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ARBITRATION BRIEFING

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DEFECTIVE ARBITRATION CLAUSES

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In-depth consideration when drafting arbitration clauses particularly with the involvement of international contracts to uphold the true intention of disputing parties is of critical importance in effective arbitration clauses. This briefing discusses the risks surrounding defective and ambiguous arbitration clauses which may render the arbitration agreement unenforceable, and reviews the consensus in favor of arbitration by courts and arbitral institutions.

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(I) WHAT IS A DEFECTIVE ARBITRATION CLAUSE

A defective arbitration clause is an ambiguously drafted arbitration agreement, which, when it comes to its implementation, may lead to a clash between its effective interpretation and the parties' will to refer their disputes to an arbitral tribunal. Indeed, there are still colliding approaches among practitioners and legal experts as to whether such agreements may be enforced or not.

Specifically, while in an arbitration clause the parties may agree upon several aspects of the arbitration proceeding, there are some essential

elements that such clauses should possess, the lack of which will give raise to a "pathology" that may render the arbitration agreement not enforceable.

Unfortunately, defective arbitration agreements are not uncommon as such clauses are generally agreed upon at the end of the contract negotiations. In fact, once the parties have set the grounds for the commercial terms, they usually leave a very limited time to the drafting of a well-structured dispute resolution clause: this is why they are usually referred to as "*Midnight clauses*"[1].

In consideration of the foregoing, bearing in mind the provisions of the 1958 New York Convention on Recognition and Enforcement of Foreign Arbitral Awards, one may assume that the requirements for a valid and enforceable arbitration clause are the ones set out in the art. 2.1, whereby "[e]*ach Contracting State shall recognize* ***an agreement in writing*** *under which the parties undertake to submit to arbitration all or any* ***differences which have arisen or which may arise between them in respect of a defined legal relationship****, whether contractual or not,* ***concerning a subject matter capable of settlement by arbitration***" (emphasis added).

However, as a matter of fact, even though a hypothetical arbitration clause may have fulfilled all the aforementioned requirements, the pitfalls it may face can emerge in many forms and shapes, the most common of which are the following[2]:

- clauses where the agreement to arbitrate is absent or not clear;
- clauses which make reference to a non-existing arbitral institution (*e.g*. International Chamber of Arbitration of Rome);
- clauses which provide for an institutional arbitration to be carried out pursuant to the rules of another arbitral institution (*e.g.* an arbitration proceeding to be administered by the Milan Chamber of

[1] See Alan Redfern & Martin Hunter with Nigel Blackaby & Constantine Partasides, *Law and Practice of International Commercial Arbitration,* Sweet & Maxwell (2004), p. 156; and *Comparative International Commercial Arbitration*, Lew, Mistelis, et al. (2003), p. 165.
[2] See Gary B. Born, *International Commercial Arbitration*, Volume I. International Arbitration Agreements, Wolters Kluwer International, 2014, p. 789.

Arbitration under the rules of the International Chamber of Commerce);

- ambiguous arbitration agreements that do not clearly state the will of the parties to resolve their disputes through arbitration (*e.g.* "*(…) if the dispute cannot be settled within twenty (20) business days through negotiation, any Party* ***may*** *submit the dispute to binding arbitration*"[3]) (emphasis added).
- dispute resolution clauses in which the parties made reference to both the jurisdiction of an arbitration tribunal and the one of a national ordinary court (*e.g.* "[a]*ll disputes under this Agreement shall be submitted for resolution by arbitration pursuant to the Rules of conciliation and Arbitration of the International Chamber of Commerce in effect as of the date any dispute arose. (…) Each of the parties to this Agreement agrees for the exclusive benefit of the others (sic) that the courts of The Republic of Singapore shall have jurisdiction to hear and determine any suit, action or proceedings and to settle any disputes (…)*"[4]).

It is thus crucial that the parties should seek informed legal guidance before the final drafting of the arbitration clause, in order to be properly advised on the possible alternatives they can agree upon to execute an effective arbitration clause which mirrors exactly their will.

(II) HOW TO DEAL WITH DEFECTIVE ARBITRATION CLAUSES

It should be noted that, although there are still different opinions among practitioners and legal experts about the enforceability of such defective arbitration clauses, it is common practice that national courts seized of their interpretation tend to consider valid and enforceable those provisions which contain vague and approximate indications.

