case shows that agreeing to such 'wildcat arbitration' should be avoided under all circumstances; see for DIS arbitrations Haller, in Nedden and Herzberg (eds), *ICC-SchO/DIS-SchO*, § 24 DIS-SchO, No. 24 (strongly advising against the use of the DIS Rules without administration by the DIS); see also Webster and Bühler, *Handbook of ICC Arbitration*, Nos 1-28 *et seq.*

4. IBA Guidelines for Drafting International Arbitration Clauses of 7 October 2010, www.ibanet.org/ENews_Archive/IBA_27October_2010_Arbitration_Clauses_Guidelines.aspx; see also Friedland, *Arbitration Clauses for International Contracts; Bishop, Practical Guide to Drafting International Arbitration Clauses*; Hyder Ali, *Best Practices in Drafting Arbitration Clauses*.
5. See Kerr, in Böckstiegel (ed.), *Commercial Arbitration in the Federal Republic of Germany and in England*, 5, 14.
6. See generally Hochbaum, *Mißglückte internationale Schiedsvereinbarungen*; Craig, Park, Paulsson, *ICC Arbitration*, 127 *et seq.*

will see in the 20th Scenario how the parties' negligence at the negotiation stage has affected the arbitration (No. 20-67).

*Parties in international contract negotiations should always pay **close attention to the careful drafting** of the dispute resolution clause. The time and money invested at the drafting stage must be considered as an investment in the future, when a dispute arises between the parties. Also, the parties' awareness of a well-drafted arbitration clause in their contract serves as an important means of **conflict avoidance** in that it provides a strong incentive for both parties to enter into direct negotiations before bringing the dispute before the competent court or arbitral tribunal.*

Question 2: The Nature and History of Arbitration

If you look at the wording of the two clauses, how would you define 'arbitration'? What are the historic origins of arbitration? Why do parties opt for arbitration? Is the nature of arbitration procedural or contractual? Is arbitration similar to litigation before domestic courts? Which roles does party autonomy play in international arbitration?

A. What Is (International) Arbitration?

16-4 While No. 13.1 ECE Conditions which were attached to ALT's fax of 3 March 1997 (⊘) simply refers to 'Arbitration of disputes', No. 10 of NedTrans' Import Conditions to which it made reference in its fax of 6 March 1997 (⊘) reflects the wording of the standard arbitration clause of the German Institution of Arbitration e.V. (*Deutsche Institution für Schiedsgerichtsbarkeit*, DIS[7]) and provides that 'all disputes arising in connection with the present contract or its validity shall be finally settled in accordance with the Arbitration Rules of the German Institution of Arbitration e.V. (DIS)'. Article 7(1) UNCITRAL Model Law (⊘) and s. 1029(1) German Arbitration Act, contained in the Tenth Book of the German Code of Civil Procedure (⊘), define an arbitration agreement as 'an agreement by the parties to submit to arbitration all or certain disputes which have arisen or which may arise between them in respect of a defined legal relationship, whether contractual or not'. Similarly, s. 6 English Arbitration Act 1996 defines arbitration agreement as 'an agreement to submit to arbitration present or future disputes (whether they are contractual or not)'. Neither the German[8] nor the English[9] Act draws a distinction between domestic and international arbitration, thereby broadening the scope of application of the laws and

7. See generally DIS Homepage www.dis-arb.de.
8. When adopting the Model Law in 1989, the German legislature realized that the provisions of the Law are apt for both domestic and international arbitrations and that the small number of special statutory provisions needed for domestic arbitrations would not justify the potential problems for

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their definition of 'Arbitration' to both domestic and international arbitration. Other arbitration laws provide special rules for 'international' arbitrations but use different approaches to determine when an arbitration is to be qualified as 'international'.[10] However, the common flaw of the definitions of 'Arbitration' contained in these and other arbitration laws is that they do not define the term 'Arbitration'. Any attempt to develop a definition of that term must start from the basic premise that the role of arbitrators is fundamentally different from that of mediators. Mediators do not possess decision-making power. They merely facilitate settlement negotiations between the parties, who retain their right to 'decide' how to settle their dispute (No. 6-22). The mandate of an arbitrator, on the other hand, is not to moderate settlement discussions between the parties, but to decide their dispute for them. By agreeing to arbitration, the parties transfer their decision-making authority over their dispute to the arbitrators: 'Mediation recommends, arbitration decides'.[11] For that reason, arbitration is a functional alternative to proceedings before domestic courts. Arbitrators are private judges who are to decide a dispute between the parties. If they are private judges, then they must deal with the parties' dispute, like their counterparts in domestic courts, in formal adjudicatory proceedings, ending with a binding decision (No. 27-42) that has the same effect as a court judgment. Starting from these basic premises, 'Arbitration' may be defined as:

legal practice connected with a statutory distinction between domestic and international arbitrations, see Berger, in: Berger (ed.), *The New German Arbitration Law*, 1, 19 *et seq.*

9. Sections 85 to 87 of the Arbitration Act 1996 contain provisions dealing with 'modifications of Part I [of the Act] to domestic arbitration agreement'. However, these provisions have never entered into force, and it is unlikely that they will enter into force in the future, so that English arbitration law has effectively abolished the distinction between domestic and international arbitration, which existed prior to the entering into force of the 1996 Act, see Merkin and Flannery, *Arbitration Act 1996*, 379.
10. See Art. 1(3) UNCITRAL Model Law which contains a broad definition of 'international' arbitration, providing that an arbitration is international (and thus governed by the Model Law) if: '1) the parties to the arbitration agreement have, at the time of the conclusion of the agreement, their places of business in different States; 2) the place of arbitration, if determined in or pursuant to, the arbitration agreement, is situated outside the State in which the parties have their places of business; 3) any place where a substantial part of the obligations of the commercial relationship is to be performed or the place with which the subject-matter of the dispute is most closely connected is situated outside the State in which the parties have their places of business; or 4) the parties have expressly agreed that the subject-matter of the arbitration agreement relates to more than one country'; see also Art. 1504 French Law on International Arbitration which provides that an arbitration is international 'if international trade interests are at stake'; according to a classical definition of this notion of 'international' arbitration in French law, the international nature of an arbitration must be determined 'according to the economic reality of the process during which it arises. In this respect, all that is required is that the economic transaction should entail a transfer of goods, services or funds across national boundaries, while the nationality of the parties, the law applicable to the contract or the arbitration, and the place of arbitration are irrelevant', Cour d'Appel de Paris, *Société Murgue Seigle v. Société Coflexip*, *Rev. d'Arb.* (1991), 345, 355; see generally for a discussion of the shortcomings of this definition because of the fact that it omits the nationality of the parties, which is a consideration that is highly relevant to the basic purpose of the international arbitral process, Born, *supra* note 2, 335.
11. Born, *supra* note 2, 272, quoting J. Moore.

