# A PRIMER ON INTERNATIONAL ARBITRATION

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A PRIMER ON INTERNATIONAL ARBITRATION

Introduction

The growth in international trade and investment during the last two decades has prompted an increasing use of arbitration to resolve international commercial disputes. This memorandum discusses several issues that are important to any company that (i) is considering international arbitration as an alternative to litigation in national courts, (ii) is drafting an arbitration clause, (iii) is approaching or participating in an arbitration, or (iv) has completed an arbitration and is facing questions of appeal or enforcement.

I. Arbitration or Litigation in National Courts

Definition of Arbitration

International arbitration is a dispute-resolution process that is sanctioned by many international treaties as well as the domestic laws of most countries. It is based in contractual undertakings and results in binding determinations that will be enforced by the courts of virtually all developed countries (and many others), subject to the limitations of national jurisdictional rules and applicable treaties and conventions.

International Arbitration v. Litigation in National Courts

Compared with litigation in national courts, arbitration generally has two advantages and one disadvantage. The first advantage is that arbitration is usually — but not invariably — quicker and cheaper than litigation, chiefly because the rules and procedures are less formal than in national courts, and delays of crowded court dockets are bypassed.¹ The second advantage is that arbitration allows a party to avoid national courts that are objectionable for reasons unrelated to efficiency, an issue further discussed below. A potential disadvantage of arbitration — at least as compared with litigation in unbiased, competent national courts — is that it can be less predictable, in part because arbitral awards are ordinarily difficult to challenge effectively.

A party to a contract may well determine that the risks of arbitration outweigh the advantages if:

¹ National arbitration laws and institutional arbitration rules do, however, ensure that arbitrators will respect generally recognized procedural and evidentiary principles.
(i) the alternative is to refer disputes to the party’s own national courts, or to other courts that are likely to be fair; and

(ii) the other party has assets within the jurisdiction of such courts, or in other jurisdictions that will enforce their judgments.

On the other hand, a party usually will find arbitration to be the more attractive option if:

(i) it is unlikely that the party’s own national courts would have jurisdiction over disputes;

(ii) it is unlikely that the judgments of the party’s own national courts would be enforceable against other parties;

(iii) there are advantages to having disputes resolved by persons with special expertise in the subject matter of the contract;

(iv) the party prefers to resolve disputes with the degree of privacy that only arbitration offers;

(v) the courts having jurisdiction are corrupt, unreliable, or take too long to decide cases; or

(vi) even if the courts having jurisdiction are not corrupt, it seems likely that they would favor the other party.

Finally, even when a party would prefer to have disputes resolved in certain national courts, other parties may have some or all of the concerns described above, thus making arbitration the only real option, unless one party’s bargaining power enables it to impose a requirement that all disputes be submitted to its preferred national courts.

II. Arbitration Clauses

Drafting Arbitration Clauses

Arbitration clauses come in many forms and range from a few lines to several pages in length. Arbitration organizations provide parties with useful model arbitration clauses, although they tend to be expansive and to give arbitrators, or the particular arbitration institution, jurisdiction over all disputes that may arise. If the parties wish, these clauses may be narrowed to require that only a defined subset of possible disputes be
submitted to arbitration. Clauses may also be modified in other ways, such as providing for expedited arbitration schedules.

Arbitration clauses should always be drafted with careful consideration of the laws of the country where the arbitration is likely to take place, and the country or countries where awards may ultimately be enforced. In some cases, domestic laws forbid arbitration of particular claims. (Labor disputes, for example, are not arbitrable in many European countries.) Moreover, arbitration clauses may be drafted in ways that could facilitate, or frustrate, enforcement of awards under the laws of particular countries.

The “principle of separability” is a strong reason for drafting arbitration clauses with particular care. This principle, adopted by U.S. courts and codified in most European arbitration laws, regards an arbitration clause as “separable” from the underlying contractual agreement in which it is contained. Accordingly, even if the underlying contract expires or is invalid, the arbitration clause may still compel the parties to arbitrate disputes falling under the clause.

