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**TOPIC  
DEFECTIVE ARBITRATION CLAUSES IN INTERNATIONAL  
COMMERCIAL CONTRACTS**

**MASTER THESIS**

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Study program state code: 62401S120

Study program ISCED code: 51238

Vilnius, 2010

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## INTRODUCTION

Parties to a commercial contract are not bound to solve their disputes always by the way of litigation. Parties have a right to agree on settlement of their disputes in arbitration as an alternative dispute resolution instrument. For everything to go smoothly in the arbitration process, the arbitration clause incorporated in the contract or existing as a separate arbitration agreement must be drafted with exceptional care in the first place. Carefully and rightfully formulated arbitration clause will save a lot of time and money when a dispute actually arises. Drafters of the contract, who pay insufficient attention to the formulation of the arbitration clause, may come up later with so called “pathological”<sup>1</sup> or “defective”<sup>2</sup> arbitration clauses. It should be noted at this point that terms “pathological” and “defective” are used as synonyms in the doctrine and they can be used interchangeably. For the purpose of clarity and in order to comply with the title of my master thesis term “defective” will be used. Defective clauses introduce many obstacles to the arbitration process and sometimes even make arbitration impossible. These arbitration clauses are defective, because they contain inconsistencies or uncertainties regarding main elements of arbitration clause e.g. the official title of arbitration institution, its location, number of arbitrators, procedure of arbitrators’ nomination or any other element of arbitration clause. Generally speaking any element of the arbitration clause let it be official title of arbitration institution, location of the institution, procedure of appointing arbitrators, rules applicable to arbitration or other, which are drafted in an ambiguous or uncertain way most likely will render arbitration clause defective. This means parties fall in a situation where there is a large space for discussions about what does one or the other element of arbitration clause really mean or what were the true intentions of the parties when drafting the arbitration clause? Sometimes defective arbitration clauses are “cured” or “saved” by competent arbitrators, nevertheless persons valuing their time and money would really be strongly advised to avoid defective arbitration clauses. Therefore my purpose is to identify features of defective arbitration clauses and find out what are the best possible solutions or ways not letting defective arbitration to appear. Consequently I believe that this topic is truly worth of investigation and the results, which I am planning to achieve, will be of great value both to practitioners and academic society.

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<sup>1</sup> Frederic Eisemann is renowned for inventing the conception of “pathological arbitration clauses” in *La clause d’arbitrage pathologique*, Arbitrage Commercial: Essais in memorium Eugenio Minoli 129. 1974.

<sup>2</sup> Defective arbitration clauses were first discussed by Clive M. Schmitthoff “Defective Arbitration Clauses” // *Journal of Business law*. 1975, Issue 9.

**The scientific problem**, which is the foundation for the development of the master thesis, is the question: what should be done in order to avoid defective arbitration clauses and what should be done in case of facing defective arbitration clauses?

**The object** of the master thesis is defective arbitration clauses and factors, which give rise to defective arbitration clauses. The scope of geographical territory, which will be involved in this research project, goes beyond the borders of Lithuania in order to assess defective arbitration clauses on international level.

**The goal** of the master thesis is after having established true definition of defective arbitration clause and analyzed its various types to provide a way to create correct arbitration clauses.

**Tasks**, which are going to be achieved, are the following: a) to identify the main features of defective arbitration clause, b) to identify the main elements of well drafted arbitration clause, c) to identify the main types of defective arbitration clauses, d) to provide a classification of defective arbitration clauses, e) to find as much as possible ways to avoid defective arbitration clauses and f) to analyze doctrine and case law in this field and draw result encompassing conclusions.

**Hypothesis.** If drafters of arbitration clause take into account all relevant circumstances of a particular situation, it is possible to create a perfect arbitration clause.

**Methods** used in this thesis: a) text analysis, b) historical, c) comparative, d) logical. All chosen methods are eligible in order to reach the goals of this master thesis.

The structure of the master thesis is composed of six parts, with their chapters and subchapters respectively. With each part and chapter foundation of knowledge is built, which helps to answer the questions of master thesis in the end.

First part briefly defines international commercial contract and in the second part the roots of defective arbitration clause are discussed in detail. Firstly the definition of arbitration clause and forms of arbitration agreement are given, next fundamental separability doctrine, features of defective arbitration clause and Eisemann's criteria follow. Third part deals with essential elements of arbitration clause and their potential defects. With each essential element possible defects are presented. Fourth part analogously focuses on important elements of arbitration clauses and their defects. In fifth part a classification of defective arbitration clause is crystallized, at that same time analysis of components is provided. Sixth chapter presents guidelines and solutions how draft correct arbitration clauses.

After all six parts conclusions follow. Conclusions show how successfully were the tasks completed, which are declared in the beginning of the master thesis.

## 1. International commercial contract

At the beginning it is necessary to emphasize that the first part of dual object of master thesis is defective arbitration clauses, which are contained in international commercial contracts. Thus defective arbitration clauses stipulated in domestic commercial contracts do not fall under the scope of master thesis. In order to have firm foundations for further analysis of defective arbitration clauses in international commercial contracts a notion of international commercial contract should be given.

The Preamble of UNIDROIT Principles establishes: *“These Principles set forth general rules for international commercial contracts.”* Official integral version<sup>3</sup> of UNIDROIT Principles gives comment for the term “international contract”. It is said that international nature of a contract may be defined by a reference to the place of business or habitual residence of the parties in different countries. Various countries may employ one of more general criteria such as the contract having “significant connections with more than one State”, “involving a choice between the laws of different States”, or “affecting the interests of international trade” should be treated as international.

When trying to find out the meaning of an international contract it is useful to look at United Nations convention on contracts for the international sale of goods (hereinafter - CISG) article 1: *“This Convention applies to contracts of sale of goods between parties whose places of business are in different States”*. UNCITRAL Digest<sup>4</sup> of case law on the CISG art. 1 says that, Convention’s sphere of application is limited to contracts for the international sale of goods. According to article 1 (1) a contract for the sale of goods is international when the parties have at the moment of the conclusion of the contract their relevant place of business in different States. Although the concept of “place of business” is paramount to the determination of internationality, the Convention does not define it. According to one court<sup>5</sup>, “place of business” can be defined as “the place from which a business activity is de facto carried out [...]; this requires certain duration and stability as well as a certain amount of autonomy”. The internationality requirement is not met where the parties have their relevant place of business in the same country.

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<sup>3</sup> UNIDROIT Principles Official integral version // <http://www.unidroit.org/english/principles/contracts/principles2004/integralversionprinciples2004-e.pdf> // connection time: 2010-09-07.

<sup>4</sup> UNCITRAL Digest of case law on the United Nations Convention on the International Sales of Goods (<http://daccess-dds-ny.un.org/doc/UNDOC/GEN/V04/547/19/PDF/V0454719.pdf?OpenElement>) // connection time: 2010-09-08.

<sup>5</sup> Oberlandesgericht Stuttgart, Germany, 28 February 2000, Internationales Handelsrecht, 2001.

What constitutes commercial nature of international contract? This is important point to analyze, because arbitration is intended to solve disputes of commercial nature and sometime it happens that parties refer disputes to arbitration, which are not capable of being arbitrated. Arbitrability issues are covered in more detail in subchapter 8.1.2. UNCITRAL Model Law on International Commercial Arbitration (hereinafter – UNCITRAL Model Law on Arbitration)<sup>6</sup> provides: *“the term “commercial” should be given a wide interpretation so as to cover matters arising from all relationships of a commercial nature, whether contractual or not. Relationships of a commercial nature include, but are not limited to, the following transactions: any trade transaction for the supply or exchange of goods or services; distribution agreement; commercial representation or agency; factoring; leasing; etc.”*

To sum up first chapter, it could be said, that although contracts between parties may be concluded in any form appropriate for them, international commercial contracts involving arbitration clauses are usually in written form, because written form is essential for validity of arbitration agreement and its recognition<sup>7</sup>. Therefore international commercial contract involving arbitration clause could be defines as follows: international commercial contract is legally binding agreement between two or more parties in a written form covering matters arising from all relationships between the parties of a commercial nature and involving cross-boarder element.

## **2. Defective arbitration clause**

### **2.1. Arbitration clause**

Since defective arbitration clauses are the object of analysis, understanding of what is arbitration clause is fundamental. Terms “arbitration clause” and “arbitration agreement” are interconnected, because arbitration clause is one of the possible forms of arbitration agreement as explained later in this chapter. As a result sections devoted to arbitration agreement automatically apply to arbitration clause.

UNCITRAL Model Law on Arbitration art. 7 (1) sets forth definition of arbitration agreement: *“Arbitration agreement” is 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. An arbitration agreement may be in the form of an arbitration clause in a contract or in the form of a separate agreement.*” As it is clear from

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<sup>6</sup> 1985 UNCITRAL Model Law on International Commercial Arbitration, with amendments as adopted in 2006, with explanatory note.