Such a trend is consistent with the process of harmonization of international commercial arbitration, and has resulted in a clear "***favor arbitri***", seeking

[3] See the U.K. Privy Council decision in Anzen v. Hermes One Ltd. [2016] UKPC 1, 18 January 2016.
[4] See the Supreme Court of Singapore decision in P. T. Tri-M.G. Intra Asia Airlines v Norse Air Charter Limited - [2009] SGHC 13, 12 January 2009.

to ensure that arbitration agreements are upheld insofar as possible. This approach is justified by the presumption that if the parties agreed to resort to arbitration, then it is clear that their will was to be bound only and exclusively by an arbitral award, which is even more understandable in case of an international commercial contract.

Indeed, with reference to arbitration clauses in which the parties agreed to submit their controversies to a non-existent (or undefined or partially unclear) institution, or improperly referred to an arbitral institution, it has been considered to be sufficient the mentioning of a specific city or the use of certain expressions to deem the arbitration clause valid and enforceable[5].

For instance, in the case HKL Group Co Ltd v Rizq International Holdings Pte Ltd[6], although the arbitration clause made reference to a non-existent institution, *i.e.* the "Arbitration Committee at Singapore", under the rules of the International Chamber of Commerce, the Singapore High Court has been able to give effect to such pathological clause, holding that "*(…) an incorrect reference to the arbitral institution has not prevented the court from referring the matter to arbitration*".
In the same manner, other national courts have generally been able to give effect to clauses that appeared uncertain when facing issues similar to the above-mentioned ones[7].

In this regard, a Stuttgart court interpreted a clause submitting disputes "*without resource [sic] to the ordinary court to Stockholm, Sweden*" to refer to a Stockholm Chamber of Commerce arbitration. Additionally, an Oldenburg court read a reference to "*the International Court of Arbitration (Internationales Schiedsgericht) in Austria*" as a reference to the international arbitration center of the Austrian Federal Economic Chamber[8].

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5 See Julian D. M. Lew QC, Loukas A. Mistelis & Stefan M. Kröll, *Comparative International Commercial Arbitration* (Kluwer Law International, 2003).
6 See https://singaporeinternationalarbitration.com/2013/02/22/case-update-singapore-high-court-gives-effect-to-pathological-arbitration-clause/
7 In the same direction, see also (1) Asland v. European Energy Corp.; (2) HZI Research Center Inc. v. Sun Instruments Japan Co. Inc.; (3) David Wilson Holmes v. Survey Services Ltd; (4) Gatoil International V. National Iranian Oil Co.
8 See OLG Stuttgart [2006] OLG Report Stuttgart 685.

The judicial inclination to uphold an arbitration clause, the wording of which, despite its defects, demonstrates that parties intended to refer their dispute to arbitration, is also clear in the High Court of Hong Kong decision in the paramount case Lucky-Goldstar v Ng Moo Kee Engineering. In the latter case, the parties agreed that "[a]*ny dispute or difference arising out of or relating to this contract or the breach thereof which cannot be settled amicably without undue delay by the interested parties shall be arbitrated in the third country under the rules of the third country and in accordance with the rules of procedure of the International Commercial Arbitration Association*" [9].

It was commonly known that the "*International Commercial Arbitration Association*" was a non-existent institution and that the "*third country*" meant any country other than Hong Kong. There was thus uncertainty as to the arbitral institution and the place of arbitration. Nonetheless, the Court upheld the arbitration clause, even if pathological, and decided in favor of arbitration.

Furthermore, a similar approach is usually followed by the Italian Supreme Court. Indeed, with the ruling n. 2750 issued on February the 2nd 2011, the Supreme Court held that when it comes to analyzing defective arbitration clauses, ordinary courts should generally give effect to those clauses[10], preferring an interpretation that does so over one that does not, pursuant to art. 1367 of the Italian Civil Code[11].

Therefore, on the basis of the aforementioned and of well-established case law, it is crystal clear the universal favor that the national courts have towards arbitration and towards the application of the principle of "*effective interpretation*". Such a favor provides that where a clause may be interpreted in different ways, the interpretation which enables the clause to

9 See http://neil-kaplan.com/wp-content/uploads/2013/08/Lucky-Goldstar-International-HK-Limited-v-Ng-Moo-Kee-Engineering-Limited-HCA94-of-1993.pdf

[10] See Award n. 211 issued by the Genova's Camera Arbitrale Immobiliare on September the 8th 2014: http://www.ilcaso.it/giurisprudenza/archivio/13742.pdf

[11] Art. 1367 of the Italian Civil Code: "*Nel dubbio, il contratto o le singole clausole devono interpretarsi nel senso in cui possono avere qualche effetto, anziché in quello secondo cui non ne avrebbero alcuno*".

be effective should be adopted instead of the others which lead to a contrary effect.