'a process by which parties consensually submit a dispute to a non-governmental decision-maker, selected by or for the parties, to render a binding decision resolving a dispute in accordance with neutral, adjudicatory procedures affording the parties an opportunity to be heard.'[12]

B. *A Brief Historical Note on Arbitration*

Arbitration has a long history. Traces of arbitration as a means of dispute resolution can be found in *Homer's* Iliad, the works of *Demosthenes*, the Bible and the Koran.[13] The history of arbitration law dates back to ancient Assyria, Egypt, Greece and Rome. The rules on arbitration in Roman and Greek law were remarkably modern and based in large part on the notion of party autonomy as we know it today (No. 16-23).[14] England's oldest surviving arbitral award dates from AD 118.[15] The '*Edit de Fontainebleau*' of the French King Francis II of August 1560 provided for mandatory arbitration between merchants.[16] In the Middle Ages, arbitrators were chosen as 'wise men' ('good men') to decide disputes between merchants according to the customs, practices and the ancient Lex Mercatoria[17] of those days.[18] In Medieval England, the charters of numerous guilds – such as the Company of Clothworkers or the Guild of St. John of Beverley de Hanshaus – provided for mandatory arbitration of disputes among its members.[19] The oldest arbitration act is the Scottish Arbitration Act from 1426.[20] England's first Arbitration Act dates from 1698.[21] Arbitration was also used as an alternative to the courts in the colonial days of the US.[22] *George Washington's* Last Will of 1799 contained an elaborate arbitration clause to ensure

16-5

12. Born, *ibid.*, 247.
13. See the collection of historic materials on arbitration at http://www.trans-lex.org/materials#133.
14. Roebuck, *Ancient Greek Arbitration*, 347 *et seq.*; Roebuck and De Fumichon, *Roman Arbitration*, 194 *et seq.*
15. See England's oldest surviving arbitral award (AD 118) with an introduction by Derek Roebuck ('Early English Arbitration', 2008, p. 50 *et seq.*) www.trans-lex.org/262120.
16. Edit de Fontainebleau, August 1560, www.trans-lex.org/601210; Le Bars, *ICCA Newsletter* (2014).
17. See for a nutshell account of the medieval and modern Lex Mercatoria Berger, www.trans-lex.org/purpose-concept.
18. Malynes, *Consuetudo, Vel Lex Mercatoria or The Ancient Law-Merchant* (1st. ed., 1622), Chapter XV, *trans-lex.org/104980*: 'The second Mean or rather ordinarie course to end the questions and controversies arising between Merchants, is by way of Arbitrement, when both parties do make choice of honest men to end their causes, which is voluntary and in their own power, and therefore called *Arbitrium*, or Free will, whence the name Arbitrator is derived: and these men (by some called good men) give their judgments by Awards, according to equity and conscience, observing the Custome of Merchants, and ought to be void of all partiality more or less to the one and to the other; having only care that right may take place according to the truth, and that the difference may be ended with brevity and expedition'.
19. Born, *supra* note 2, 31.
20. Historic Scottish Arbitration Act of July 1, 1426 (Latin with English translation by Derek Roebuck) www.trans-lex.org/802000.
21. Historic English Arbitration Act 1698, www.trans-lex.org/803000.
22. See, *e.g.* A court, holden att Boston, 7 November 1632, Records of the governor and company of the Massachusetts bay in New England. Printed by order of the legislature (1853); Ordinance of the Director and Council of New Netherland establishing a Board of Nine Men. Passed 25

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effective and speedy resolution of potential disputes between his heirs.[23] Inter-state arbitration also has a long history, with the *Jay* Treaty of 1794, the *Ghent* Treaty of 1814 and the *Alabama Claims* Award of 1872, which resulted from the Washington Treaty of 1871, as important milestones.[24] The *Lena Goldfields* Award constitutes a milestone in investor-state arbitration.[25]

C. *Why Parties Opt for Arbitration*

16-6 Throughout this long history of arbitration, a general consensus on a number of advantages of arbitration over dispute resolution before domestic courts has emerged. Modern Studies of arbitration confirm that a large number of these long-standing advantages are still accepted today:

- primacy of party autonomy (No. 16-23);
- free choice of arbitrators with legal/technical/commercial/expertise (No. 16-126);
- confidentiality of the proceedings (No. 16-75);
- finality of the award (No. 27-42);
- facilitation of amicable settlement (No. 22-1); and
- worldwide enforceability of the award under the New York Convention (No. 29-11).[26]

16-7 While speed and cost-efficiency have long been regarded as additional advantages of arbitration, users today increasingly complain about the length and costs of international arbitration proceedings (No. 16-33).[27] These complaints are due to the fact that arbitration has fallen victim of its own success.[28] Because of the advantages just mentioned, arbitration lends itself much better than proceedings before domestic courts to the resolution of complex, large-scale transnational business disputes which, for the very reason that they are complex and large, require lengthy and

September, 1647; The Duke of York's Laws for the government of the Colony of New York, Ordinance of April 1664, www.trans-lex.org/materials#133.

23. Arbitration clause in The Will of George Washington, 1799, www.trans-lex.org/800900; see Berger, *ICCA Newsletter*, December 2012, 11.
24. King and Graham, in AAA (ed.), *Dispute Resolution Journal*, January-March 1996, 42 *et seq.*, www.trans-lex.org/133900; see for the text of the *Genth* and *Jay* Treaty www.trans-lex.org/materials#135; see for the *Alabama Claims* Arbitration Award of 1872 and the text of the Washington Treaty of 1871 between the UK and the US which provided the legal basis and procedural framework for the *Alabama* arbitration www.trans-lex.org/262137.
25. *Lena Goldfields v. Soviet Government*, Award of 2 Sept. 1930, German original text previously unpublished and English translation www.trans-lex.org/261300.
26. Queen Mary and PriceWaterhouseCoopers (eds), *International Arbitration: Corporate attitudes and practices 2008*, 2; see also Girsberger and Voser, *International Arbitration in Switzerland*, Nos 118 *et seq.*; Morrissey and Graves, *International Sales Law and Arbitration*, 312 *et seq.*; Born, *supra* note 2, 73 *et seq.*
27. *Ibid.*; see also Born, *supra* note 2, 88: 'On balance, international arbitration does not necessarily have either dramatic speed and cost advantages or disadvantages as compared to national court proceedings.'
28. See Rivkin, *Arb. Int'l* (2008), 375, 377 *et seq.*

costly proceedings. The parties therefore adopt proactive conflict management methods (No. 20-19) and look for less costly alternatives such as mediation or other ADR tools (No. 16-32). Sometimes, these ADR processes and arbitration do not exclude themselves but are used as successive tiers in a multi-tier dispute resolution process (No. 2-71).

D. *The Hybrid Nature of Arbitration: Contractual and Procedural*

Neither of these contract clauses, nor statutory provisions, defines the term 'arbitration'. What they reveal is the hybrid nature of the arbitral process. There is a long-lasting debate on whether arbitration has a 'jurisdictional', 'contractual', 'hybrid' or 'autonomous' nature.[29] From a practical perspective, this discussion is highly academic and resembles the 'tempest in a teapot': **16-8**

> 'In spite of their apparent diametrically opposed views, the jurisdictional and contractual theories can be reconciled. Arbitration requires and depends upon elements from *both* the jurisdictional and the contractual viewpoints; it contains elements of *both* private and public law; it has procedural *and* contractual features. It is not surprising that a *compromise theory*, claiming arbitration to have a mixed or hybrid character should have been developed.'[30]

In addition, nowadays, answers to specific questions are typically derived from the interpretation of applicable rules, rather than from the conceived legal nature or character of the arbitral process.[31] Today, no one can dispute that any arbitration is a private means for the adjudication of disputes, comprising both contractual (1.) and procedural (2.) elements. **16-9**

1. *The Contractual Nature of Arbitration*

a. The Requirement of an Arbitration Agreement

The reference to an agreement of the parties reflects the contractual or consensual nature of arbitration (No. 2-50). Leaving aside special scenarios such as arbitration under investment protection treaties[32] or free trade agreements, every arbitration requires an agreement by the parties: 'contract is the gateway to arbitration',[33] provided that this contract contains a binding and valid commitment of the parties to **16-10**

29. See Lew, Mistelis, Kröll, *Comparative International Commercial Arbitration*, Nos 5-2 *et seq.*; Born, *supra* note 2, 214 *et seq.*
30. Lew, Mistelis, Kröll, *ibid.*, No. 5-23 (emphasis added).
31. Várady, Barceló, von Mehren, *International Commercial Arbitration*, 132.
32. See Lörcher, *Neue Verfahren der Internationalen Streiterledigung in Wirtschaftssachen*, 173 *et seq.*
33. Carbonneau, *Cases and Materials on the Law and Practice of Arbitration*, 17.