<sup>7</sup> New York Convention art. 2 part 1// [http://www.uncitral.org/pdf/english/texts/arbitration/NY-conv/1958\\_NYC\\_CTC-e.pdf](http://www.uncitral.org/pdf/english/texts/arbitration/NY-conv/1958_NYC_CTC-e.pdf); connection time: 2010-09-10.

the last sentence of abovementioned article, arbitration clause is one of the available forms of the arbitration agreement. Arbitration clause is incorporated into the underlying contract and is a part of it. Law on commercial arbitration of Republic of Lithuania<sup>8</sup> provides almost identical definition of arbitration agreement in article 9: “*“Arbitration agreement” means an agreement between 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, and which may be the subject matter of arbitral examination*”. There is an additional requirement regarding the disputes, which have arisen or which may arise between the parties in respect of a defined legal relationship. Disputes must be capable of being subject matter of arbitration. This means, that disputes must be arbitrable. Traditionally, certain kinds of claims such as antitrust or competition law issues, securities issues, intellectual property disputes, personal status and employment issues were not considered as proper subjects for arbitration<sup>9</sup>. Law on commercial arbitration of Republic of Lithuania is based on the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards (hereinafter - New York Convention), therefore in article II (1) of the New York Convention<sup>10</sup> we can find the same requirement regarding subject matter of the dispute, that dispute must be capable of settlement by arbitration in order for arbitration agreement to be recognized and valid: “*Each 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*”. Thus is it advisable for parties to a contract before resorting to arbitration to consider first whether their dispute is arbitrable, because there is a possibility that in their particular situation only the State courts have jurisdiction over the dispute.

To sum up this chapter, arbitration clause could be defined as a contract clause, contained in the main contract or incorporated by reference in other binding agreement, which establishes the consensus between the parties to submit to arbitration all or certain arbitrable disputes, which have arisen or which may arise between them in respect of a defined legal relationship, whether contractual or not. Incorporation of arbitration clauses by reference is covered in the next subchapter.

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<sup>8</sup> Law on commercial arbitration of Republic of Lithuania //

[http://www3.lrs.lt/pls/inter2/dokpaieska.showdoc\\_l?p\\_id=325446](http://www3.lrs.lt/pls/inter2/dokpaieska.showdoc_l?p_id=325446); connection time: 2010-10-13.

<sup>9</sup> R. Doak Bishop. A practical guide for drafting international arbitration clauses. Houston: King & Spalding. 2000, P. 9.

<sup>10</sup> New York Convention // [http://www.uncitral.org/pdf/english/texts/arbitration/NY-conv/1958\\_NYC\\_CTC-e.pdf](http://www.uncitral.org/pdf/english/texts/arbitration/NY-conv/1958_NYC_CTC-e.pdf); connection time: 2010-09-10.

## **2.1. Forms of Arbitration agreement**

Arbitration clause is one of the possible forms of arbitration agreement, therefore for the purpose of understanding the topic of defective arbitration clauses better other forms of arbitration agreement should be discussed too. An arbitration agreement may be in the following forms: a) arbitration clause incorporated in a contract, b) a separate agreement, c) arbitration clause incorporated by reference and d) submission agreement. When the main contract between the parties refers to a separate agreement, where arbitration clause is located, the form of arbitration agreement in such a case is called incorporation by reference. At this point it is important to note that parties must express their consent to be obliged by that separate contract, where arbitration clause is stipulated. Otherwise such arbitration clause incorporated by reference might be hardly useful when trying to resort to arbitration, because one party might argue that it did not agree to separate contract involving arbitration clause, therefore arbitration clause has no power and is not valid. During large projects parties may conclude a number of contracts between them concerning commercial or financial matters and they conclude one main arbitration agreement, which applies to all other contracts concluded between the parties. In this case we would have an “umbrella arbitration agreement”<sup>11</sup>. Moreover, it should be noted, that in the absence of arbitration agreement parties can agree and refer existing dispute to arbitration, such agreement is called submission agreement<sup>12</sup>. Submission agreements are not so frequently used in practice, because submission agreement requires the disputing parties to submit their already existing dispute to arbitration and when a dispute arises it is usually hard to agree on anything. So it would be preferable to include arbitration clause in a contract in order to avoid the difficulties relating to the submission of existing disputes to arbitration.

### **2.1.1. Incorporation of arbitration clauses by reference**

Incorporation of arbitration clauses by reference is one of possible expression forms of arbitration agreement. Due to potential problems, which parties to a contract may face, when selecting this particular form, it is worth of analysis in greater detail. In many cases the arbitration clause will be a clause within underlying contract. However, it is sometimes the case that the underlying contract will refer to the terms of another contract, which will then contain the arbitration clause. There is a conflict of opinion as to whether the reference to another

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<sup>11</sup> . D. Bishop. A practical guide for drafting international arbitration clauses. Houston: King & Spalding. 2000, P.12

<sup>12</sup> Margaret L. Moses. The principles and practice of international commercial arbitration. New York (N.Y.): Cambridge University Press. 2008, P. 17



contract is sufficient to incorporate the arbitration agreement from that contract to the underlying contract<sup>13</sup>. The issue of the incorporation of an arbitration clause by reference has also been considered in *Tradax Export SA v Amoco Iran Oil Co*<sup>14</sup>. The Swiss Federal Supreme Court reviewed both domestic and foreign case law on this issue. The court stated: “*Generally speaking, when one is dealing with an agreement which refers to a separate contract in which the requirement for arbitration is set out, usually in the general conditions, foreign case law and opinion seem to accept the validity of the latter, when there is a specific reference to the arbitration clause...*”. In other words courts’ position is that reference must namely refer to arbitration clause of another contract in order for arbitration clause to be successfully incorporated. A general reference to another contract would not suffice.

Article 7 (2) of the UNCITRAL Model Law on Arbitration deals with incorporation of arbitration clauses by reference and states that: “*The reference in a contract to any document containing an arbitration clause constitutes an arbitration agreement in writing, provided that the reference is such as to make that clause part of the contract.*” This provision of the UNCITRAL Model Law on Arbitration is generally thought to permit the incorporation of an arbitration clause by general reference<sup>15</sup>. In a number of cases dealing with incorporation, under article 7 of the UNCITRAL Model Law on Arbitration, it has been held that general words of incorporation would suffice. In *Astel-Peiniger Joint Venture v Argus Engineering & Heavy Industries Co Ltd.*<sup>16</sup> the High Court of Hong Kong considered a sub-sub-contract with general reference to another contract that contained the arbitration clause. The High Court stated: “*I would find it to be strange result if the parties had agreed to incorporate by the words they used only some of the terms of the assembly subcontract but not others including the arbitration clause – particularly where others in the contractual train ahead agreed on arbitration*”.

To conclude this section, the answer to the question whether the reference to another contract is sufficient to incorporate an arbitration clause depends on the type of the reference itself. If the reference clearly refers to an arbitration clause in other document then it is sufficient and on the contrary if the reference refers to the other document as a whole then the reference could be treated as insufficient.

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<sup>13</sup> Tweeddale, Andrew. *Arbitration of Commercial Disputes: International and English Law and Practise*. Oxford: Oxford University Press. 2007, P. 103.

<sup>14</sup> *Arrets du Tribunal Federal* (1984), 110, II, 54, (1986) XI Ybk Comm Arbn 532-6, 7, February 1984, Tribunal Federal.

<sup>15</sup> Tweeddale, Andrew. *Arbitration of Commercial Disputes: International and English Law and Practise*. Oxford: Oxford University Press. 2007, P. 105.

<sup>16</sup> *Case Law on UNICITRAL texts (CLOUT)* Case No. 78.

### 2.1.2. Written form requirement

In chapter 2 forms of arbitration agreement were covered as possible expression means of arbitration agreement. Now emphasis will be put on the formal requirements or in other words legitimate means to express arbitration agreement. In an international context the need for the arbitration agreement to be in writing is fundamental. First, without an agreement in writing there may be no right to arbitrate. Secondly, if arbitration is to be enforced then the right to arbitrate must be unambiguously stated. There is a requirement in New York Convention that an arbitrator's award, if it to be enforced, should be made pursuant to an agreement in writing. There is no universal definition of the words "in writing". However, a starting point for an analysis of what constitutes an agreement in writing is the New York convention. The New York Convention imposes on the signatories to that Convention an obligation to recognize arbitration agreements. The New York Convention provides a presumptive validity of arbitration agreement in abovementioned article II (1) of the Convention. The obligations imposed upon a contracting State by the New York Convention therefore require that the State should give effect to arbitration agreement between parties who have a defined legal relationship and where the subject matter of the dispute is "*capable of settlement by arbitration*". Articles II (2) and (3) of the New York convention provide partial definition to the phrase "agreement in writing". Article II (2) states that "*The term "agreement in writing" shall include an arbitral clause in a contract or an arbitration agreement, signed by the parties or contained in an exchange of letters or telegrams.*" This provision of the New York Convention is generally seen as imposing a minimum requirement on the contracting States. State can enact arbitration legislation which provides for the term "in writing" a broader meaning. Most modern legislation recognizes that the definition within New York Convention is narrow and that a broader definition to the phrase "in writing" should be provided.

