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ARBITRATION AND STATE LAW

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Abstract

It is universally accepted that an arbitral award can be challenged if the arbitrator did comply *with the agreement of the parties* (cf. Art. V of New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958). However, theory and practice do not always meet. Many jurisdictions seem to allow the arbitrator to deviate from such agreement without effect to the award.

The article focuses on the question as to which extent the arbitrator is bound by the state/national law chosen by the parties or applicable but by virtue of international private law. Common wisdom has it that an arbitral award cannot be annulled or denied recognition because the arbitrator erred in the interpretation of the substantive law. Author accepts that in a motion to challenge an arbitral award the state court shall not act as some kind of court of appeal. Therefore, arbitrator must not apply the substantive law in the same way the courts of the respective country do, but he is obliged and the state court is competent to review, whether the award has been made *in accordance with the agreement of the parties.* To this end, the arbitration clause must be carefully interpreted to find out what the parties by choosing, e.g., Swiss law really meant: namely, "law" and not a paralegal regime like *ex aequo et bono*, as well as "Swiss" – and not German, English etc. Unless this is shown in the reasons of the award, it may be annulled or denied recognition for not being in *accordance with the agreement of the parties.*

Keywords: error in substantive by arbitrator, challenge of award, UN Convention, interpretation of arbitration, reasons of award

I. General

The parties are the masters of the arbitral process, not the arbitrators. The parties decide what to do and how. This principle is universally accepted and not challenged anywhere. That is to say – in theory. In real life, however, it seems that the arbitrator enjoys almost unbounded liberty to proceed and to decide even if this runs counter to what the parties asked him to do. Ultimately, the arbitral procedure comes down to the question, whether the arbitral award can be recognized and enforced in the country where recognition and enforcement is sought. This article deals with international arbitral awards and, more specifically, with the question: In which cases is the disregard of the parties wishes by the arbitrator a ground for not recognising and/or not enforcing

an arbitral award? More particularly: Are mistakes of the arbitrator in the application of the applicable law a ground to deny recognition?

Sedes materiae is the *United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards*[1] (New York, 10 June 1958)[2].

II. Disregard of Parties' Intent

1. Place of Arbitration

The parties decide on the place where the arbitration takes place. Failing such decision, the arbitrators decide or, as the case may be, the arbitration institution designated by the parties. The seat is legally important. If the arbitration clause does not contain any reference to the applicable law, the validity of the arbitration clause must be examined under the law of the seat of arbitration[3]. In the case of *Société of Beton etc. v. Libye* (Paris Court of Appeal 1998, Craig p. 186), the following was decided:

The agreed seat of arbitration was Geneva. But the arbitral tribunal had held all hearings in and issued all procedural orders from Paris, where the award was signed.

The losing party challenged the award in the French State Court as contradicting the arbitration agreement. The Paris Court of Appeal declined its jurisdiction. It held that Swiss courts being the seat of the arbitration are competent to rule on the question. *...The seat of arbitration is purely a legal concept, carrying with it important legal consequences and notably the jurisdiction of state courts over applications for annulment, and depends on the will of the parties. It is not a factual concept on the locale of the hearings or that of the effective place of signature of the award, which is liable to vary according to the imagination the arbitrators.*

The view expressed by the French court seems to be generally accepted. German and common law would decide in the same way. But – is it really right? The parties said that the seat of arbitration should be Geneva and not Paris. It does make a difference, whether you convene in Geneva or, for example, in Dubai. May be not in the strict legal sense. A man on the small Carribean island of Barbados, who had lived many years in the USA, once said to the author: *In a small country you think small, in a big country you think big.* So it is. It does have an influence whether you have your sessions in the flamboyant atmosphere of Paris or in the more protestant climate of Geneva. Some parties prefer a posh hotel like the ones to found on Lake Geneva, others may feel that the cold and sober climate of Moscow or Kazan is more appropriate for an arbitral proceeding. Therefore, the express wish of the parties should prevail; and if this wish is unclear, the arbitration clause must be interpreted like any other contract.

2. Language

In international arbitration language can be of big importance. Again the parties decide.

UN-Model Law Article 22 I reads: *The parties are free to agree on the language or languages to be used in the arbitral proceedings. <…> This… shall apply to any*

[1] Italics indicate official names or verbatim citations.