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arbitrate their (present or future) disputes.[34] An American court has expressed this in the following words:

> 'Arbitration is fundamentally a creature of contract, characterized by consent. As a matter of contract law, no party should be forced to arbitrate its claims unless that party has agreed to do so.'[35]

16-11 The English Commercial Court has explained the contractual character of arbitration as follows:

> 'An arbitration clause in a commercial contract like the present one is an agreement inside an agreement. The parties make their commercial bargain, *i.e.* exchange promises in relation to the subject-matter of the transaction, but in addition agree on a private tribunal to resolve any issues that may arise between them.'[36]

16-12 The US Supreme Court acknowledged as early as 1972 the intrinsic value of forum selection clauses, *i.e.* also of arbitration agreements, in international trade:

> 'The elimination of all ... uncertainties by agreeing in advance on a forum acceptable to both parties is an indispensable element in international trade, commerce, and contracting. There is strong evidence that the forum selection clause was a vital part of the agreement, and it would be unrealistic to think that the parties did not conduct their negotiations, including fixing the monetary terms, with the consequences of the forum clause figuring prominently in their calculations ...'[37]

16-13 Arbitration is, thus, essentially an agreement on establishing 'private justice', *e.g.* private dispute resolution by a 'private tribunal'.[38] The parties' agreement makes adjudication and dispute settlement a private matter. Pursuant to s. 1029(2) German Arbitration Act, such an arbitration agreement may be in the form of a separate agreement ('separate arbitration agreement') or, as in our case, in the form of a clause – or two clauses contained in the parties' standard forms – in a contract ('arbitration clause'). It is fair to assume that today almost 90 per cent of all major international contracts contain an arbitration clause. International arbitrators have become the 'natural judges' of international business.

34. The English High Court has held in *Kruppa v. Benedetti and des Pallières*, [2014] EWHC 1887 (Comm) that a clause providing that 'the parties will *endeavour* to first resolve the matter through Swiss arbitration' (emphasis added) does not constitute a binding agreement to arbitrate, but merely an agreement to attempt to refer the matter to arbitration by a further agreement between the parties; the Court made it clear that in such a case, '[t]he requirement to submit finally to a binding arbitration is absent ...'.
35. *E. I. Du Pont De Nemours and Co. v. Rhodia Fiber and Resin Intermediates SAS, Int'l Arb. Rep.* (June 2001), 13, 15 *et seq.* (US Court of Appeals for the 3rd Circuit); see also Geimer, in Zöller (ed.), *Zivilprozessordnung*, Vor §1025, No. 4: 'nobody may be deprived of the state court system against his will'.
36. *Union of India v. McDonnell Douglas Corp.*, (1993) 2 Lloyd's L. Rep. 48, 50.
37. *The Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 5 (1972).
38. See Rau, Sherman, Peppet, *Processes of Dispute Resolution*, 600.

b. The Requirement of a 'Dispute' ('Rights' vs 'Interest' Arbitration)

aa. The 'Dispute-Oriented' Definition of Arbitration

Based on this private and contractual character of arbitration, legal doctrine has developed the following definition of 'arbitration': **16-14**

> 'Arbitration ... may be defined as a private mechanism for the resolution of disputes which takes place in private pursuant to an agreement between two or more parties, under which the parties agree to be bound by the decision to be given by the arbitrator according to law after a fair hearing, such decision being enforceable at law.'[39]

According to this definition, an arbitration agreement is a private contract concerning the resolution of a dispute or disputes between the parties that have concluded the agreement. Arbitration therefore requires a 'dispute'.[40] The arbitrator is called upon to decide the dispute between the parties in a 'yes/no' decision. Arbitration is thus a zero-sum game. One party loses at the expense of the other (No. 4-12). This is the basic difference between arbitration and mediation which is characterized by the mediator's lack of decision-making power and his endeavour to 'expand the pie' and allow for win/win outcomes (No. 6-28). Despite these essential differences between arbitration and mediation, American courts[41] have stayed all litigation and compel mediation under ss. 3 and 4 Federal Arbitration Act, because mediation, as an alternative to settle controversies between the parties, 'fits within the Act's definition of arbitration'. This reasoning is highly problematic because it blurs the clear-cut distinction between arbitration as third-party adjudication and mediation as a facilitated negotiation process.[42] **16-15**

This definition of arbitration is used to distinguish arbitration not only from other non-judicial dispute settlement procedures such as mediation but also from hybrid procedures such as 'quality arbitration' ('sniff and look' arbitrations) in international commodity trade and other forms of third-party 'expert' determination such as the *Schiedsgutachter* of German law,[43] *bindend advies* of Dutch law,[44] price arbitration pursuant to s. 1592 French Civil Code[45] and *arbitrato irrituale* of Italian law.[46] **16-16**

39. See Vol. I (Case Study and Interactive USB Card), Glossary of Terms; see also Lew, Mistelis, Kröll, *supra* note 29, Nos 1-5 *et seq.*
40. See, *e.g. Arenson v. Casson Beckman Rutley & Co.* (1977), A.C. 405, 424; *N.E. Co-operative Society Ltd v. Newcastle Upon Tyne City Council* (1987) E.G.L.R. 142, 146 (Ch. 1986).
41. *CB Richard Ellis, Inc. v. Am. Environmental Waste Management*, not reported in F. Supp. 2d (1998), WL 903495, EDNY Dec. 04, 1998.
42. See Rau, *Texas Int'l L.J.* (2005), 449, 469.
43. See Raeschke-Kessler and Berger, *Recht und Praxis des Schiedsverfahrens*, Nos 451 *et seq.*
44. See Nolen, *Handleiding voor Arbiters*, 249 *et seq.*
45. See *Frydman v. Cosmair, Inc.* (1995), WL 404841.
46. See Patocchi and Schiavello, *Arb. Disp. Res. L.J.* (1998), 132 *et seq.*

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23rd Scenario*

Challenge of Arbitrator

ISSUES COVERED

Question 1: Standards and Procedures

Meaning and Significance of Impartiality and Independence – Meaning of Justifiable Doubts – Reasonable Third Person Test – IBA Guidelines on Conflicts of Interest – Challenge of Party-Appointed Arbitrators – AAA/ABA Code of Ethics for Arbitrators – Chairman's Exposure to Challenge

Question 2: Business Contacts as Grounds for Challenge

Indirect Contacts between Arbitrator and Party – Significance of Past Business Relationship – Remoteness of business contacts – Involvement of Family Member – Family Member of Arbitrator as Counsel in Unrelated Matter – IBA Guidelines on Conflicts of Interest – Reasonable Third Person Test – Red List – Orange List

Question 3: Failure to Disclose as Ground for Challenge?