Place of Arbitration

Parties should specify the site of any arbitration in the arbitration clause. (If the parties cannot agree, most institutional arbitration rules provide methods for designating a place of arbitration without the parties’ assistance.) Because the place of arbitration determines many of the national laws that may apply to the arbitration (including domestic arbitration provisions, conflict-of-law rules, and international treaties), the parties should carefully consider several questions in selecting the arbitration site.

First, arbitration agreements should be recognized as enforceable contractual arrangements under the law of the place of arbitration. Second, the kinds of claims likely to arise under the contract should be arbitrable under the laws of that country. Third, the laws and national courts of the arbitration site should be pro-arbitration, rather than potential sources of procedural delay and litigation. Fourth, the laws of the arbitration site should not restrict the parties’ ability to use counsel (including foreign counsel) of their choice or impose restrictions on the nationality of the arbitrators. Fifth, because the place of the proceedings is generally the place where the award is finalized for purposes of recognition

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2 For instance, some institutions may fix the place, or make an “initial designation,” subject to confirmation or alteration by the arbitrators. Some rules give the arbitrator sole authority to designate a site, absent agreement of the parties. Other rules contain pre-determined site designations. See, e.g., ICC Rules of Arbitration, Rule 14(1) (1998); AAA International Arbitration Rules, Article 13 (1996); LCIA Arbitration Rules, Article 7(1) (1998); and English Arbitration Act of 1996, Section 3.
and enforcement, parties should select a country that is a party to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention).

In selecting the place of arbitration, keep in mind that this selection does not preclude the parties from holding meetings and hearings in other localities as necessary to suit the convenience of the arbitrators, parties, or witnesses. Also, remember to designate the language of the arbitration in the arbitration clause. It is much more efficient if the parties can agree upon a single language for all written submissions and oral proceedings (with interpreters and translators used as necessary to put all evidence into the selected language).

**Choice of Law**

Three principal choice-of-law questions arise in international arbitrations:

1. What substantive law governs the underlying contract?
2. What law governs the arbitration proceeding?
3. What conflict-of-law rules will apply in selecting any of the preceding laws, absent an express choice by the parties?

The parties to a contract are free to designate its governing law. In most cases, this same law will provide the necessary conflict-of-law rules, unless the parties state a contrary intention (which they can readily do, e.g.: “the law of X, excluding its conflict-of-law rules”). In selecting the governing law of a contract, the parties will often select the law of some third country. But there are options beyond the simple designation of some national body of law. For example, one might designate “the law of X insofar as it is not inconsistent with international law.” One might also state in an arbitration clause that, in applying the contract’s governing law, the arbitrators are to be guided by the customs and practices of the industry in question. One can also limit the influence of any designated body of governing law by stating that the arbitrators shall first apply the words and plain meaning of the contract and shall look to the designated body of governing law only to the extent necessary to resolve ambiguities or to fill lacunae in the contract. Or one might exclude particular areas or doctrines of the otherwise governing law (though it is unusual to do so). Finally, the parties are always free to instruct the arbitrators to decide the case ex aequo et bono, that is, on the basis of equity rather than by strict application of the law.

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3 The New York Convention broadly obligates member states to enforce arbitral awards rendered in other member states.
If the parties do not designate a governing law for a contract, arbitrators will apply “default” choice-of-law rules, which may be found either in the applicable institutional arbitration rules or in national arbitration laws. They may, for example, apply “the rules of law with which the case has the closest connections,” or apply “the law determined by the conflict of law rules which [they consider] applicable.” Occasionally, international treaties will furnish the appropriate choice-of-law rules.