[2] See also Aden M. Wrong answers to wrongs questions? A new approach to judicial review of international arbitral awards, *Revista Brasileira de Arbitragem*, 2015, no. 47, pp. 55–69.

[3] ICC Case No. 14046, Yearbook Commercial Arbitration 2010, *Yearbook Commercial Arbitration 35*, van den Berg A.J. (Ed.), 2010, vol. XXXV, p. 246.

written statement by a party, any hearing and any award, decision or other communication by the arbitral tribunal.

English is the language most used in international cases, but it is not the mother tongue of everybody. Parties, witnesses or arbitrators etc. may not be fluent in English as would be desirable for an arbitrational procedure. This can be important if the agreed language is, such as Turkish or Arabic, a language which none of the arbitrators speaks. It is problematic if the applicable law is that of a country, which language none of the arbitrators speaks or reads.

1. Case: Parties had agreed on the German language for the arbitration proceedings. Arbitrator nevertheless conducted certain proceedings in English[4].

The losing party challenged the award in the State Court of Austria. The Supreme Court of Austria declined to set aside as the award because it saw no causation link between the change of language and the outcome of the arbitration. Is this right? In can make a difference, and in most cases it does, whether you express your views in your own or in another language. The parties wish should prevail.

2. Case: Turkish parties in Germany concluded a contract in the English language under the German law. Turkish law says: Turkish companies… are obliged to keep all their contracts, transactions… in Turkish language[5].

Again the losing party moved to set aside this award. The Argument was refused as the arbitration agreement was under the German law, where no such rule exists. This case is different. The parties' wish prevailed over the political intention of the Turkish law.

III. Mistakes in the Application of Law

The objective of state judiciary is twofold. First: to bring justice to the parties in an individual case. Second: to produce what is called *Rechtssicherheit* in German, i.e., the predictability of law or the stability of the legal structure of the state in which these courts function. In an ideal society both objectives will coincide, but in real life it happens rarely or never. Legislators in national states have learned that the law of international trade is emancipating itself from national laws. This has consequences on how national courts look at arbitral awards. They do not see themselves (any more!) in the role of a "higher instance" of arbitration. As far as arbitration is concerned, the task of the national law and of the state courts is not to preserve predictability of law and stability of the legislative structure of the state. It now seems to be universally accepted that the competence of state judiciary in the area of arbitration has been reduced to giving effect to the parties' agreement[6].

Therefore, the mission of state courts with respect to arbitration is not to oversee whether the arbitrator decides a dispute upon the same understanding of the law as lined out by the respective Supreme Court, courts of appeal etc. The only legitimate question, which can be put by a state court with respect to an arbitral award, is the following:

[4] Yearbook Commercial Arbitration 1997, *Yearbook Commercial Arbitration 22*, van den Berg A.J. (Ed.), 1997, vol. XXII, p. 264.

[5] ICC – Award 16168, Yearbook Commercial Arbitration 2013, *Yearbook Commercial Arbitration 38*, van den Berg A.J. (Ed.), 2013, vol. XXXVIII, p. 212.

[6] Nigeria may be a good African reference for today`s world wide understanding of commercial and arbitration law. cf. therefore: Ola O. Olatawura, Constitutional foundations of commercial and investment arbitration in Nigerian law and practice, *Commonwealth Law Bulletin*, 2014, vol. 40, no. 4, pp. 657–689. doi 10.1080/03050718.2014.972965.

Was the procedure by which the arbitrator reached his decision in line with what the parties agreed?

IV. Interpretation of Arbitration Clause

1. Arbitration as Contract

The nature of the arbitration clause would typically read as follows: *All disputes arising out of this contract shall be decided by arbitration according to the laws of* NN (e.g. Switzerland, New York etc.) *in XX* (State or city).

This clause contains two different agreements. First, an agreement to arbitrate. Second, an agreement by which the parties a) agree on a designated substantive law for the decision of their dispute and b) the parties already now agree to give a joint order to the future arbitrator to apply that law. The agreement to arbitrate (arbitration clause) is a "normal" contract and must be interpreted like any other contract. So, the words "*according to the laws of* NN" (or any other wording to this effect) must be interpreted as to their true meaning. The general presumption is that the parties meant what they said. If the parties choose, e.g., the Swiss law they must be presumed to mean the Swiss law. What did the parties mean when they said: *the dispute shall be decided according to the laws of*, e.g., Switzerland?