Disclosure of circumstances – Subjective Test – Non-Disclosure as Independent Ground for Challenge – Relationship between Disclosure and Challenge – IBA Guidelines on Conflict of Interest – Orange List – Green List – 'Traffic Light Scheme' under IBA Guidelines – Arbitrator's Duty to Conduct Reasonable Inquiries to Investigate Potential Conflicts of Interests

Question 4: Waiver of Right to Challenge

Parties' Knowledge of Grounds for Challenge – Principle of 'Venire Contra Factum Proprium' – Preclusion of Right to Challenge

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* For the Facts of this Scenario please refer to the Case Study.

Question 5: Involvement of Arbitral Institution and Challenged Arbitrator

Tribunal's Decision on Challenge – Involvement of Arbitral Institution – Party Agreement on Removal of Arbitrator – Participation of Challenged Arbitrator in Tribunal's Vote on Challenge

Question 6: Challenges before Domestic Courts

Court Control of Tribunal's Decision on Challenge – Misuse of Right to Challenge ('Torpedo Challenges') – Continuation of Arbitration

Question 7: Consequences of Successful Challenge

Appointment of Substitute Arbitrator – Challenge as Cause of Delay of Arbitration

Question 8: Resignation of Arbitrator

Arbitrator's Resignation and Acceptance of Grounds for Challenge

ANSWERS

Question 1: Standards and Procedures

What is the underlying rationale behind the concepts of 'impartiality' and 'independence'? Does it make a difference whether a party-appointed arbitrator or the chairman/sole arbitrator is challenged?

A. The Concept of 'Independence' and 'Impartiality'

23-1 We have seen that arbitrators exercise genuine judicial functions (No. 16-25). For that reason, the concepts of 'impartiality' and 'independence' of international arbitrators are of paramount importance to ensuring and safeguarding the integrity of the international arbitral process.[1] This is especially important in an era of increasing attacks on the legitimacy of international arbitration.[2] It is generally accepted[3] that a lack of impartiality and independence on the part of an arbitrator is a ground for setting aside the award and refusing enforcement because the composition of the tribunal was not in accordance with the provisions of the arbitration law at the seat of the arbitration[4] and the award thus violates international public policy.[5]

1. Redfern and Hunter, *Law and Practice*, Nos 4-52; Born, *International Commercial Arbitration*, 1760 *et seq.*
2. See for the 'public challenge' to arbitration Paulsson, *The Idea of Arbitration*, 98 *et seq.*; see also *ibid.*, at 177: 'Arbitration is under recurrent attacks by those who fear it may undercut the authority of regulations and regulators'.
3. See Mayer, Sheppard, Nassar, in ILA (ed.), *Report of the Sixty-Ninth Conference*, 340, 365 *et seq.*
4. See for the corresponding grounds for setting aside Art. 34(2)(a)(iv) UNCITRAL Model Law; s. 1059(2) No. 1(d) German Arbitration Act; for the corresponding grounds for refusal of enforcement see Art. 36 (1)(a)(iv) UNCITRAL Model Law, Art. V (1)(d) New York Convention, to which reference is made in s. 1061 German Arbitration Act.

In this important area of arbitral procedure, the freedom of the parties to tailor the proceedings (No. 16-23), which would result in the freedom of the parties to select their 'own' arbitrators as they wish, even if they are biased, is restricted in the interest of preserving the integrity of the process.[6] Together with the basic and mandatory procedural rights of the parties to be heard and to be treated equally laid down in Art. 18 UNCITRAL Model Law (🔗) and s. 1042(1) German Arbitration Act (🔗) (No. 16-26), these principles serve to ensure that dispute resolution through arbitration enjoys the same degree of legitimacy and worldwide acceptance as adjudication before domestic courts. The preservation and safeguarding of these principles is the very reason why arbitration has the same standing as dispute resolution before domestic courts (No. 16-25). In fact, it is frequently argued that because of this judicial quality of the arbitrator's decision-making duty, the same neutrality standards must be applied to arbitrators that apply to domestic judges.[7]

23-2 While it is perfectly legitimate for a party to select an arbitrator who is generally predisposed to it personally or to its legal position (No. 16-134), the arbitrator must be and remain throughout the proceedings[8] impartial and independent, meaning that he or she can decide the dispute – without partiality – in favour of the party with the better case.[9] The arbitrator can be favourably disposed towards one of the parties but must have an open mind and must be and remain in a position to decide the dispute against the party that appointed him.

5. See for the corresponding grounds for setting aside Art. 34(2)(b)(ii) UNCITRAL Model Law and s. 1059(2) No. 2(b) German Arbitration Act; for the corresponding grounds for refusal of enforcement see Art. 36(1)(b)(ii) UNCITRAL Model Law, Art. V(2)(b) New York Convention to which reference is made in s. 1061 German Arbitration Act.
6. Born, *International Commercial Arbitration*, 1762.
7. See Annex I (Uniform Law) Art. 12(1) European Convention Providing a Uniform Law on Arbitration of 20 January 1966 providing in Art. 12 that '[a]rbitrators may be challenged on the same grounds as judges', http://conventions.coe.int/Treaty/en/Treaties/Html/056.htm; see also Nariman, *Arb. Int'l* (1988), 311 *et seq.*: '[S]tandards of behaviour expected of arbitrators … are no less stringent than those demanded of judges; in fact, arbitrators are expected to behave a shade better since judges are institutionally insulated by the established court-system, their judgments being also subjected to the corrective scrutiny of an appeal'; see for German law DIS Award SV-217/02, *BB* (2003), Beilage No. 8, 24 *et seq.*; OLG München *SchiedsVZ* (2014), 45, 48; OLG Frankfurt *SchiedsVZ* (2008), 96, 99; KG Berlin *SchiedsVZ* (2013), 110 *et seq.*; Klich, in Nedden and Herzberg (eds), *ICC-SchO/DIS-SchO*, § 18 DIS-SchO, No. 10; see for Swiss law Swiss Federal Tribunal BGE 92 I 271, 276; BGE 135 I 14; 139 III 433; see for English law *AT&T Corp. v Saudi Cable Co.*, [2000] 2 Lloyd's Rep. 127, 135 emphasizing that equal standards should apply, but also stating: 'The courts are responsible for the provision of public justice. If there are two standards I would expect a lower threshold to apply to courts of law than applies to a private tribunal whose "judges" are selected by the parties. After all, there is an overriding public interest in the integrity of the administration of justice in the courts'; *but see* for US law *Commonwealth Coatings Corp v. Continental Casualty Co.*, 393 US 145, 150 (1968), emphasising that arbitrators are not held to the same standards as judges; see also *Employers Insurance v. National Fire Insurance*, 933 F. 2nd 1481 (9th Cir. 1991): 'to hold arbitrators to the same rigorous standard of impartiality as judges would, in many cases, erase the salutary aspects of arbitration as opposed to litigation.'
8. These standards must be applied throughout the proceedings, irrespective of whether the arbitration proceedings are at the beginning or at a later stage, see *Morrison & Anor v AWG Group Ltd & Anor* [2006] EWCA Civ. 6 (20 January 2006); General Standard 3(d) IBA Guidelines on Conflicts of Interest in International Arbitration.
9. Bishop and Reed, *Arb. Int'l* (1998), 395, 396.