This consensus is justified by a strong policy in favor of arbitration, which allowed courts and arbitral institutions from all over the world to recognize that where the parties have shown a clear intention to settle any dispute by arbitration, the court should give effect to such intention. The courts should nonetheless give effect to the aforementioned intention even if certain aspects of the agreement may be ambiguous, inconsistent, incomplete or lacking in certain particulars, so long as the arbitration can be carried out without prejudice to the rights of either party and as long as the giving effect to such intention does not result in an arbitration that is not within the will of either party.

(III) HOW TO DRAFT A VALID AND ENFORCEABLE ARBITRATION CLAUSE

It is now worthy to draw our attention to how an effective arbitration clause should be properly drafted[12]. Indeed, in order to have a non-disputable arbitration proceeding, the parties should pay great attention when construing an arbitration clause.

In this regard, many arbitration experts and scholars agree that "*by writing it short and concisely, much is achieved*"[13]: such a consideration is strengthened by the idea that the sample model clauses offered by the majority of the arbitral institutions are sufficient. In fact, these well-established arbitration bodies provide straightforward arbitration clauses that encompass all the required essentials, preventing the parties to

[12] A sample of an effective arbitration clause may be the following: "*Any dispute, controversy, or claim arising out of, relating to, or in connection with this contract, including with respect to the formation, applicability, breach, termination, validity or enforceability thereof, shall be resolved by arbitration. The arbitration shall be conducted by [**one or three**] arbitrators, in accordance with [**identify rules**] in effect at the time of the arbitration, except as they may be modified herein or by mutual agreement of the parties. [**Method of selection of arbitrators**.] The seat of the arbitration shall be [**city, country**], and it shall be conducted in the [**specify**] language. The arbitration award shall be final and binding on the parties, and the parties undertake to carry out any award without delay. Judgment upon the award may be entered by any court having jurisdiction of the award or having jurisdiction over the relevant party or its assets*".

[13] See Julian D. M. Lew QC, Loukas A Mistelis & Stefan M. Kröll, *Comparative International Commercial Arbitration* (Kluwer Law International, 2003), p. 166.

stumble into undesired mistakes which may render the clause unenforceable.

That being stated, there are some key elements that the parties should take into account when agreeing upon an arbitration clause.

As a starting note, the parties that will engage in an international commercial contract should formalize their arbitration agreement in writing, pursuant to the provisions set out in the Article II of the New York Convention, which provides common legislative standards for the recognition and enforcement of foreign arbitration agreements and awards.

That being said, as a first element, since the arbitration agreement constitutes the wave of an important right, the "*judiciary justice*", from its wording the intent of the parties to resort to arbitration, should a dispute arise out of their contractual relationship, has to be clear and unequivocal, meaning that there has to be no room from alternative interpretations.

Secondly, the arbitration clause must precisely draw its boundaries, depicting whether some of, or all, and any disputes arising in connection with the contract, and the interpretation of it must be referred to arbitrators. In this regard, it is advisable to draft an arbitration clause as wide as possible, encompassing all the controversies the parties may be faced with.

As a third element, if the parties decided to rely on an arbitral institution, the drafters should verify the existence and the proper name of the institution chosen to administer the arbitration proceeding. However, when deciding for a well-established local or international institution which has ample and specialized experience on the matter, the parties should insure that the appointed authority will agree to fulfill its mandate.

The fourth element is connected to the third one. It involves the choice of the law governing the substantive contract, the law governing the arbitration agreement and the curial law governing the arbitration proceeding. With specific regard to the curial law, if the parties opted for an

institutional arbitration, it is most recommended for them to choose the arbitration rules of the same institution.

There are other elements that may be included in an arbitration agreement, such as (*a*) the number of arbitrators, (*b*) the qualifications required of arbitrators, (*c*) the method of selection and replacement of arbitrators, (*d*) the language of arbitration, and (*e*) the level of confidentiality that should be granted to the arbitration proceeding.

In conclusion, it is important that all aforementioned elements be considered in-depth prior to the final drafting of any arbitration clause, especially those involving international contracts, so as to ensure that the commercial agreement portrays an enforceable and effective agreement that reflects the true intention of the disputing parties.

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The information provided in this briefing should not be construed as a legal advice. For questions or legal advice on related matters, please contact Prof. Avv. Roberto Pirozzi.

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