They said: it should be a) law and b) Swiss. This means: a) parties did not want paralegal systems or structures, they wanted a national law, and b) they did not want the law of any, but of a clearly designated state. Presumably, parties prefer the national law of Switzerland because of its "Swissness", which they for some reason perceive as being different from Frenchness, Germanness, etc. If parties prefer "Swissness" to, e.g., "Frenchness", there is no reason to assume that parties did not really care how the arbitrator will apply this law. The parties were free to choose the law of, for instance, Iceland. This is also a good and civilized country with good laws. But it may not have courts experienced enough to try certain cases. The Swiss law has a reputation of well-reasoned verdicts based on a long and steady tradition and assisted by renowned legal scholars. This is what parties choose when they agreed on the Swiss law or – mutatis mutandis – on the law of New York, Germany or Korea. The arbitrator has either to comply with this or decline his appointment.

2. Meaning of Arbitration Clause

The arbitration clause substitutes the state court judge by a private judge called arbitrator. Nothing more. Neither national arbitration laws nor the arbitration clause say anything as to how the arbitrator shall apply the law. National arbitration laws and parties obviously never mean to allow the arbitrator to interpret the law in a different way than in the "normal" way, namely as state court judges do it. Therefore, it is not enough to pay tribute to the wording but: *Scire leges non hoc est verba earum tenere, sed vim ac potestatem*[7], which would translate into our understanding: it is not enough to know the words of the law, but the judge must ascertain what the words and the law mean under the given circumstances in real life. For state judges it is, therefore, beyond doubt that they have to mind precedents set by other courts and in case of doubt they will consult legal scholars and even the social environment. The law is binding as it stands – on the judge and the arbitrator. Thus, there can be no

[7] Dig 1, III, 17.

real difference in this point between the judge and arbitrator. Consequently, Art. 1496 of the French Code of Civil Procedure says: *L`arbitre tranche le litige conformément aux règles de droit que les parties ont choisies* (*The arbitrator decides the case according to the rules of law chosen by the parties).* This is exactly the same position as in the German law and apparently in other system laws.

3. Special Elements of Interpreting the Choice of Law Clause in Arbitration

The right of every human to have access to state courts to protect his rights is one of the major achievements of the world civilization[8]. This right may not always and everywhere be put into practice, but there is no place in the world, where it is not recognized as a principle. It is, therefore, no small thing to deny access to national courts, because the parties waived it by a private contract (arbitration clause). It is no small thing that a private instrument (arbitration award) can be enforced like a state court judgement.

National laws to this effect must, therefore, be seen as extraordinary exceptions to the fundamental rule that nobody may ever be denied access to state court protection. It would then follow from the general legal principles that such national laws must be interpreted in the narrowest and strictest way. That is: denial of access to state courts can only be justified if the arbitration procedure and the award were in strict accordance with the agreement of the parties.

V. Consequences: Reasons of the Award and Non-Recognition

1. Reservations

As it has been said, the objectives of state laws and state court jurisdiction are twofold, justice *inter partes* in the given case and *Rechtssicherheit* (= predictability) for the general public. Only the first applies to arbitration. The parties of arbitration do not aim at public policy issues; they only want a just and equitable decision of their case. In arbitration the choice of law clause should, therefore, be interpreted as meaning: parties want the law to be applied as it is done by state courts. All rules must be applied in the way as they are applied in, e.g., Swiss courts. But considerations in statutes or interpretations thereof which aim at political objectives of Switzerland or are otherwise of a public policy shall be disregarded.

This principle would allow an arbitrator to deviate from a rule (set by the law or the leading jurisdiction of, for the example, the Swiss Supreme Court) in those cases, where such rule has a "political" nature; e.g., the mandatory Turkish law on the use of the Turkish language (see above II 3).

2. Fair Trial and Understandable Reasons

Not only must Justice be done; it must also be seen to be done[9]. This often quoted phrase would mean in the context of the foregoing: not only must the arbitrator do what the parties mandated him to do, but it must be seen that he did. To do this,

[8] Art. 8 of the Universal Declaration of Humans Rights (10.12.1948): Everyone has the right to an effective remedy by the competent national tribunals for acts violating the fundamental rights granted him by the constitution or by law.