Explanatory note<sup>17</sup> of UNCITRAL Model Law on Arbitration establishes a broad definition of the phrase "in writing". Article 7 (parts 3-6) states: "*An arbitration agreement is in writing if its content is recorded in any form, whether or not the arbitration agreement or contract has been concluded orally, by conduct, or by other means. ... The reference in a contract to any document containing an arbitration clause constitutes an arbitration agreement in writing, provided that the reference is such as to make that clause part of the contract.*"

It is evident that UNCITRAL Model Law on Arbitration provides much broader definition of the term "in writing" than New York Convention. The term "in writing" has got a new meaning. The key aspect is the requirement for the arbitration agreement to be recorded

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<sup>17</sup> Explanatory note of UNCITRAL Model Law on Arbitration //

[http://www.uncitral.org/pdf/english/texts/arbitration/ml-arb/07-86998\\_Ebook.pdf](http://www.uncitral.org/pdf/english/texts/arbitration/ml-arb/07-86998_Ebook.pdf) // connection time: 2010-09-20.

irrespective of the way how the arbitration agreement was achieved. This flexible definition helps to meet the needs of contemporary world.

## 2.2. Separability Doctrine

When discussing topic of defective arbitration clauses separability doctrine should be touched as well. Nearly every jurisdiction now recognizes the concept of separability or autonomy of the arbitration agreement<sup>18</sup>. The essence of this doctrine is that the arbitration clause is an independent agreement, separate from the remainder of the contract in which it is contained<sup>19</sup>. This means that termination of a contract containing an arbitration clause does not affect arbitration clause itself and therefore agreement to refer all or any disputes to arbitration regarding that terminated contract does not cease to exist. Moreover the principle of separability means that the underlying contract containing arbitration clause may be void but the arbitration agreement may survive. An arbitral tribunal may declare a contract invalid yet retain its jurisdiction to decide a dispute as to the consequences of such invalidity provided that the arbitration clause is valid as a separate entity<sup>20</sup>. Separability doctrine implies that if someone enters into a contract with an arbitration clause, it actually enters into two separate agreements: main contract and arbitration agreement. The principle of separability is supported in the case-law of various countries e.g. in the Swiss case of *Tobler*<sup>21</sup> the Swiss Federal Tribunal decided: *“The nullity of the principal contract does not necessarily result in the nullity of the arbitration agreement, but only if the nullity grounds apply simultaneously to the principal and arbitration agreement (e.g. a party was unlawfully forced to sign a contract with arbitration clause).”* In *Heyman v Darwins*<sup>22</sup> the House of Lords held that an arbitration agreement was not terminated by a breach of the underlying contract. The House of Lords made a distinction between the effect on the arbitration clause contained in the principal contract when the contract was wrongfully terminated by one of the parties and the effect on the arbitration clause when the underlying contract was void. The House of Lords held that in the first case arbitration clause would not be affected and in the second it would be.

ICC Rules of Arbitration acknowledge the doctrine of separability in article 6 part 4: *“Unless otherwise agreed, the Arbitral Tribunal shall not cease to have jurisdiction by reason of*

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<sup>18</sup> Tweeddale, Andrew. *Arbitration of Commercial Disputes: International and English Law and Practise*. Oxford: Oxford University Press. 2007, P. 122.

<sup>19</sup> *Prima Paint Corp. v. Flood & Conklin Mfg. Co.* 388 U.S. 395, 402, 1967.

<sup>20</sup> *Ybk Comm Arbn* 384, 406, 1990.

<sup>21</sup> 59 Swiss Federal Tribunal decisions I 177 at 179. 1933T

<sup>22</sup> Tweeddale, Andrew. *Arbitration of Commercial Disputes: International and English Law and Practise*. Oxford: Oxford University Press. 2007, par. 20.03.

*any claim that the contract is null and void or allegation that it is non-existent, provided that the Arbitral Tribunal upholds the validity of the arbitration agreement. The Arbitral Tribunal shall continue to have jurisdiction to determine the respective rights of the parties and to adjudicate their claims and pleas even though the contract itself may be non-existent or null and void.”* UNCITRAL Model Law on Arbitration also entrenches the essence of the doctrine in article 16(1): *“The arbitral tribunal may rule on its own jurisdiction, including any objections with respect to the existence or validity of the arbitration agreement. For that purpose, an arbitration clause which forms part of a contract shall be treated as an agreement independent of the other terms of the contract. A decision by the arbitral tribunal that the contract is null and void shall not entail ipso jure the invalidity of the arbitration clause.”* Law on Commercial Arbitration of Republic of Lithuania establishes identical provision in Article 19(1).

The doctrine of separability is essential in order to fulfil parties’ intentions to refer their dispute to arbitration. Judge Schwebel lists four reasons<sup>23</sup>, which justify the importance of separability doctrine: 1) Autonomy of the parties, which reflects the intentions of the parties to resort only to arbitration, if parties agreed on arbitration, 2) Without separability doctrine arbitration agreement would become easily contestable and would lose its advantages, 3) There is no reason for treating agreement in an underlying contract differently than an *ad hoc* agreement (ad hoc agreement is not affected by the termination of underlying contract, the same treatment should be regarding arbitral clause contained in the main contract), 4) Absence of separability doctrine would give possibility for state courts to interfere. This would deny the whole purpose of arbitration.

To conclude this chapter it is clear that doctrine of separability is widely recognized on international level both in practice and doctrine, because it is a cornerstone in helping arbitration agreement to perform its functions.

### **2.3. Features of defective arbitration clause**

Now that the fundamental concepts of international commercial contract and arbitration clause have been analyzed in depth it is time to shift focus onto defective arbitration clauses. As already mentioned in the introduction terms “defective” and “pathological” arbitration clauses are used as synonyms, because in doctrine these two terms are used to describe the same arbitration clause, which has been drafted with some kind of inaccuracies, which may hamper arbitration later on.

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<sup>23</sup> Judge Schwebel, *International Arbitration: Three Salient Problems*. 1987

Pathological<sup>24</sup> arbitration clauses might be defined as those drafted in such a way that may lead to disputes over the interpretation of the arbitration agreement, may result in the failure of the arbitral clause or may result in the unenforceability of an arbitral award. Examples<sup>25</sup> of such problems include (1) equivocation as to whether binding arbitration is intended, (2) naming a specific person as arbitrator who is at the time of dispute deceased or who refuses to act, (3) naming an institution to administer the arbitration proceeding or to appoint the arbitrators if the institution never existed, is misnamed in the clause or refuses to act, (4) providing unreasonably short deadlines for action by the arbitrators, (5) providing too much specificity with respect to the arbitrators' qualifications, or (6) providing for conflicting or unclear procedures. Basically any element of arbitration clause (name of the arbitration institution, place of arbitration etc.) drafted in ambiguous or imprecise way may render the whole arbitration clause defective.

Thus the features of defective arbitration clause are the following: a) ambiguous arbitration clause elements, b) imprecise arbitration clause elements and c) absence of essential or important arbitration clause elements. Next the famous Eisemann's criteria, which reflect essential functions of arbitration clause, are introduced.

#### **2.4. Eisemann's Criteria**

When the topic of pathological arbitration clauses is examined, it is useful at the beginning to set out Eisemann's criteria as to the essential functions of an arbitration clause<sup>26</sup>. These are four, translated into English from the original French:

(1) The first which is common to all agreements, is to produce mandatory consequences for the parties,

(2) The second is to exclude the intervention of state courts in the settlement of the disputes, at least before the issuance of the award,

(3) The third is to give powers to the arbitrators to resolve the disputes likely to arise between the parties,

(4) The fourth is to permit the putting in place of a procedure leading under the best conditions of efficiency and rapidity to the rendering of an award that is susceptible of judicial enforcement.

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<sup>24</sup> Defective arbitration clauses were first denominated as "pathological" in 1974 by Frederick Eisemann, who served at that time as the Secretary General of the ICC International Court of Arbitration. W. Laurence Craig, William W. Park, & Jan Paulson. *International Chamber of Commerce Arbitration*. Third edition. Oceana Publications, 2000, P. 158.

<sup>25</sup> R. Doak Bishop. *Practical guide for drafting arbitration clauses* // *Int'l Energy L. & Tax'n Rev.* 2000, 16, P. 18.

<sup>26</sup> B.G. Davis. "Pathological Clauses: Frédéric Eisemann's still vital criteria" // *Arbitration International*. 1991, Vol. 7, No 4.

These four functions are the crown jewels of Eisemann's article<sup>27</sup>. They are a synthesis of the four points any drafter of arbitration clauses, whether for ad hoc or institutional arbitration should have in mind as he decides on each word of the text<sup>28</sup>.

### 3. ESSENTIAL ELEMENTS OF ARBITRATION CLAUSE AND DEFECTS

After fundamental considerations it is time to go on to the construction and contents of arbitration clause. Poorly drafted arbitration clauses, which lack one or the other essential element or have any ambiguities, are the main source of defective arbitration clauses, therefore good understanding of what elements well-drafted arbitration clauses should consist is vital. Usually arbitration clause elements in doctrine<sup>29</sup> are classified under 1) standard or essential, 2) important and 3) additional or helpful arbitration clause categories. Categories represent the importance of elements, which comprise arbitration clauses. Attention will be paid to the first and second categories, because they are vital for the existence of arbitration clause.