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23-3 The concepts of 'impartiality' and 'independence' are intentionally formulated rather broadly in order to cover all possible circumstances which might justify a challenge from a party of the arbitration.[10] Sometimes, a strict distinction between both concepts is advocated. 'Independence' is seen to refer to the relationship between the parties and the arbitrators while the arbitrator's 'impartiality' is said to require a judgment that relates more to the arbitrator's relationship with the substance of the dispute.[11]

23-4 In reality, the differences in this field are more a matter of how these grounds can be detected than a matter of substance. In general, these concepts must be interpreted so as to cover all biased behaviour of the arbitrators during the arbitral proceedings.[12] Sections 1(a) and 24(1)(a) English Arbitration Act 1996 (🔗) therefore make reference only to the tribunal's or the arbitrator's 'impartiality'. It is the indirect or direct dependence of the arbitrator on one of the parties, a potentially important witness or the arbitral institution administering the proceedings, which provides the decisive evidence indicative of the arbitrator's partiality or impartiality. Section 15 DIS Arbitration Rules lists as a specific example for the independence of an arbitrator that he may not, in exercising his office, be 'bound by any directions', whether from one of the parties or from a third party.

23-5 Always of particular importance are close personal or professional relationships with a co-arbitrator or a party, and any direct personal or professional interest in the outcome of the case, as well as secret party communications during the proceedings. The nationality of an arbitrator (No. 19-20) on its own does not provide a ground for challenge while aggressive statements by the arbitrator about the nationality of a party may justify a challenge.[13] The same applies to unjustified or impertinent comments of an arbitrator on a challenge that a party has raised against him.[14]

10. Lew, Mistelis, Kröll, *Comparative International Commercial Arbitration*, No. 11-7; Lörcher, Lörcher, Lörcher, *Das Schiedsverfahren*, No. 108.
11. Berger, *International Economic Arbitration*, 243 *et seq.*; Bishop and Reed, *Arb. Int'l* (1998), 395, 398: 'An "impartial" arbitrator, by definition, is one who is not biased in favor of, or prejudiced against, a particular party or its case, while an "independent" arbitrator is one who has no close relationship – financial, professional or personal – with a party or its counsel'; see also Decision of Sir *Robert Jennings*, Appointing Authority to the Iran-US Claims Tribunal of 7 May 2001, reprinted in *Int'l Arb. Rep.* (May 2001), B-1, B-3: 'Independence implies freedom from external control or authority or finance … The question of impartiality is more difficult … any judge, though he ought to begin in an impartial stance, is required as a matter of judicial duty eventually and on the basis of the presented arguments to become partial to one side or the other. To remain neutral to the end would be a dereliction of duty'.
12. Holtzmann and Neuhaus, *UNCITRAL Model Law*, 389.
13. See the judgment by the English King's Bench Division in *Catalina v. Norma* [1938] 61 *Lloyd's L. Rep.* 360, 364 where a challenge was brought because of the arbitrator's statement: 'The Italians are all liars in these cases and will say anything to suit their book. The same thing applies to the Portuguese' and the court argued: 'It is impossible in this case to suppose that the parties who were acquainted of those words so spoken by the arbitrator, should feel anything but bitter dissatisfaction, and an almost certain conclusion would arise in their minds that justice was not being done and that the arbitrator had not acted impartially in the matter.'
14. OLG München *SchiedsVZ* (2014), 45, 48; OLG Frankfurt *NJW-RR* (1998), 858.

B. The Objective Nature of the Concept of 'Justifiable Doubts'

23-6 Article 12(1) UNCITRAL Model Law as well as s. 1036(2) German Arbitration Act do not require that an arbitrator's partiality or dependence must be proven. Instead, it suffices that 'justifiable doubts' exist as to his or her impartiality or independence. There is one basic problem with this vague concept: who decides whether there are 'justifiable doubts' as to the arbitrators' independence or impartiality? At first sight, it would make sense to leave it to the parties to decide whether one of them has such 'justifiable doubts'. In fact, the real reason for a challenge on these grounds is that a party might otherwise lose confidence in the fairness of the arbitral process. However, adopting such a purely subjective approach would open the floodgates for unjustified challenges raised by parties to delay or disrupt the procedure or because that party is particularly sensitive to *any* connection that the arbitrator might have with the subject matter of the dispute or the other party.

23-7 In order to avoid misuse of the parties' right to challenge a member of the arbitral tribunal, the Working Group that drafted the IBA Guidelines on Conflicts of Interest, which were published in a revised version in 2014 (🔗), rejected the purely subjective approach and adopted an objective test for the interpretation of challenge provisions such as Art. 12 UNCITRAL Model Law or s. 1036(2) German Arbitration Act.[15] This test, known as the so called 'reasonable third person test', had already been incorporated into Art. 3.2 IBA Rules of Ethics for International Arbitrators (🔗).[16] General Standard 2(b) IBA Guidelines provides that an arbitrator shall refuse to act or resign (or may be challenged by one of the parties) if circumstances exist that, *'from a reasonable third person's point of view having knowledge of the relevant facts and circumstances'*, give rise to justifiable doubts as to that arbitrator's impartiality or independence. This objective test is based on the concept of the 'fair-minded lay observer with knowledge of the material objective facts', which was developed in Australian case law.[17] A similar test was adopted by the English House of Lords in the *Saudi Cable* case:

> '… when deciding whether bias [of an arbitrator] has been established, *the Court personifies the reasonable man*. The Court considers on all the material, which is placed before it whether there is any real danger of unconscious bias on the part of the … arbitrator'.[18]

15. See Born, *supra* note 6, 1793 *et seq.*
16. No. 8 of the Introduction to the IBA Guidelines on Conflicts of Interest provides that the IBA Guidelines supersede the IBA Rules as to the matters treated in the Guidelines.
17. De Witt Wijnen, Voser, Rao, *B.L.I.* (2004), 433, 442; see also *Webb v. The Queen* (1996), 181 CLR 41 (HCA).
18. *AT&T Corporation And Another v. Saudi Cable Co.* (2000), 2 *Lloyd's L. Rep.* 127, 136 (emphasis added); see also *R. v. Gough* (1993), A.C. 646, 670: '… it unnecessary, in formulating the appropriate test, to require that the court should look at the matter through the eyes of a reasonable man, because the court in cases such as these personifies the reasonable man'; *Laker Airways Inc. v. FLS Aerospace Ltd* (1999), 2 *Lloyd's L. Rep.* 45, 48 *et seq.*: 'A real danger rather than a real likelihood of partiality … A real possibility rather than a real probability'; *Porter v. Magill* [2002] AC 357, 360 (test of 'what a fair-minded and informed observer would conclude having considered the facts'); *A.S.M. Shipping Ltd of India v. T.T.M.I Ltd of England* (2005),

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23-8 The objective test to determine whether justifiable doubts as to an arbitrator's independence or impartiality exist has been confirmed by various German Courts of Appeal[19] and by an ICSID tribunal in a 2008 challenge decision in the *Aguas de Barcelona* case:

> 'The words "justifiable doubt" clearly indicate that Article 10(1) [UNCITRAL Arbitration Rules] establishes an objective, rather than a subjective standard for determining the existence of a circumstance that creates justifiable doubts as to an arbitrator's impartiality and independence. Thus ... *it is not sufficient that such doubt exist in the mind of a party. Such doubt must be justifiable from an objective point of view.* The application of such standard in the particular case requires an answer to the following question: Would a reasonable, informed person viewing the facts be led to conclude that there is a justifiable doubt as to the challenged arbitrator's independence and impartiality? Moreover, the party challenging the arbitrator has the burden of proving that such justifiable doubt exists'.[20]