Arbitration proceedings are subject to their own legal rules, commonly referred to as the lex arbitri. The lex arbitri includes rules governing (i) agreement on substantive and procedural issues during arbitration, (ii) appointment and removal of arbitrators, (iii) judicial involvement in the arbitration, (iv) the form of the arbitration award, (v) interpretation and enforceability of the arbitration agreement, and (vi) interest and attorneys’ fees. The lex arbitri typically will be determined under the law of the place of arbitration. Indeed, the law of the place of arbitration may contain mandatory provisions that cannot be affected by any agreement of the parties.

Arbitration Rules: Institutional v. Ad Hoc

Parties that have elected to arbitrate rather than litigate should decide in advance whether arbitration will be conducted under the supervision of an established arbitral institution or will proceed before a tribunal created ad hoc. Institutions that employ professional staffs can provide a wide range of services that may not be available in an ad hoc arbitration. For instance, institutions can act as appointing authorities when parties cannot agree on the appointment of a sole arbitrator, or when party-appointed arbitrators cannot agree on the appointment of a neutral arbitrator. They also can supervise proceedings, assist the arbitrators when necessary, fix the remuneration of arbitrators, and collect any advances against the costs of arbitration.

A leading international arbitration institution is the International Court of Arbitration of the International Chamber of Commerce (ICC), headquartered in Paris. The ICC has National Committees in almost 60 countries. As is true of virtually all institutional arbitrations, ICC arbitrations are conducted under the institution’s own set of procedural rules and may be conducted anywhere in the world. Administrative expenses and arbitrators’ fees associated with ICC arbitrations are calculated as a percentage of the sum in

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dispute. Total expenses and fees begin at a minimum of $5,000 for sums in dispute of less than $50,000 and, for disputes involving more than $100 million, reach a maximum of $335,000 plus 0.05 percent of that part of the amount in dispute that exceeds $100 million.\(^6\)

The American Arbitration Association (AAA) and the CPR Institute for Dispute Resolution, both based in New York City, also handle international arbitrations under their respective procedural rules.\(^7\) Outside the United States, however, the AAA and CPR are generally regarded as American institutions and, therefore, when a transaction involves an American party, the remaining parties often prefer to select a “neutral” institution. Unlike the ICC, the AAA and CPR do not closely supervise their arbitrations. For this reason, AAA and CPR arbitrations may be expected to cost less than ICC arbitrations. In both cases, the fees of arbitrators are set by agreement with the arbitrators, and both the AAA and CPR are compensated only for their actual administrative expenses.

The London Court of International Arbitration (LCIA) is the second most important European arbitration institution. Like the AAA, the LCIA does not closely monitor its arbitrations. Thus, the administrative costs of LCIA arbitrations are relatively low. The fees of arbitrators are charged at daily rates ranging from £800 to £2000.\(^8\)

The International Centre for the Settlement of Investment Disputes (ICSID) is a specialized institution, created under the auspices of the World Bank, which is based in Washington, D.C. ICSID arbitration is available only in investment disputes and only if (i) one of the parties is a government or government agency and the other a foreign investor, and (ii) both the investor’s country and the host country have ratified the Convention on the Settlement of Investment Disputes Between States and Nationals of Other States (the Washington Convention).\(^9\) ICSID arbitrations are comparatively inexpensive, in part because ICSID arbitrators are paid at rates substantially below those generally applicable to arbitrators in ICC and other institutional arbitrations.

Finally, arbitrations are often conducted under rules promulgated by the United Nations Commission on International Trade Law (“UNCITRAL”). UNCITRAL is not in any sense an arbitration institution. Instead, the UNCITRAL Rules are available to be

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\(^7\) The AAA and the CPR Institute publish separate sets of rules for international arbitrations.

\(^8\) LCIA Arbitration Rules, Schedule of Costs (1998).

\(^9\) ICSID’s “Additional Facility” is available for disputes in which the country of only one party is an ICSID member.
adopted by parties for use in *ad hoc* arbitrations. They also are often employed in the settlement of disputes arising under international agreements.\(^\text{10}\) One unique advantage of the UNCITRAL Rules is that they are the subject of an extensive *published* jurisprudence, having governed all of the cases that have been heard by the Iran-United States Claim Tribunal in The Hague.