#### 3.1. Essential elements of arbitration clause and floating arbitration clause

##### 3.1.1 Essential elements of arbitration clause

Often it is enough to have a standard or model arbitration clause recommended by an arbitration institution. Although standard clauses seem short and laconic, they are perfectly able to perform their function of excluding State courts jurisdiction and referring dispute to arbitration. The choice of an institution naturally presents a party with the standard or model arbitration clause advocated by the chosen institution. The ICC, for example, has the following model clause: *"All disputes arising out of or in connection with the present contract shall be finally settled under the Rules of Arbitration of the International Chamber of Commerce by one or more arbitrators appointed in accordance with the said Rules."*<sup>30</sup> Vilnius Court of Commercial Arbitration provides such a model arbitration clause: *"Any dispute, controversy or claim arising out of or relating to this contract, its breach, termination or validity, shall be*

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<sup>27</sup> F. Eisemann, *La clause d'arbitrage pathologique*, Commercial Arbitration Essays in Memoriam Eugenio Minoli, U.T.E.T. 1974.

<sup>28</sup> B.G. Davis. "Pathological Clauses: Frédéric Eisemann's still vital criteria" // *Arbitration International*. 1991, Vol. 7, No 4. P. 1.

<sup>29</sup> R. Doak Bishop. *Practical guide for drafting arbitration clauses* // *Int'l Energy L. & Tax'n Rev.* 2000, 16.

<sup>30</sup> ICC arbitration model clause // <http://www.iccwbo.org/court/arbitration/id4090/index.html>; connection time: 2010-10-20.

*finally settled by arbitration in the Vilnius Court of Commercial Arbitration in accordance with its Rules. The number of arbitrators shall be .... The venue of arbitration shall be .... The language of arbitration shall be ...* <sup>31</sup>. Lithuanian arbitration clause is more detailed, because it asks parties to specify additional information regarding number of arbitrators, venue of arbitration and language of arbitration. Nevertheless both of these and other model arbitration clauses, recommended by other world known arbitration institutions, has been said to contain the three “key expressions” essential for an arbitral clause to function: “all/any disputes”, “in connection with/relating to this contract”, “finally settled”<sup>32</sup>.

The term “all disputes” encompasses all types of controversies, without exception. Most arbitration clauses are drafted widely in order to cover any dispute. Historically, the courts of United Kingdom have interpreted words “any disputes” or “all disputes” as encompassing any dispute, whether fact of fact or law, relating in some way to the substantive contract<sup>33</sup>. In the *Angelic Grace*<sup>34</sup> case court held that the phrase “*all disputes concerning alleged breaches of contracts*” was sufficiently broad to encompass claims for the tort of unlawful conspiracy, misfeasance in public office and inducement to commit a breach of contract, which arouse out of alleged breach of contract.

The language, “in connection with”, creates a broad form clause that will cover non-contractual claims such as tort and fraud in the inducement. Many of the arbitration clauses submitted to the ICC refer to disputes “*arising out of or related*” to the contract, disputes “*arising under*” under the contract, disputes “*related directly and/or indirectly to the performance/execution*” of the contract<sup>35</sup>. These all various phrases may appear of similar meaning. However, a line of legal analysis has developed that draws a sharp distinction between a so-called "narrow" arbitration clause and a "broad" arbitration clause. A "broad" arbitration clause is more clearly "separable" from the contract in which it is contained so that even when there is an allegation that the contract itself is null and void because, for example, it was induced by fraud, the "broad" arbitration clause permits the arbitral tribunal to retain jurisdiction in order to determine its own competence<sup>36</sup>. In *Mediterranean Enterprises, Inc. v. Sangong Corp.* case a Federal District Court found that the phrase "arising hereunder" was "relatively narrow as

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<sup>31</sup> Vilnius Court of Commercial Arbitration model clause // <http://www.arbitrazas.lt/index.php?handler=en.ar.clause>; connection time: 2010-10-20.

<sup>32</sup> W. Laurence Craig, William W. Park, & Jan Paulson. *International Chamber of Commerce Arbitration*. Third edition. Oceana Publications. 2000, P. 111.

<sup>33</sup> *Forwood and Co v Watney* (1880) LJQB 447.

<sup>34</sup> *The Angelic Grace* (1995) 1 Lloyd's Rep 87.

<sup>35</sup> S.R. Bond. “How to draft an arbitration clause?”// *Journal of International Arbitration*. 1989, Vol. 6, No 2, 70 P.

<sup>36</sup> *Ibid.* P. 70.

arbitration clauses go" and the relevant arbitration was considered by this Court to be restricted solely to "disputes and controversies relating to the interpretation of the contract and matters of performance."<sup>37</sup> Under such an interpretation, matters relating to fraud in the inducement, for example, could not be examined by the arbitral tribunal. Conclusion could be drawn in respect of this passage, that parties should be extremely careful not to narrow the scope of the arbitration clause by restricting the clause simply to disputes "arising under" the contract or "related to execution or performance" of the contract. Better to use "arising out of or relating to this contract".

"Finally settled" indicates the parties intend the arbitrator's ruling to be final. It is common for arbitration clauses to provide that any arbitration award rendered will be "final and binding". In this context, "binding" means the parties intend that the award will resolve the dispute and be enforceable by national courts against the losing party<sup>38</sup>. It will not result merely in an advisory opinion that the parties are free to disregard e.g. as in conciliation process. A reference that any award will be "final" means the substance of the award will not be reviewed by the courts. Even if the parties do not say explicitly that the award will be final and binding, they may accomplish the same result by adopting the ICC, AAA or LCIA Rules. By including the terms, "final and binding", or an equivalent phrase – "any disputes shall be finally settled by binding arbitration" – parties express their intent for courts to enforce the award without reviewing the evidentiary foundations of the award. This is an important provision, and especially so if institutional rules are not adopted.

### 3.1.2. Floating arbitration clause

The opposite of arbitration clause having essential elements is floating<sup>39</sup> arbitration clause. Floating arbitration clauses pose great uncertainty regarding the will of the parties to refer their dispute to arbitration or even if term 'arbitration' is mentioned in the clause it is still unclear how arbitration should proceed, because of the lack of essential arbitration clause elements.

B. G. Davis gives such an example<sup>40</sup>:

*"Any disputes arising from the interpretation of the present contract will be settled by an arbitral tribunal sitting in a country other than that of each of the parties"*. The most evident

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<sup>37</sup> Mediterranean Enterprises, Inc. v. Sangong Corp., 708 F.2d 1458 (9th Circuit, 1983).

<sup>38</sup> U.S. courts have held that the phrase "final and binding" means "that the issues joined and resolved in the arbitration may not be tried de novo in any court." M&C Corp. v. Erwin Behr, GmbH & Co., 87 F.3d 844, 847 (6th Cir. 1996); Iran Aircraft Industries v. Avco Corp., 980 F.2d 141, 145 (2d Cir. 1992).

<sup>39</sup> Term "floating" arbitration was used by B.G. Davis. "Pathological Clauses: Frédéric Eisemann's still vital criteria" // Arbitration International. 1991, Vol. 7, No 4. P. 19.

<sup>40</sup> Ibid. P. 19.



drawback of this arbitration clause is term “arbitral tribunal”. Dispute might take place regarding the meaning of this term, which institution has the competence to solve dispute between the parties? A number of other important arbitration clause elements are not stipulated in the clause such as location of arbitral tribunal, number of arbitrators, appointment procedure etc. Interpretation of this arbitration clause would require intervention of a state court. Again which court would have jurisdiction if parties reside in different countries. It is clear that such arbitration clause raises many questions and because of this it is called floating.

Maleville, Marie-Helene provides further floating arbitration clauses<sup>41</sup>:

- 1) *“All disputes arising from this contract shall be brought to arbitration”*,
- 2) *“Possible arbitration: Arbitral Chamber of Oran”*,
- 3) *“All disputes arising from the present contract shall be resolved by way of arbitration”*.

John M. Townsend rightly points out that floating arbitration clauses might be cured, if the parties clearly express their will to submit their dispute to arbitration and are able to agree on all missing important elements of arbitration clauses<sup>42</sup>. He presents the following clause: *“Any disputes arising out of this Agreement will be finally resolved by binding arbitration.”*

W. Laurence Craig, William W. Park and Jan Paulson discuss the following defective arbitration clause: *“In the event of any unresolved dispute, the matter will be referred to the International Chamber of Commerce”*. Although institution is identified, still it is unclear whether arbitration or conciliation is intended. Other important arbitration clause elements are not defined.

### **3.2. Method of Selecting Arbitrators and related defects**

#### **3.2.1. Method of Selecting Arbitrators**

Indication of number of arbitrators is not enough. Potential disputes may arise in respect of the way arbitrators should be appointed. As mentioned above appointment of a three-person panel usually involves each party appointing one arbitrator, and these two then agreeing on a third arbitrator to be the chairman of the tribunal. If the parties simply adopt institutional rules, some provide that the institution will determine the number of arbitrators and will select the third

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<sup>41</sup> Maleville, Marie-Helene. *Pathologies Des Clauses Compromissaires* // International Business Law Journal. 2000, Int'l Bus. L.J. 6. P.79.