23-9 Likewise, the Swiss courts grant the challenge of an arbitrator only if an objective examination reveals circumstances which form the basis for the appearance of lack of independence or the danger of partiality. The purely subjective impression of a party cannot be taken into account, the mistrust with regard to the partiality of the arbitrator must appear to be objectively founded. Therefore, the parties' subjective impressions can only be taken into account if they are based on concrete facts and if these facts are by themselves susceptible to objectively and reasonably justify such an impression by a reasonable party.[21] A similar approach is adopted by US courts. They require that in order to show 'evident partiality', *'a reasonable person* would have to conclude that the arbitrator was partial' to the other party to the arbitration.[22] General Standard 2(c) IBA Guidelines makes it clear that such doubts are justifiable if a reasonable and informed third party would reach the conclusion that there was

EWHC 2238 (Comm.) (a 'properly informed independent observer'); *Helow v. Secretary of State for the Home Departement*, [2008] UKHL 62, describing the fair-minded and informed observer as 'a relative newcomer among the select group of personalities who inhabit our legal village and are available to be called upon when a problem arises that needs to be solved objectively'); see also Eastwood, *Arb. Int'l* (2001), 287, 291 *et seq.*; Marriott, in Karrer (ed.), *Conflict of Interests*, 25, 27 *et seq.*

19. OLG Frankfurt, *SchiedsVZ* (2008), 96, 99; OLG München, *SchiedsVZ* (2008), 102, 103; OLG Bremen, *SchiedsVZ* (2007), 53 *et seq.*; OLG Naumburg, *SchiedsVZ* (2003), 134 *et seq.* ('an objective ground for challenge is always required, *i.e.* a ground that by reasonable assessment gives rise to the concern that the arbitrator will not decide the matter in an impartial manner'); see also Nacimiento, Abt, Stein, in Böckstiegel, Kröll, Nacimiento (eds), *Arbitration in Germany*, §1036, No. 30 ('The expressed doubt must be objectively verifiable, purely subjective concerns are therefore neither adequate nor sufficient for a challenge').
20. *Suez, Sociedad General de Aguas de Barcelona S.A. and Vivendi and The Argentine Republic* (12 May 2008), *Mealey's Int'l Arb. Rep.*, June 2008, at C-1, C-4 (footnotes omitted, emphasis added).
21. Swiss Federal Tribunal BGE 128 V 82, 84; Swiss Federal Tribunal (19 February 2009), 4A.539/2008, available at http://jumpcgi.bger.ch/cgi-bin/JumpCGI?id=19.02.2009_4A_539/2008 ('The purely subjective impressions of one of the parties to the proceedings are not decisive'); see also Müller, *International Arbitration*, 74.
22. *Kaplan v. First Options of Chicago* 19 F.3d 1503, 1523 (3rd Cir. 1994); *Apperson v. Fleet Carrier Corp.* 879 F.2d 1344, 1358 (6th Cir.1989); *Morelite Constr. Corp. v. New York City Dist. Council Carpenters Ben. Funds* 748 F.2d 79, 84 (2nd Cir.1984); *Spector v. Torenberg* 825 F. Supp. 201, 209 (S.D.N.Y. 1994).

a likelihood that the arbitrator may be influenced by factors other than the merits of the case as presented by the parties in reaching his or her decision.

23-10 The IBA Guidelines therefore establish a carefully balanced system of grounds for challenge and a useful reference point for best practices (No.16-38) in this area.[23] An arbitrator must refuse to act or to continue the proceedings and may always be challenged if he himself has any doubts as to his ability to be impartial or independent.[24] If, however, the arbitrator considers himself to be impartial and independent, he may still be challenged if he does not meet the 'reasonable third person test'. The Guidelines establish two groups of cases where this test is met and the challenge is justified. In the first group, the test is met because the arbitrator violates the basic principle that no one may be his own judge. General Standards 2(d) and 4(b) IBA Guidelines, together with the 'Non-Waivable Red List' contained in Part II of the Guidelines, make it clear that, in such serious cases, a party cannot waive its right to challenge the arbitrator and the parties may not agree on such a waiver. The arbitrator may always be challenged by either party. In a second, less serious group of cases of conflict of interest, General Standard 4(c) IBA Guidelines, together with the 'Waivable Red List' contained in Part II of the Guidelines, provides that, even though there are justifiable doubts as to an arbitrator's independence or impartiality from a reasonable third person's point of view, the parties, in full knowledge of the conflict of interest, may expressly agree that such a person acts as arbitrator, provided they have full knowledge of the conflict of interest. This applies to cases where the arbitrator has given legal advice on the dispute to one of the parties, holds shares in one of the parties or currently represents one of the parties. Even though the cases listed in the 'Waivable Red List' are considered less serious than those listed in the 'Non-Waivable Red List', the IBA Arbitration Committee was of the opinion that the parties' waiver in the case of a conflict of interest should be the exception rather than the rule.[25]

C. *Challenge of Party-Appointed Arbitrators*

23-11 Years ago, a discussion arose in international arbitral doctrine about whether the same standards of impartiality and independence should be applied to both party-appointed arbitrators like Dr Regli on the one hand and sole arbitrators and chairmen on the other. The discussion was triggered by Anglo-American legal doctrine, which regarded the party-appointed arbitrator more as a representative of that party than as an independent arbitrator.[26]

23. Webster and Bühler, *Handbook of ICC Arbitration*, No. 11-7, emphasising that, as imperfect as they may be, the IBA Guidelines are considered by parties, ICC Court members and ICC Secretariat as a useful additional reference point for decisions on appointments and challenges of arbitrators, *ibid.*, No. 11-8 *in fine*.
24. General Standard 2(a) IBA Guidelines on Conflicts of Interest; Explanation (a) to General Standard 2 states that this is a basic principle that is spelled out in these Guidelines in order to avoid confusion and to foster confidence in the arbitral process.
25. De Witt Wijnen, Voser, Rao, *B.L.I.* (2004), 433, 453.
26. Bishop and Reed, *Arb. Int'l* (1998), 395, 402 *et seq.* with reference to the arbitration laws of some US states which allow, and sometimes even endorse, overt partiality for party-appointed arbitrators.

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23-12 Today, it is generally acknowledged in international arbitral doctrine that, with respect to their challenges, there is no separate standard for party-appointed arbitrators which is different from that governing sole arbitrators or chairmen:

> 'To the overwhelming majority of us ... drawing ... a fundamental distinction between party-appointed arbitrators and presiding arbitrators is an absolute anathema. Confidence in the administration of justice demands that all the decision-makers be and remain impartial.'[27]

23-13 Thus, General Standard 1 IBA Guidelines on Conflict of Interest provides that 'every' arbitrator shall be and remain impartial and independent. Likewise, General Standard 5(a) makes it clear that the Guidelines apply equally to chairmen, sole arbitrators and party-appointed arbitrators unless the applicable arbitration law or rules allow for a non-neutral arbitrator who has no obligation to be impartial or independent. In addition, the introduction of the 2004 edition of the AAA/ABA Code of Ethics for Arbitrators in Commercial Disputes provides that it is preferable 'for all arbitrators – *including any party-appointed arbitrators* – to be neutral and to comply with the same ethical standards'.[28] The Code of Ethics emphasizes that this principle is essential in arbitrations where the parties, the nature of the dispute, or the enforcement of any resulting award may have international aspects and that the situation may only be different in domestic arbitrations in the US where special ethical considerations apply.[29] While parties in international commercial arbitration sometimes expect the arbitrator they appoint to act as their advocate on the panel,[30] it is generally acknowledged that the advocacy role must be performed exclusively by each party's counsel or other representatives, as permitting arbitrators to play such a role would be prejudicial to the disinterested and candid deliberations in which the arbitral panel should engage (No. 16-135). Even though it has to be accepted that there is naturally a certain degree of difference between the party-appointed arbitrators and the neutral chairman or sole arbitrator with respect to their predisposition *vis-à-vis* the merits of the case,[31] the standards for the arbitrators' unbiased conduct during the arbitration are the same, regardless of whether the