**Arbitrators: Number, Appointment Mechanisms, and Appointing Authorities**

Arbitral tribunals usually consist of either a single arbitrator or a panel of three arbitrators. For disputes involving modest sums, panels of arbitrators will usually involve undue expense. Moreover, regardless of the amount at issue, a sole arbitrator is capable of acting more quickly than a panel. On the other hand, panels are deliberative bodies that enjoy a collective expertise beyond that usually found in a sole arbitrator. Therefore, while a panel may be slower and more expensive than a sole arbitrator, it is also less likely to make a mistake. When the parties have not indicated the preferred number of arbitrators, some rules presume that a single arbitrator should be appointed (*e.g.*, ICC, AAA, LCIA), whereas others presume that a panel of three should be selected (*e.g.*, UNCITRAL, ICSID).

The appointment mechanisms for arbitrators vary. The most common procedure requires that the contracting parties each appoint a single arbitrator and then either the parties or the two selected arbitrators agree on the third and presiding arbitrator.\(^\text{11}\) The arbitration rules selected by the parties should provide for an appointing authority who can intervene if one of the parties fails to appoint an arbitrator or if agreement cannot be reached on a sole arbitrator or on the third presiding arbitrator. Virtually every institution and national arbitration law makes some provision in this regard.

**III. Issues That Arise Once a Dispute Is Submitted to Arbitration**

**Appointment of Arbitrators**

The appointment of arbitrator(s) is the most important initial step in every arbitration. The identity of the arbitrator(s) invariably will affect the character and quality of the arbitral proceedings and may directly influence the outcome. Any arbitrator — whether

\(^{10}\) *E.g.*, investment disputes arising under Chapter 11 of the North American Free Trade Agreement may be arbitrated under the UNCITRAL Rules.

\(^{11}\) In disputes involving more than two parties, some rules (*e.g.*, ICC, LCIA) specifically provide for the appointment of one arbitrator by each side of the dispute, with the chairman appointed in the usual manner, and for the appointment of all three arbitrators by the appointing authority if the parties cannot divide themselves into two opposing sides.
a party-appointed member of a panel or the presiding or sole arbitrator — should be selected with a view to his or her legal ability in the field of the dispute, proficiency in the relevant language, and reputation for independence and impartiality. (In international arbitrations, even party-appointed arbitrators are subject to a requirement of independence and impartiality.) Like judges, arbitrators can be impartial as between the parties while at the same time having clear views on some of the questions that will be at issue in the arbitration. Thus, a potential arbitrator’s record on the relevant issues should be carefully examined, to the extent possible.  

In selecting a party-appointed arbitrator, one should also keep in mind the importance of that person’s ability to communicate effectively with the panel chairman and the other arbitrator. Since the parties appoint their arbitrators before the chairman is selected, there can be no assurance that any particular arbitrator will enjoy the respect of the chairman. But it is possible to make reasonable assumptions in many cases concerning the type of person who will end up being appointed a panel’s chairman. For example, in a dispute between a Japanese and an American company concerning a construction contract governed by English law to be performed in England, the person ultimately selected as chairman would most likely be a Queen’s Counsel from the commercial bar experienced in construction disputes, particularly if England was the site of the arbitration. In this case, a similarly qualified barrister would be a sensible choice as a party-appointed arbitrator.

The grounds for disqualifying arbitrators are set forth in the rules of the various arbitration institutions. In general, disqualification follows from a demonstration that the arbitrator lacks the requisite independence and impartiality. An advantage of institutional arbitration over ad hoc arbitration is that institutions generally provide some means of expeditiously dealing with challenges to arbitrators, whereas in ad hoc arbitrations challenges can only be directed to domestic courts.

Every arbitration institution maintains a list of arbitrators and provides information and résumés for individuals on the list. Another source of information will often be a party’s counsel. Covington & Burling has compiled a sizable amount of information on arbitrators around the world.