<sup>42</sup> John M. Townsend. *Drafting arbitration clauses: Avoiding the 7 deadly sins* // Dispute Resolution Journal. 2003, Vol. 58, No. 1. P. 2.

arbitrator when three are deemed appropriate<sup>43</sup>. In an ad hoc arbitration, it is important that the parties include a back-up provision for appointment by an independent authority if a party fails to appoint its arbitrator or if the party appointed arbitrators cannot agree on the presiding arbitrator<sup>44</sup>. They should also either provide for the replacement of arbitrators who die or resign or authorize the continuance of the proceedings with a truncated tribunal, or both<sup>45</sup>. A truncated tribunal is one that begins with three arbitrators but is able to continue its work with a lesser number, if necessary.

### 3.2.2. Defective appointment procedure

One of the more frequent defects hides in the arbitration clause wordings, which establish the procedure of appointment or nomination of arbitrators.

Maleville, Marie-Helene provides an arbitration clause with a defect in appointment procedure: *“a clause providing for the designation of two arbitrators by each of the parties and, if the arbitrator does not come to render an award, the appointment “at their request”, by the President of the Tribunal of Commerce, of a third arbitrator”*<sup>46</sup> Basically this clause establishes such a arbitrator appointment procedure: each party appoints one arbitrator, if they are unable to reach a decision, then parties have to request President of the Tribunal of Commerce to select a third arbitrator. Not to mention that the number of arbitrators to begin with should always be an odd number, the weakest part of this clause is that parties have to request for President of the Tribunal of Commerce to appoint third arbitrator. It means President of the Tribunal of Commerce has no obligation to nominate a third arbitrator and in case President of the Tribunal of Commerce would show no willingness to appoint third arbitrator the arbitration process would probably come to a dead end. W. Laurence Craig, William W. Park, and Jan Paulson point out that: *“Occasionally, parties conceive the idea that while they wish to opt for ICC arbitration, a particular judge or public official or public official or president of chamber of commerce should select the chairman of arbitral tribunal rather than ICC. If so, they are well advised to determine whether the authority so designated in fact will make such appointment”*<sup>47</sup> This applies to the above clause. Parties had to pay attention and establish whether President of the Tribunal of Commerce will appoint a third arbitrator on their request.

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<sup>43</sup> ICC Rules art 8(2) & 8(4).

<sup>44</sup> ICC Rules art. 8(4);

<sup>45</sup> ICC Rules art. 12(5);

<sup>46</sup> Maleville, Marie-Helene. Pathologies Des Clauses Compromissaires // International Business Law Journal. 2000, Int'l Bus. L.J. 6, P. 75.

<sup>47</sup> W. Laurence Craig, William W. Park, & Jan Paulson. International Chamber of Commerce Arbitration. Third edition. Oceana Publications. 2000, P. 130.

A pair of further examples from Alan Redfern<sup>48</sup>:

*“All disputes arising in connection with the present agreement shall be submitted in the first instance to arbitration. The arbitrator shall be well-known Chamber of Commerce (like the ICC) designated by mutual agreement between both parties”.*

*“If any disputes arises between A and B in connection with this agreement, such dispute shall be finally settled by arbitration by two arbitrators, one appointed by A and one by B. Should the arbitrators fail to agree on a decision of the dispute, either of them shall apply to ICC, Paris, for an appointment of an umpire. All arbitration proceedings shall be carried out in Thailand in accordance with the rules of Conciliation and Arbitration of the ICC. Each party shall bear the costs of its own arbitrator”.*

In the first clause two points are potential grounds for a dispute. Firstly what is “well-known” arbitrator, parties might argue by imposing different requirements, which a well-known arbitrator should satisfy. This could amount to endless arguing.

In the second clause arbitrators were nominated by the parties, in case they are not able to agree on decision of the dispute, have to apply to ICC, Paris for an appointment of umpire. What is an umpire and what powers does he have? Again different positions might be taken by the parties. Parties could have chosen a term “third arbitrator”. This term would have expressed their intentions in much clearer way.

### **3.2.2.1. Encyclopaedia Universalis case**

One case solved in US perfectly reflects the need to draft arbitrator appointment procedures carefully is Encyclopaedia Universalis case<sup>49</sup>. First the factual situation and arbitration clause will be presented, secondly the argumentation of the court and finally its decision. Remarks regarding this case are added at the end.

#### ***Factual situation***

Encyclopaedia Universalis S.A. (“EUSA”) is a société anonyme (analogous to a corporation) organized under the laws of Luxembourg. Encyclopaedia Britannica, Inc. (“EB”) is a Delaware corporation, with its principal place of business in Illinois. Both parties are in the business of publishing and distributing reference materials and other learning products. In 1966, EUSA and EB entered into a Literary Property License Agreement (“License Agreement”),

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<sup>48</sup> Alan Redfern. Law and practice of international commercial arbitration. Sweet & Maxwell. 2004, P. 172.

<sup>49</sup> Encyclopaedia Universalis v. Encyclopaedia Britannica inc., United States Court of Appeals, Second Circuit, Argued: Oct. 19, 2004 - March 31, 2005.

granting EB the right to translate, produce, distribute, and license in any language other than French the contents of a French reference work, Encyclopaedia Universalis. In exchange, EB agreed to pay royalties to EUSA based on sales of the non-French editions. On the same day, EB entered into a “Two Party Agreement” with Club Français du Livre (“CFL”), a French corporation. They agreed to form a new entity, Encyclopaedia Universalis France, which would have certain rights to the French-language version of the encyclopedia. The License Agreement required arbitration of all disputes between the parties and explicitly incorporated the arbitration procedures set out in the Two Party Agreement.

Article 14 of the License Agreement provides: *“All disputes arising in connection with the present Agreement shall be finally settled by a Board of Arbitration established and governed by the procedures set forth in the [Two Party] Agreement entered into this day between EB and CFL; provided, however, that EUSA and not CFL shall select one of the arbitrators; and provided further, that the third arbitrator shall be selected by the President of the Tribunal de Commerce of Luxembourg from a list of arbitrators maintained by the British Chamber of Commerce in London at the request of the arbitrator who is first to make such a request.”*

The Two Party Agreement provides that either party may demand that any dispute be referred to arbitration and that: *“The Board of Arbitration shall be composed of two arbitrators of which one shall be chosen by EB and the other by CFL. In the event of disagreement between these two arbitrators, they shall choose a third arbitrator who will constitute with them the Board of Arbitration. Upon the failure of the two arbitrators to reach agreement upon the choice of a third arbitrator, the third arbitrator, who must be fluent in French and English, shall be appointed by the President of the Tribunal of Commerce of the Seine from a list of arbitrators maintained by the British Chamber of Commerce in London at the request of the arbitrator who is first to make such a request.”*

In October 1995, EB stopped making royalty payments to EUSA under the License Agreement. The parties disagreed about EB's obligation to continue such payments and were unable to resolve the matter. After an initial dispute over who would serve as EUSA's arbitrator, in May 1998, EUSA sent a letter to EB describing its claim and naming as its arbitrator Raymond Danziger, an accountant residing in Paris.

In July 1998, EB appointed Robert Layton, a New York attorney, to serve as its arbitrator. Layton and Danziger communicated by fax and telephone between September 1998 and December 1998. During this period, they discussed the scope of the arbitration and the arbitral procedures to be followed, but not the merits of the underlying claim or the identity of the third arbitrator.

In March 1999, Danziger wrote to the President of the Tribunal of Commerce of Luxembourg (“Tribunal”) asking the Tribunal to name a third arbitrator. He stated that he and Layton had been unable to agree on a third arbitrator and requested that the Tribunal appoint one pursuant to the License Agreement. Danziger also informed the Tribunal that the parties had agreed for the third arbitrator to be drawn from a list maintained by the British Chamber of Commerce (“Chamber”); he noted, however, that he had recently learned that the Chamber no longer maintained such a list.

Two weeks later, Danziger made Layton aware of his letter to the Tribunal, and Layton immediately informed the Tribunal that he intended to object to Danziger's request for a third arbitrator. Before receiving Layton's letter of objection, however, Maryse Welter, the Presiding Judge of the Tribunal, appointed Nicolas Decker, a Luxembourg attorney, as the third arbitrator.

Shortly thereafter, Layton wrote to the Tribunal, objecting that “a major step in the course to be followed under the applicable arbitration clause has been overlooked.” According to Layton, he and Danziger “never had [an] opportunity to confer” regarding the choice of a third arbitrator, as required by the Two Party Agreement. The letter went on to suggest that, because the parties' agreement was to be interpreted under the laws of New York, it would be appropriate for the third arbitrator to be a New York lawyer or a London resident familiar with New York law. Layton recommended consulting the London Court of International Arbitration for a list of arbitrators.

In early May 1999, Judge Welter suspended all arbitration proceedings led by Decker. On May 27, 1999, Danziger responded to Layton's letter to the Tribunal, stating that he did not agree that the arbitrator should necessarily be a New York or London lawyer, and “therefore, there is no doubt that we failed to reach an agreement upon the choice of the third Arbitrator.”