27. Partasides, *VJ* (2001), 217, 222; see also DIS Award SV-217/02, *BB* (2003), Beilage No. 8, 24 *et seq.* (there are no 'non-neutral' arbitrators in arbitrations conducted under the DIS Arbitration Rules).
28. See Sheppard, *Arb. Int'l* (2005), 91, 92, 97: 'The most fundamental and far-reaching change contained in the 2004 Revision [of the AAA/ABA Code of Ethics] is the application of the presumption of neutrality to all arbitrators, including party-appointed arbitrators ... The 2004 Revision ushers in a new era of arbitration in the United States ... The presumption of neutrality should assure that the practice of appointing non-neutral arbitrators, still permitted if the parties agree, becomes the exception rather than the rule'.
29. Introduction AAA (ed.), *The Code of Ethics for Arbitrators in Commercial Disputes*, 3.
30. See BGH, *NJW* (1972), 827: 'Parties are very much inclined to look to the persons appointed as advocates of their particular interests within the tribunal and, therefore, they select arbitrators that they expect will decide in their favour' (translation by the author).
31. Redfern and Hunter, *Law and Practice*, No. 4-56.

arbitrator has been appointed by the parties, by the arbitral institution or, in the case of the chairman, by the two party-appointed arbitrators:

> '... a party may nominate an arbitrator who is generally predisposed towards him personally, or as regards his position in the dispute, provided that he is at the same time capable of applying his mind judicially and impartially to the evidence and arguments submitted by both parties.'[32]

23-14 Thus, a chairman's potentially higher exposure to challenges is a matter of practice but not a matter of law. In every day practice, a chairman has a much higher exposure to a risk of challenge simply because he is in charge of the day-to-day conduct of the arbitration (No. 19-15) and is, thus, continuously in the 'firing line'. Therefore, the opportunities for challenge by the parties are much greater. If a party-appointed arbitrator keeps silent for the whole arbitration, there is little opportunity for violation of any ethical rules (except to keep awake and respond to the chairman's messages on time). Thus, *in practice* more might be expected from the chairman, but this is simply due to the greater statistical probability of error from the chairman rather than to the inherent nature of the position.

23-15 It follows from this uniform treatment of all arbitrators that party-appointed arbitrators are not allowed to have appeared as counsel for the party prior to the arbitral proceedings or to engage in unilateral communications with the party that appointed them during the proceedings.

> *A party may challenge an arbitrator if it has justifiable doubts as to his or her **impartiality** or **independence**. This is not a subjective but an objective test. The question is not whether the challenging party was right in losing its trust in the proper conduct of the arbitral procedure but whether circumstances exist that, from a **reasonable third person's point of view** having knowledge of the relevant facts, give rise to justifiable doubts as to that arbitrator's impartiality or independence. A **party-appointed arbitrator** is subject to the same standards as a sole arbitrator or chairman.*

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32. Redfern and Hunter, *ibid.*; Partasides, *supra* note 31, 223 ('predisposed but ultimately impartial').

Question 2: Business Contacts as Grounds for Challenge

Do you think that the indirect and past business relationship which Dr Regli's wife had with the Respondent in the past justifies his challenge? Can you think of other scenarios which might justify a challenge of Dr Regli?

A. Types of Business Contacts

23-16 Mr Stels' challenge of Dr Regli, the arbitrator appointed by ALT, poses intricate problems because it is based not on a direct and verifiable business relationship with the party that appointed him but on an indirect and remote contact with ALT. This remoteness involves:

- the character of Dr Regli's connections with ALT – it was not Dr Regli himself but his wife who was involved in ALT's business affairs,
- the intensity of this involvement from the perspective of ALT – the law firm of Dr Regli's wife did not represent ALT itself but one of its subsidiaries,
- the time factor – the involvement of his wife's law firm took place three years ago.

23-17 No clear-cut rules can be proposed in such cases of a remote connection between parties and arbitrators. The ultimate test is the one explained under Question 1 above (No. 23-7): Does the involvement of Dr Regli's wife give rise to an appearance of bias from the perspective of a reasonable third person?

B. Remoteness of Business Contacts

23-18 The answer to this question lies between two extreme positions. On the one hand, an arbitrator's past business relationships with a party *alone* do not operate as an absolute bar to acceptance of appointment or ground for challenge.[33] On the other hand, such past relationships may create the appearance of bias if it is of such magnitude or nature as to be, or appear to be, likely to affect the arbitrator's judgment.[34] Such an impression of bias may be created not only if the arbitrator personally, but also if a family member has or had business relationships with a party to the arbitration. Thus, in a 1992 decision the Swiss Federal Tribunal held that an arbitrator might be challenged for lack of independence and impartiality if his wife had worked for a law firm now representing one of the parties to the arbitration.[35] Likewise, ss. 2.2.2, 2.2.3, and 2.3.9 Waivable Red List contained in Part II of the IBA

33. See Art. 3.4 IBA Rules of Ethics (🔗) ('Past business relationships will not operate as an absolute bar to an acceptance of appointment, unless they are of such a magnitude or nature as to be likely to affect a prospective arbitrator's judgment'.
34. See Lörcher, Lörcher, Lörcher, *Das Schiedsverfahren*, No. 112.
35. BG, BGE 92 I 271; Berger, *International Economic Arbitration*, 244, No. 304.

Guidelines on Conflicts of Interest (🔗) make it clear that doubts as to an arbitrator's independence and impartiality may exist because of the involvement of a close family member.

23-19 The ICSID tribunal in *Aguas de Barcelona*[36] dealt with the issue of the remoteness of business contacts. It must be noted that, contrary to our case, this challenge decision involved a situation in which the contacts still existed at the moment the challenge was raised. That decision is important for two reasons: first, it acknowledges the fact that in a globalized business environment business contacts are natural and the mere fact alone that such contacts existed or still exist does not lead to an automatic disqualification of an arbitrator. This applies to both contacts with the parties and with lawyers working in the field of arbitration. This view was confirmed by the Court of Appeal of Frankfurt. The Court held that it is a matter of course that lawyers practising in a specialized area like arbitration know each other, publish in law reviews or books edited by colleagues involved in the same arbitration and cooperate with each other in professional bodies such as commissions of arbitral institutions. In the eyes of the Court, such inevitable professional connections between arbitrators or with counsel for one of the parties do not as a rule give rise to doubts as to that arbitrator's impartiality or independence.[37] Secondly, the ICSID tribunal in the *Aguas de Barcelona* case developed a four-tier test to be applied in order to determine the remoteness of business contacts in the context of the challenge of an arbitrator.