[9] *R v Sussex Justices* ([1924] 1 KB 256, [1923] All ER Rep 233).

the arbitrator must show this in the reasons of the award. If not, the award should be set aside and/or recognition and enforcement should be denied.

Under the New York Convention, lack of or insufficient reasons of the award can affect recognition and enforcement of the award under two legal aspects.

National arbitration laws generally oblige the arbitrator to give reasoned award. Art. 31 II MAL says: *The award shall state the reasons upon which it is based, unless the parties have agreed that no reasons are to be given…* Failure to state reasons can, therefore, be a ground to set aside an award under the national law under which the award was made[10]. If the award was set aside under that law, *this* – not the lack of reasons as such – would under Art. IV 1e of the New York Convention be a ground to refuse recognition and enforcement.

Lack of reasons is not listed in Art. V of the New York Convention. This does, however, not affect the scope of Art. V 1 *(d) …the arbitral procedure was not in accordance with the agreement of the parties.* Giving reasons is part of the procedure on which the parties agreed. It is a ground to deny recognition if the reasons of the award are not as the parties agreed them to be. To know, whether this is the case or not, the arbitration agreement must be interpreted. It follows from the universal principle of fair trial that the parties must be able to understand the verdict. For arbitral proceedings this would mean that they must also be able to understand two things. First: why does the arbitrator reach at his conclusion? Second: Was this done *in accordance with their agreement?*

If the reasons fall short of one these two points, the *arbitral procedure was not in accordance with the agreement of the parties,* and the award should not be recognized and enforced under the New York Convention.

3. Law as It Really Is

The parties want the chosen law to be applied by the arbitrator in the same way as the state court judge would do. This means that not only the statutes, but also the Swiss jurisprudence and, in case of controversy, legal writings must be consulted. If the arbitrator in preparing his decision does not proceed as a Swiss judge would, then the *arbitral procedure was not in accordance with the agreement of the parties* and the award should be set aside the respective national law and/or recognition should be denied under Art. V. of the New York Convention.

Mistakes occur always and everywhere. The interpretation of the arbitration clause would, therefore, normally mean that the parties would condone minor slips and even outright mistakes in the application of law as being within the human range of fallibility. This will particularly be the case if the parties deliberately chose a technical or other expert as arbitrator instead of a trained lawyer[11]. Series of mistakes or open blunders would, however, give rise to the presumption that the arbitrator did not know the law he undertook to apply when accepting his mandate and, therefore, did not do what the parties wanted him to do.

[10] UNCITRAL 2012 Digest of Case Law on the Model Law on International Commercial Arbitration, New York, United Nations, 2012, p. 127 with further references.

[11] Superior Court of Quebec 16. April 1987, quoted in: Aden, Internationale Handelsschiedsgerichtsbarkeit, München, ed. 2, 2003, p. 362: *Arbitrators cannot be criticized for expressing themselves as commercial men and not as lawyers.*

Errors in law can, thus, to a certain extent be accepted. It be must be clear, however, that the arbitrator committed these within the framework of the chosen law. It would be contrary to parties agreement if he filled a gap in his knowledge of the Swiss law with some legal ideas he gathered from elsewhere[12].

4. Errors of Law in System Law

System laws like in Germany, France, Russia, etc. are characterized by statutes. If the parties have chosen a system – law, the statutes must be read and the reasons must show that they have understood in the light of the pertaining jurisprudence and in their systematic context. The award shall be set aside if this is not done. The arbitrator is presumed to have been given by the parties the same judicial freedom as the state courts of that system of law. A procedural error is also in a clear legal error in the meaning of Art. V. of the New York Convention will only be there if his interpretation is simply not tenable. So, the arbitrator would not be bound by a supreme court ruling provided, however, that he took cognizance of this and he shows in his reasons why he did not follow that line.

In common law it can be difficult to find out what the law is, as this is traditionally built precedents, which should (but not always must) be followed under the principle of *stare decisis.* When choosing a law from the common law family, the mandate to the arbitrator must be understood as meaning that he makes himself acquainted with the relevant cases and decisions.