In December 1999, Judge Welter held a hearing regarding Decker's appointment, which both EB and EUSA attended, and, in February 2000, issued an order that Decker proceed with the arbitration. Decker then scheduled a meeting between the arbitrators, which Layton refused to attend. In July 2000, Decker informed counsel for both parties that the Board of Arbitration, composed of Danziger and Decker, would commence proceedings.

In January 2002, the Board of Arbitration, without the participation of EB or Layton, found that EUSA was entitled to terminate the License Agreement and ordered EB to pay EUSA 3.1 million Euros, plus interest and certain costs.

In June 2003, EUSA sued in the Southern District of New York seeking recognition and enforcement of the arbitration award pursuant to the New York Convention, which governs foreign arbitral awards. Plaintiff, at the behest of the District Court, later moved for summary judgment and to confirm the arbitral award. The District Court denied enforcement on two

grounds. First, the court concluded that Danziger's request to the Tribunal to appoint a third arbitrator was premature and thus the arbitral board was improperly composed under Article V(1)(d) of the New York Convention. The court reasoned that whereas the arbitration agreement required the parties to discuss the identity of a third arbitrator before asking the Tribunal to appoint one, there was no evidence that they had done so before Danziger petitioned the Tribunal. Second, the District Court found that the two-person Board of Arbitration exceeded its powers in issuing the award. The court reasoned that “because the arbitral tribunal was improperly composed, it had no power to bind the parties; any assertion of such power, by definition, exceeded its mandate.”

### *Court argumentation and decision*

When a party applies to confirm an arbitral award under the New York Convention, “[t]he court shall confirm the award unless it finds one of the grounds for refusal or deferral of recognition or enforcement of the award specified in the said Convention.” Article V of the Convention specifies seven exclusive grounds upon which courts may refuse to recognize an award. These grounds include when “the composition of the arbitral authority or the arbitral procedure was not in accordance with the agreement of the parties.” Art. V(1)(d). The District Court held, pursuant to Article V(1)(d), that the Board of Arbitration was improperly composed and EUSA's arbitral award could not be enforced.

The License Agreement, which incorporates by reference the arbitration procedures set forth in the Two Party Agreement, provides that disputes between the parties are to be resolved by arbitration, and that the Board of Arbitration is initially to be composed of two arbitrators, one chosen by EUSA and one by EB. The Two Party Agreement further provides that “[i]n the event of disagreement between these two arbitrators, they shall choose a third arbitrator . Upon the failure of the two arbitrators to reach agreement upon the choice of a third arbitrator,” the third arbitrator is to be selected by the President of the Tribunal from a list maintained by the British Chamber of Commerce. As previously noted, the Chamber ceased maintaining such a list prior to this dispute.

Court of Appeals agrees with the District Court that the parties' agreement contains three requirements: (1) the arbitrators must “disagree” before appointing a third arbitrator; (2) the two party-appointed arbitrators must attempt to choose a third arbitrator; and (3) upon the failure of the two party-appointed arbitrators to agree on a third, the Tribunal must appoint one from the Chamber's list. Here, the first requirement was met because the arbitrators disagreed about the procedural rules to be applied to the proceedings. We reject EB's contention that

Layton and Danziger were required to disagree as to the merits of the case. Nothing in the language of the Two Party Agreement limits the subject of qualifying disagreements.

Fatally for EUSA, the second requirement was not met. There is no evidence that the parties attempted to agree upon a third arbitrator before Danziger asked the Tribunal to appoint one. EUSA points to Danziger's May 27, 1999 letter to Layton, in which Danziger stated that he disagreed with Layton that the third arbitrator should be a New York or London lawyer; Layton had originally expressed this preference in his April 28, 1999 letter to the Tribunal. Danziger concluded in his May 27 letter to Layton that, "therefore, there is no doubt that we failed to reach an agreement upon the choice of the third Arbitrator." In relying on Danziger's letter, EUSA fails to appreciate that the arbitration clause required the two party-appointed arbitrators to disagree on a third arbitrator before asking the Tribunal to appoint one. However, Danziger's letter was written after Layton's letter, which was written after Danziger petitioned the Tribunal. Thus, it cannot serve as evidence that they disagreed before he approached the Tribunal. We agree with the District Court that the letter was merely an "ingenious but disingenuous" attempt to "construct a process of deliberation and deadlock after the fact."

Court of Appeals thus concludes that the District Court properly refused to confirm Plaintiff's arbitral award on the grounds that the appointment of a third arbitrator was premature, and, therefore, the composition of the arbitral authority was not in accordance with the parties' agreement. See New York Convention Art. V(1)(d).

### ***Conclusions regarding Encyclopaedia Universalis case***

First flaw evident in arbitration is the fact that: "*the third arbitrator shall be selected by the President of the Tribunal de Commerce of Luxembourg from a list of arbitrators maintained by the British Chamber of Commerce in London*". The problem here is the list of arbitrators maintained by the British Chamber of Commerce in London. As it was mentioned in factual situation, at the time of the dispute British Chamber of Commerce did not maintain such a list anymore. This is an obstacle and the question from which other list third arbitrator should be chosen? This situation might not be fatal if parties would be able to agree on other list of arbitrators, from which then President of the Tribunal de Commerce of Luxembourg could choose the third arbitrator.

The biggest problem in this case was not following the third arbitrator appointment procedure. As previously stated: "*a major step in the course to be followed under the applicable arbitration clause has been overlooked*". Parties had to attempt to agree upon a third arbitrator before applying to the President of the Tribunal de Commerce. So the second weak part of arbitration clause was wording "*failure of the two arbitrators to reach agreement upon the*

*choice of a third arbitrator*". As it is mentioned in factual situation EUSA was of opinion that the parties failed to reach an agreement, while EB stated that the parties did not even had an opportunity to agree on third arbitrator. Every element of an arbitration clause, which might lead to discussions, should be avoided. In this case parties could have defined what situation amounts to "failure to reach an agreement on third arbitrator", then it would be clear whether parties reached that stage or not.

### **3.3. Arbitration as the Method to Resolve Disputes and possible defects**

#### **3.3.1. Arbitration as the Method to Resolve Disputes**

Besides 3 essential elements of arbitration clause another requirement for an arbitration clause is that the parties' agreement must expressly state their intention to resolve their disputes by arbitration. While this seems obvious, occasionally parties have said that controversies would be referred to an institution that administers arbitration proceedings, but without mentioning arbitration as the method for deciding their issues<sup>50</sup>. Institutions such as the ICC have other methods for determining disputes that do not include arbitration. These procedures encompass conciliation, expert determination and a pre-arbitral referee procedure. Thus, if the parties want their disputes decided by arbitration, they should say so explicitly.

#### **3.3.2. Reference to different types of dispute resolution**

There are cases when parties combine both litigation in state courts and arbitration into one arbitration clause. In such a case litigation is mixed up with one alternative dispute resolution type – arbitration. This subchapter deals with cases when parties combine two different alternative dispute resolution types into one clause (e.g. arbitration and conciliation). Such situations also amount to defective arbitration clause. Therefore this type of defective arbitration clause falls within the scope of master thesis and is worth of discussion.

B. G. Davis analyzing defective arbitration clauses of this type provides the following clause: *"In case of any dispute concerning the merchandise, the parties agree to have recourse to the procedure of conciliation foreseen in the Rules of Conciliation and Arbitration of the International Chamber of Commerce. Disputes other than those cited above will be finally settled according to the Rules of Conciliation and Arbitration of the International Chamber of Commerce by one or more arbitrators appointed in accordance with these Rules."*<sup>51</sup> As it is seen

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<sup>50</sup> Redfern & Hunter. *International Arbitration*. 1986, P. 178.

<sup>51</sup> B.G. Davis. "Pathological Clauses: Frédéric Eisemann's still vital criteria" // *Arbitration International*. 1991, Vol. 7, No 4. P. 18.



form the first sentence of arbitration clause part of the possible disputes (concerning merchandise) are submitted to conciliation. Second sentence refers all other disputes to arbitration. Recalcitrant parties may disagree on type of dispute, which has arisen, because one could say that disputes relates to merchandise, while other may allege that existing dispute is in no way connected to merchandise. Conciliation differs from arbitration in that the conciliation process, in and of itself, has no legal standing, and the conciliator usually has no authority to seek evidence or call witnesses, usually writes no decision, and makes no award<sup>52</sup>. The two methods of dispute resolution differ to the extent that the conciliator proposes a solution to the parties who are free to adopt it, whereas an arbitrator imposes his decision on the contracting parties<sup>53</sup>. Maybe by selecting conciliation parties thought that they could solve disputes easier regarding merchandise or better to say solve dispute in amicable way. However choice of two alternative dispute resolution types in one arbitration clause allows for a defective arbitration clause to arise.

Comparing to Eisemann's essential functions, the first essential function is destroyed in relation to the first paragraph of the clause, since these disputes do not lead to mandatory consequences. The third essential function is weakened as the arbitrators' powers are so circumscribed. Finally, the conditions are far from optimal for the rendering of an enforceable award, touching on the heart of the fourth essential function.