23-20 In its decision rejecting the challenge of one of its members the ICSID tribunal stated:

> 'Arbitrators are not disembodied spirits dwelling on Mars, who descend to earth to arbitrate a case and then immediately return to their Martian retreat to await inertly the call to arbitrate another. Like other professionals living and working in the world, arbitrators have a variety of complex connections with all sorts of persons and institutions … In seeking criteria for the evaluation of such alleged connection between a party and an arbitrator and its effect on that arbitrator's independence and impartiality, we identify four that we think are particularly important. They are as follows:
> **Proximity**: How closely connected is the challenged arbitrator to one of the parties by reason of the alleged connection? The closer the connection between an arbitrator and a party, the more likely that the relation may influence an arbitrator's independence and impartiality.
> **Intensity**: How intense and frequent are the interactions between the challenged arbitrator and one of the parties as a result of the alleged connection? The more frequent and intense the interaction by virtue of the relationship between an arbitrator and a party, the more probable that such relationship will affect the arbitrator's independence of judgment and impartiality.
> **Dependence**: To what extent is the challenged arbitrator dependent on one of the parties for benefits as a result of that connection? The more an arbitrator is dependent on a relationship for the benefits or advantages, the more likely that the relationship may influence the arbitrator's independence of judgement and impartiality; and

36. *Suez, Sociedad General de Aguas de Barcelona S.A. and Vivendi and The Argentine Republic* (12 May 2008), *Mealey's Int'l Arb. Rep.*, June 2008, at C-1, C-4.
37. OLG Frankfurt, *SchiedsVZ* (2008), 96, 100 *et seq.*

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> **Materiality**: To what extent are any benefits to the challenged arbitrator as a result of the alleged connection significant and therefore likely to influence in some way the arbitrator's judgement? Obviously, significant benefits derived from a relationship will be more likely to influence an arbitrator's judgement and impartiality than negligible or insignificant benefits.'[38]

23-21 This test may be applied to an arbitrator's present and past business relationships. Thus, the Paris Court of Appeals decided in a 2009 judgment that the cumulative effect (Intensity) of various non-disclosed client relationships between the chairman's law firm (Proximity) and the mother company of one of the parties and other members of that party's corporate group – some of them still ongoing at the time the award was rendered – and the fact that his firm derived fees in excess of EUR 110,000 out of these client relationship (Materiality, Dependence) justified the setting aside of the award due to a lack of independence and impartiality of the chairman.[39]

23-22 In the present case, there are various factors which indicate that, in applying the 'reasonable third person test' (No. 23-7), NedTrans' challenge of Dr Regli cannot be sustained due to the remoteness of Dr Regli's contacts with ALT. Based on the considerations of the ICSID tribunal in the *Aguas de Barcelona* case, Dr Regli passes the 'Proximity', 'Dependence' and 'Materiality' test: the law firm of Dr Regli's wife did not work for ALT directly but only for one of its subsidiaries, Dr Regli's wife was not involved in that transaction, her law firm was involved in the transaction three years before the present arbitration took place, and the law firm of Dr Regli's wife has not worked for that subsidiary since then.

23-23 Also, Dr Regli's connection with Respondent ALT was not 'intense' enough to justify a challenge. As a general guideline, sporadic business relationships between an arbitrator or a family member and one of the parties to the arbitration do not justify a challenge if they have been terminated years before the arbitration was commenced and involved matters which were totally unrelated to the dispute before the arbitral tribunal. This rule is reflected in the Orange List (No. 23-31) contained in Part II of the IBA Guidelines. Sections 3.1.1 and 3.1.4 of that List make it clear that the fact that an arbitrator himself or his law firm has served as counsel for one of the parties or one of its affiliates in an unrelated matter within the past three years does not automatically serve as a ground for challenge, but much more for a duty to disclose (No. 23-27). These and other rules contained in the Guidelines are an indication of the general approach adopted by the IBA Arbitration Committee, which was incorporated into General Standard 6(a), pursuant to which the arbitrator must, in principle, be considered to bear the identity of his or her law firm, but the activities of the arbitrator's law firm shall not automatically create a conflict of interest. With

38. *Suez, Sociedad General de Aguas de Barcelona S.A. and Vivendi and The Argentine Republic*, *supra* note 36, C-6 *et seq.* (emphasis added).
39. *J&P AVAX SA v. Tecnimont Spa*, (12 February 2009), *Rev. d'Arb.* (2009), 186 *et seq.*; the judgment was set aside by the French Cour de Cassation in 2010 and remitted to the Cour d'Appel de Reims which confirmed the judgment of the Cour d'Appel de Paris in 2011, see Wilske and Markert, *SchiedsVZ* (2012), 58, 63.

this pragmatic approach, the Guidelines take account of today's reality in international arbitration that the growing size of law firms has led to a dramatic increase of conflicts of interest, and that, in light of this reality, the activities of an arbitrator's firm should not automatically constitute a conflict of interest but that the relevance of such activities, such as the nature, timing and scope of the work by the law firm, as well as the individual corporate structure of which the party is a member and the specific relationship of that corporate entity with the arbitrator's law firm, should be reasonably considered in each individual case:[40]

> 'A long-standing and continuing relationship with the arbitrator's law firm may cast doubts on the arbitrator's independence. By contrast if the law firm has only worked in a few completely unrelated matters for either party or an affiliate of the parties, that should in general not impair an arbitrator's independence. In particular, with law firms growing or merging and the limited number of arbitration specialists it becomes less likely to find a suitable person where no connection whatsoever exists with either party.'[41]

23-24 In line with this general approach of the IBA Guidelines and international arbitration practice, s 3.3.5 of the Orange List clarifies that, even the fact that a close family member of the arbitrator is a partner of the law firm representing one of the parties, but is not assisting with the dispute, does not constitute, in and of itself, a ground for challenge.

23-25 On the other hand, if there are clear indications that an arbitrator does not meet the four-tier test developed by the ICSID tribunal in the *Aguas de Barcelona* case (No. 23-20), then the courts are ready to uphold the challenge. Thus, in 2007, the Swedish Supreme Court has set aside an award because one party was part of a corporate group that was a major client of the chairman's law firm. The Supreme Court held that even if the arbitrator has not himself had a direct client relation with the party, and the arbitration activities are conducted separately from the chairman's ordinary law firm practice, and the arbitration comprised different matters than his normal client assignments, there are still circumstances which, from a reasonable third party's point of view, affect the confidence in the chairman's impartiality.[42]

23-26 It should be noted that, in the past years, the increasing 'judicialization' of international arbitration (No. 16-29) tends to result in increased challenges of international

40. Explanation (a) to General Standard 6(a) IBA Guidelines on Conflicts of Interest.
41. But see Lew, Mistelis, Kröll, *Comparative International Commercial Arbitration*, No. 11-22; DIS Award No. SV-217/02, *BB* (2003), Beilage No. 8, 24 *et seq.*, arguing that a client-relationship of a partner of the arbitrator's law firm with a party of the arbitration or one of its subsidiaries must be attributed to the arbitrator, irrespective of the size of the law firm and of whether that arbitrator was aware of that client relationship or not; see for a different (and heavily criticized) view of barristers working in the same Chambers *Laker Airways Inc. v. FLS Aerospace Ltd and Another* [1999] 2 Lloyd's L. Rep. 45; Merkin and Flannery, *Arbitration Act 1996*, 86; see for a critical approach *Hrvatska Elektroprivreda dd v. Slovenia*, ICSID Case Arb/05/24, https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=viewCase&reqFrom=Home&caseId=C69, ordering a party to refrain from using the services of a QC from a London chambers because one of the arbitrators was a door tenant of the same chambers.
42. See Bagner, *Mealey's Int'l Arb. Rep.*, November 2007, 21 *et seq.*

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