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12 Any examination of a potential arbitrator’s views must be done with care. There are limits on what questions may legitimately be asked of an arbitrator being considered for appointment, and on the information that may be revealed to him.
**Costs of Arbitration: Who Pays What?**

There are three categories of fees and expenses that parties must consider. There are fees and expenses for (i) the arbitration tribunal, (ii) the arbitration institution (if the arbitration is not *ad hoc*), and (iii) the parties’ own lawyers. Sometimes, institutional arbitration rules fix tribunal and institutional fees in advance. Alternatively, parties and arbitrators may decide the fees that the arbitrators will receive. Fees may be set as a percentage of the sum in dispute, as a daily rate, or as a lump sum. It is usually necessary for each party to advance a portion of the arbitration fees. If the sum is not paid, the arbitration request generally will be suspended until payment is made. It is also necessary to consider the costs arising from employing legal counsel. Except for the general practice in the United States and under AAA arbitration rules, which require fees and costs to be borne equally by each party, most rules provide for fees and costs (including counsel’s fees) to be borne by the unsuccessful party, unless otherwise determined by the tribunal.

**Interim Measures**

The purpose of a motion for “interim measures” is to protect a party, during the time required to complete the arbitration, from injury that could undermine the arbitration’s purpose. Common examples are dissipation of assets, destruction of evidence, loss of market value of property, and interference with customer relations. There are many kinds of interim measures, and the same measure may be applied differently in different countries.

Authority to grant interim measures varies depending on the applicable national arbitration laws and institutional arbitration rules. Some rules grant this authority to arbitrators, others to courts, and many authorize both. One criticism that is often expressed concerning interim measures is that, even if arbitrators have the authority to grant such measures, they lack the power to enforce them. Arbitrators often do have limited power to enforce interim measures, however, if the parties have previously posted security, or put evidence or property into the custody of the tribunal. Local law, moreover, often authorizes arbitral tribunals to obtain the assistance of courts to enforce interim measures.

**IV. Issues That Arise Once an Arbitration Is Completed**

**Methods of Appealing an Arbitral Award**

Arbitral awards are generally final and binding on the parties. Occasionally, however, proceedings for setting aside an award may be instituted. In ICSID arbitrations, for example, an internal system of review may be invoked by any party to the dispute. And ICC awards must be approved by the ICC’s Court of Arbitration before they become final,
whether or not either party requests such review. Procedures such as these are more the exception than the rule, however.

**Enforcement of Arbitral Awards**

Recognition and enforcement of foreign arbitral awards is determined by the national law of the country where enforcement is sought, which law may include international treaties and agreements in force in that country. The leading agreement in this field is the New York Convention, to which 110 countries were parties as of January 1, 1997. The New York Convention places the burden of establishing the invalidity of an award on the party opposing enforcement. The grounds for vacating an award are quite narrow. They include: the incapacity of the parties at the time of the conclusion of the underlying agreement to submit disputes to arbitration, the violation of a party’s fundamental right to participate in the proceeding, and the irregular composition of the tribunal.

**Conclusion**

Parties to international commercial contracts often prefer arbitration over litigation in national courts. Indeed, international arbitration frequently provides the only mutually agreeable means of resolving disputes. Arbitration must be approached carefully, however, and at all stages, from the drafting of the arbitration clause, to the selection of arbitrators, to the litigation of the dispute, to enforcement of any award.

More than 20 Covington & Burling lawyers have broad experience in the area of international arbitration. All have acted as counsel for parties in such arbitrations; some have served as arbitrators. We have represented parties in arbitrations governed by all of the most important sets of arbitration rules and in proceedings before established international tribunals such as the International Court of Justice and the Iran-U.S. Claims Tribunal. We also have represented parties in a wide range of actions seeking to enforce foreign arbitral awards, both in the United States and in Europe. As a result of this work, we can provide clients with valuable assistance at every stage of the arbitration process.

*Covington & Burling*

*May 1998*