Maleville, Marie-Helene provides more examples<sup>54</sup>, including confusion between arbitration and expert appraisal:

1) *„Disputes shall be submitted to arbitration according to Rules of Conciliation and Arbitration of the ICC...; disputes which may be resolved by conciliation shall be submitted first to conciliation“.*

2) *“Disputes submitted to arbitration according to the rules of conciliation and arbitration of the ICC and for disputes which may be resolved by conciliation, the parties would proceed first with such conciliation“.*

3) *“In the event of a dispute relative to the interpretation or execution of the present agreement, the parties agree to accept the decisions rendered by an arbitral body set up by the parties, each informing the other of the name of the expert appointed.“*

Third example is a reflection of arbitration and expert appraisal combination in one arbitration clause. Similarly as with arbitration and conciliation, the purpose of arbitration and

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<sup>52</sup> Conciliation // <http://en.wikipedia.org/wiki/Conciliation> // connection time: 2010-11-20.

<sup>53</sup> Maleville, Marie-Helene. Pathologies Des Clauses Compromissaires // International Business Law Journal. 2000, Int'l Bus. L.J. 6, P.69.

<sup>54</sup> Ibid. P. 70.

expert appraisal is different. Expert, chosen on the basis of his or her knowledge of the area in dispute, investigates the dispute and provides advice as to the facts of the dispute and possible, probable or desirable outcomes and how these may be achieved<sup>55</sup>. These were only some of the examples, it is possible for defective arbitration clauses to occur in respect of arbitration confusion with other alternative dispute resolution techniques e.g. mediation.

#### **4. IMPORTANT ELEMENTS OF ARBITRATION CLAUSE AND DEFECTS**

Essential elements should be enough for arbitration clause to “survive”. Despite that fact important clauses may render arbitration clause much clearer and easier to execute. Therefore important elements are worth of looking in more detail.

##### **4.1. Number of Arbitrators and related defects**

###### **4.1.1. Number of Arbitrators**

Most arbitration rules provide for the number of arbitrators and a method for selecting them if the parties do not specify the number or a mechanism for their appointment. Nevertheless, it is generally desirable that the parties express their preference. In model arbitration clauses like model clause of Vilnius Court of Commercial Arbitration parties have to identify the number of arbitrators. The custom in international arbitrations involving significant monetary amounts is to appoint a three-person panel, but when the amount in dispute does not justify three, a single arbitrator may be preferred. Margaret L. Moses in his book<sup>56</sup> provides guidelines, which could help when choosing the right number of arbitrators: *“In a dispute involving contract interpretation issues, in which the amount at stake is around U.S. \$500,000 to U.S. \$1,000,000 or less, one arbitrator is probably adequate, although in any given case, needs and requirements may be different”*. One arbitrator means less costs and quicker proceedings, because no joint decisions of several arbitrators on procedural questions are needed. Three arbitrators may be considered when monetary sum of dispute is substantial, because the bigger number of qualified persons will solve the dispute the more qualified solution will be found. Three arbitrators are also chosen in cases when each party wants to appoint their arbitrator. In such a case third arbitrator is usually appointed by those two arbitrators already appointed by the parties. It is important to note, that if an arbitrator is appointed by a party, this fact does not oblige appointed arbitrator to solve the dispute in favour of that party. Criteria, on which parties

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<sup>55</sup> Expert Appraisal // <http://www.lawhandbook.sa.gov.au/ch25s11s06.php> // connection time: 2010-11-21.

<sup>56</sup> Margaret L. Moses. The principles and practice of international commercial arbitration. Cambridge University Press. 2008, P. 42.

base their choice regarding arbitrators, is knowledge of legal system, where a party is situated, or qualification in particular area or practice in disputes similar to the existing or potential one, which might arise between parties. If the parties do not agree upon method of choosing arbitrators, selection will occur in accordance with the rules of the administering institution. For example ICC Rules on Arbitration article 8 part 2: *“Where the parties have not agreed upon the number of arbitrators, the Court shall appoint a sole arbitrator, save where it appears to the Court that the dispute is such as to warrant the appointment of three arbitrators. In such case, the Claimant shall nominate an arbitrator within a period of 15 days from the receipt of the notification of the decision of the Court, and the Respondent shall nominate an arbitrator within a period of 15 days from the receipt of the notification of the nomination made by the Claimant.”* Parties might agree that the sole or third arbitrator may not be a national of the parties' countries, in this way interest of both parties will be protected.

#### **4.1.2. Imprecision regarding the number of arbitrators**

An example of such a clause: *“Any dispute arising out of the execution of this contract which the contracting parties fail to settle in an amicable way shall be settled by the arbitration court of the International Chamber of Commerce in Paris in accordance with the rules of the arbitration. Decision of the arbitrator is final and binding for both parties.”*<sup>57</sup> In this case the parties were arguing on the meaning of the term *“arbitrator”*, more precisely what number of arbitrators does this term imply? Claimant as probably almost anyone who would read this clause would say definitely, that *“arbitrator”* means one arbitrator. However defendant in this case *“arbitrator”* refers to three-member arbitral tribunal. Defendant based such position on article 2.2. of ICC rules, which say: *“The dispute may be settled by a sole arbitrator or by three arbitrators. In the following Articles the word ‘arbitrator’ denotes a single arbitrator or three arbitrators as the case may be.”* The International Court of arbitration decided that is hard to interpret this term as meaning tree arbitrators and that the intentions of the parties when drafting this clause were to opt for one arbitrator. As B. G. Davis wisely notes, that *“if ‘sole’ or ‘one’ had been added then, this apparent misunderstanding might have been avoided or if ‘one or more’ had been added, the flexibility sought by the defendant would have been apparent”*.

Having in mind Eisemann’s four criteria, the above clause disrespects the fourth function, which is putting in place of a procedure leading under the best conditions of efficiency and rapidity to the rendering of an award that is susceptible of judicial enforcement.

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<sup>57</sup> B.G. Davis. “Pathological Clauses: Frédéric Eisemann’s still vital criteria” // Arbitration International. 1991, Vol. 7, No 4. P. 5.

To sum up no place for disputes over the intended number of arbitrators should be left in arbitration clause, parties are advised to identify the number clearly.

## **4.2. Place of the arbitration and related defects**

### **4.2.1. Place of the arbitration**

In case parties fail to agree to the place of the arbitration, some institutions' rules allow the arbitrators to decide the situs based on the circumstances of the parties and the case<sup>58</sup>, while other rules authorize the institution itself to select the situs. U.S. courts will rarely overturn the parties' choice of arbitral forum when the agreement specifies one. If the parties do not specify a venue, but have agreed to submit to particular arbitration rules that allow the arbitrators to decide the forum, it will be difficult for the parties to challenge the arbitrators' choice of venue<sup>59</sup>. It should be noted that choosing a situs does not mean that all arbitral proceedings have to take place there. Arbitrators generally have discretion under the arbitral rules to conduct some proceedings at other venues. Gary B. Born provides the following factors related to the legal system of the venue, which should be taken into account: (1) It is especially important to select a forum whose arbitral awards will be enforceable in other countries (e.g., a country that has ratified the New York or Panama Conventions recognizing arbitral awards). (2) The forum's law should recognize the agreement to arbitrate as valid. Article V(1)(a) of the New York Convention contemplates that the validity of an arbitration agreement may be determined by the law of the country where the award was made, so compliance with local laws is important. (3) Because the arbitral site is usually the country whose courts will hear an action to vacate an award, it is important to consider the scope of review of awards available in that country<sup>60</sup>. (4) The national courts of the situs should not unnecessarily interfere in ongoing arbitral proceedings, thereby creating an incentive for dilatory tactics and expensive procedural disputes. (5) The forum's courts should, however, assist the proceedings when necessary (e.g., by compelling arbitration or by enforcing discovery orders made by the tribunal)<sup>61</sup>. (6) The host country should allow non-nationals to appear as counsel in international arbitration proceedings. This is not always the case; for example, Japan and Singapore have at times required that the parties' representatives be lawyers admitted to practice, and reside, in the forum state. Other

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<sup>58</sup> AAA International Rules art. 13 (administrator may initially determine the place of arbitration, subject to the power of the arbitrators to determine the situs); UNCITRAL Rules art. 16.

<sup>59</sup> *Stanicoff v. Hertz*, 406 N.E.2d 1318, 1319 (Mass. App. 1980).

<sup>60</sup> *Southern Pacific Properties Ltd. v. Arab Republic of Egypt*, 2 Int'l Arb. Rep., No. 1, at 17 (Cass. Civ. 1re 1987) (French court's reversal of ICC arbitral award rendered in Paris).

<sup>61</sup> U.S. Arbitration Act, 9 U.S.C. §§ 4, 7.

countries require that representatives be lawyers (e.g., Indonesia, Israel, Saudi Arabia and Spain), while others require representatives to present a power of attorney to the arbitral panel (e.g., Argentina, Greece, Austria). (7) The situs should not unduly restrict the choice of arbitrators. In Saudi Arabia, arbitrators must be Muslim and male.