VI. Practical Aspects

Author is well aware that some of his findings run counter to prevailing practice of arbitration. It should, however, be kept in mind what kind of financial and other interests are involved in the practice of international commercial arbitration on the side of arbitrators and arbitration institutions. This has the very clear tendency to emancipate arbitration from state law. The following quotation sums this up: *Arbitration is often run like a business, which attracts large fees. It has even led to a monopolisation tendency among a small group of practitioners, which raise issues of credibility, legitimacy, openness and accountability*[13].

In the article *Confidentiality of Arbitral Proceedings – An Infringement on Fundamental Procedural Rights?*, the present author has proposed that in certain big cases arbitrators and their proceedings should be put under some sort of supervision of the state courts[14]. This is very similar to what Dalhuisen proposes in his letter to Financial Times: *There should be an international commercial court to supervise this activity. It would not mean a full appeal… but supervision of the appointment and behaviours of arbitrators. Such a court could also take the lead in the challenges and enforcement of the awards. Importantly, arbitrators should be able to ask preliminary opinions from this court…*

[12] contra: UNCITRAL Digest 2012, Art. 36, p. 181 with further references.

[13] Financial Times, 7th May 2015: Letter to the Editor from Jan Dalhuisen.

[14] Die Nichtöffentlichkeit des Schiedsververfahrens – Verstoß gegen ein prozessuales Grundrecht, *Deutsche Zeitschrift für Wirtschaftsrecht*, 2012, p. 363.

VI. Practical Advice

Author wants to add a practical advice. If parties want to safeguard that the arbitrator really does what they want him to do, they should be precise in the wording of their arbitration clause, for example as follows:

The arbitrator shall decide upon Swiss law. He shall be obliged to apply this law in the same way as a state court judge. The award must clearly show that the arbitrator was fully aware of the state of Swiss law at the time of making the award. In case of a clear legal mistake, the award shall be challengeable.

As a further encouragement for the arbitrator to strictly comply with the parties wishes, parties should consider to insert a clause in the contract with the arbitrator somehow as follows: if the award has been successfully challenged for non-compliance with parties agreement, the costs and fees, which will follow from a new whether arbitral or state court procedure shall be borne by the arbitrator.

To put it short: parties should be more careful and circumspect when negotiating an arbitration clause.

VII. Results

If the arbitrator does not exactly do what the parties wanted him to do or if he cannot show his reasons to the arbitral award that he did, *the arbitral procedure was not in accordance with the agreement of the parties* and recognition and enforcement of the award shall run upon the request of the aggrieved party be denied according to Art. V of the New York Convention of 1958.

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Аннотация

В настоящее время общепризнано, что арбитражное решение может быть отменено строго на основе *соглашения сторон* (ст. 5 Конвенции ООН о признании и приведении в исполнение иностранных арбитражных решений 1958 г.). Однако реальная практика часто расходится с этим положением. В ходе целого ряда правовых ситуаций арбитр получает возможность отступать от указанного соглашения без исправления арбитражного решения.

В статье рассматривается вопрос о том, в какой степени действия арбитра должны соответствовать государственной/национальной системе законодательства, которую выбрали стороны правового процесса, или международному частному праву. Известно, что в признании и исполнении арбитражного решения не может быть отказано, если арбитр совершил ошибку в ходе толкования норм материального права. Автор придерживается точки зрения, согласно которой государственный суд той или иной страны не может действовать подобно апелляционному суду в ходе рассмотрения вопроса о правомерности арбитражного решения. Таким образом, арбитр не должен применять материальное право так, как это делают судебные инстанции какого-либо государства. Действия арбитра и компетенция государственного суда должны основываться именно на *соглашении сторон*. В связи с этим толкование арбитражной оговорки в соглашении необходимо проводить с особой осторожностью, для того чтобы понять, что в действительности имели в виду стороны. Так, например, что подразумевается под швейцарским законодательством: был ли это «закон» или параюридические нормы (*ex aequo et bono*), а также означало ли это приверженность швейцарским правовым нормам в отличие от норм, принятых в Германии или Англии. Если вышеуказанные условия не соблюдаются при вынесении арбитражного решения, то последнее может быть отменено или не приведено в исполнение как *противоречащее соглашению сторон*.

Ключевые слова: ошибочное толкование норм материального права арбитром, отмена арбитражного решения, Конвенция ООН, толкование арбитражного решения, условия вынесения арбитражного решения

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