#### 4.2.2. Defective location of Arbitral Tribunal

Very frequently, contract draftsmen fail to rigorously localize the arbitration. The choice is essential to the extent that this contractual precision allows full protection to be afforded under the New York Convention. The error is often related to the seat of the International Chamber of Commerce. The International Court of Arbitration is frequently seised with arbitration clauses that locate 'International Chamber of Commerce' 'in Zurich', 'in London', 'in Geneva', 'in New York' as the case may be. These are cases of clauses with a minor pathology where it is usually clear that the parties have sought ICC arbitration but have not stated the exact location of the ICC<sup>62</sup>. Another example is a clause providing for arbitration under the "Rules of the ICC sitting in Geneva", whereas there is no International Chamber of Commerce in that city. The parties are in reality invoking the competency of the ICC seated in Paris while localizing it in Switzerland. Thus, in 1987, sixteen clauses referred to the ICC in Zurich or Geneva, nearly 7% of the total, and twelve in 1989, or 6% of the total, according to one author<sup>63</sup>. Moreover, in 1989, of the 56 clauses referring to the ICC "of" or "at" Paris, 33 contained information on the place of arbitration. The Hamm Court of Appeals in Germany decided an arbitration clause was fatally ambiguous and void in a case in which the clause read: "*[The parties] shall proceed to litigate before the Arbitration Court of the International Chamber of Commerce in Paris with the seat in Zurich.*"<sup>64</sup> The court ruled it could not determine if the parties intended to submit to the ICC in Paris or to the Zurich Chamber of Commerce, both of which maintained permanent arbitral tribunals.

In order to have a consistent practice to assure that a significance is attributed to the place mentioned, the International Court of Arbitration, pursuant to Article 12 of the ICC Rules with regard to fixing of the place of arbitration (*The place of arbitration shall be fixed by the International Court of Arbitration, unless agreed upon by the parties*), has a practice of interpreting a reference to a place other than the location of the ICC to mean that the parties have

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<sup>62</sup> B.G. Davis. "Pathological Clauses: Frédéric Eisemann's still vital criteria" // *Arbitration International*. 1991, Vol. 7, No 4. P. 3.

<sup>63</sup> Maleville, Marie-Helene. *Pathologies Des Clauses Compromissoires* // *International Business Law Journal*. 2000, Int'l Bus. L.J. 6, P. 74.

<sup>64</sup> R. Doak Bishop. *Practical guide for drafting arbitration clauses* // *Int'l Energy L. & Tax'n Rev.* 2000, 16. P-19.

agreed for the place of arbitration to be in Zurich or London or Geneva or New York as the case may be<sup>65</sup>.

Arbitration clause designating the arbitral organization under its former name the "Arbitration Commission" instead of Court of Arbitration of the Bulgarian International Chamber of Commerce was saved, according to the arbitrators, there was no doubt as to the wishes of the parties because this organization is the only permanent arbitral institution within the Bulgarian International Chamber of Commerce<sup>66</sup>. Audacious was the interpretation given by the Geneva Court of to an agreement providing that all disputes will be "*settled by arbitration of the Geneva Commercial Court*" and that this court would also appoint a third arbitrator. There is no Commercial Court in Geneva, nonetheless the Court of Justice held that the agreement sufficiently showed the will of the parties to arbitrate in Geneva and competent Geneva court had the jurisdiction to constitute an arbitral aribunal<sup>67</sup>.

Contract negotiators should rigorously indicate the localization of the competent arbitral tribunal and, in particular, distinguish between its seat and its diverse de-localized components such as the Court of Arbitration of the ICC. Moreover, this is the safest point at which to make this choice as it helps avoid problems during the arbitration procedure.

Viewed against Eisemann's four essential functions such arbitration clauses causes a dysfunction with regard to the fourth essential function, as the presence of such language does not lead in the best conditions of efficiency and rapidity to the rendering of an award. An opening is provided to a recalcitrant party to raise a preliminary point that could have been avoided by better drafting.

### **4.3. Language of arbitration and related defects**

#### **4.3.1. Language of arbitration**

Parties should specify the language of arbitration in the arbitration clause. Some parties may assume the language of the contract will be the language of the arbitration, but may not necessarily be the case if arbitral tribunal decides differently<sup>68</sup>. Another point parties should

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<sup>65</sup> B.G. Davis. "Pathological Clauses: Frédéric Eisemann's still vital criteria" // *Arbitration International*. 1991, Vol. 7, No 4. P. 3.

<sup>66</sup> Maleville, Marie-Helene. *Pathologies Des Clauses Compromissoires* // *International Business Law Journal*. 2000, Int'l Bus. L.J. 6, P-75.

<sup>67</sup> Jean-François Poudret, Sébastien Besson. *Comparative law of international arbitration*. Sweet & Maxwell. 2007, P-129.

<sup>68</sup> Margaret L. Moses. *The principles and practice of international commercial arbitration*. Cambridge University Press. 2008, P. 43.

consider is translations of a contract containing arbitration clause. Do translations have the same meaning? This problem is discussed in the following subchapter.

#### **4.3.2. Difference in translations**

B. G. Davis provides the following example<sup>69</sup> reflecting two different translations of the same arbitration clause: *“In French: place of arbitration will be Barcelona if (Party A) is the Claimant and Paris if (Party B) is the Claimant. In Spanish: place of arbitration will be Barcelona if (Party A) is the Defendant and Paris if (Party B) is the Defendant.”* The difficulty would arise here, because parties are called differently. In French version parties are named as claimants and in Spanish version as defendants. Let’s envisage situation where French party is a claimant and Spanish party is defendant, then both of these parties would claim, that place of arbitration should be decided by them. In case parties would not be able to reach an agreement such Arbitral Tribunal should provide a neutral place.

### **5. CLASSIFICATION OF DEFECTIVE ARBITRATION CLAUSES**

There are several classifications of defective arbitration clauses used by different authors. Alan Redfern<sup>70</sup> classifies defective arbitration clauses under categories of:

1. inconsistency,
2. uncertainty,
3. inoperability,
4. repudiation and waiver of arbitration agreement.

John M. Townsend<sup>71</sup> provides defective arbitration clauses in categories of:

1. equivocation,
2. inattention,
3. omission,
4. over-specificity,
5. unrealistic expectations,
6. litigation envy,
7. overreaching.

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<sup>69</sup> B.G. Davis. “Pathological Clauses: Frédéric Eisemann’s still vital criteria” // *Arbitration International*. 1991, Vol. 7, No 4. P. 7.

<sup>70</sup> Alan Redfern. *Law and practice of international commercial arbitration*. Sweet & Maxwell. 2004, P 171.

<sup>71</sup> John M. Townsend. *Drafting arbitration clauses: Avoiding the 7 deadly sins* // *Dispute Resolution Journal*. 2003, Vol. 58, No. 1. P. 1-4.

B.G. Davis<sup>72</sup> breaks all defective arbitration clauses into two groups, which to a lesser or greater extent have presented certain types of pathologies:

- a) Arbitration clauses having lesser pathologies,
- b) Arbitration clauses having greater pathologies.

Other authors such as Jean-François Poudret<sup>73</sup> or Pierre A. Karrer<sup>74</sup> present separate cases when defective arbitration clauses most frequently occur or group defective arbitration clauses according to the elements of an arbitration clause.

Although authors introduce different classifications of defective arbitration clauses, in essence they cover the same main categories and many similarities can be found. For example, the category of uncertainty by Alan Redfern might be somewhat similar to the category of inattention by John M. Townsend, because similar defective arbitration clauses fall under these categories.

One of the tasks of this master thesis is to crystallize one defective arbitration clause classification encompassing as much as possible various pathologies that may arise in poorly drafted arbitration clauses. A new classification will be provided, which classifies defective arbitration clauses under the two categories of curable and hardly curable defective arbitration clauses, which encompasses a variety of defective arbitration clauses. At the same time each element of a category is analyzed in depth and compared to Eisemann's criteria.

### **5.1. Curable defective arbitration clauses**

Under this category fall defective arbitration clauses, which have quite a high chance of being "cured", interpreted in order to make them operable. Nevertheless such clauses surely hamper the arbitration process and demand extra time and money from the parties. It is important to note that some of the curable defective arbitration clauses were already discussed in chapter 4 with important elements of an arbitration clause, these include: a) imprecision regarding the number of arbitrators, b) defective location of the Arbitral Tribunal and c) Difference in translations. The remaining curable defective arbitration clauses are analyzed hereunder.

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<sup>72</sup> B.G. Davis. "Pathological Clauses: Frédéric Eisemann's still vital criteria" // *Arbitration International*. 1991, Vol. 7, No 4. P. 2-20.

<sup>73</sup> Jean-François Poudret, Sébastien Besson. *Comparative law of international arbitration*. Sweet & Maxwell 2007. P. 128-131.

<sup>74</sup> Nedim Peter Vogt, Thomas Bär, Robert Karrer. *The international practice of law: liber amicorum for Thomas Bär and Robert Karrer*. Kluwer Law International. 1997.



### 5.1.1. Hidden threat of “may”

B. G. Davis provides the following clause: *“Any dispute of whatever nature arising out of or in any way relating to the Agreement or to its construction or fulfilments may be referred to arbitration. Such arbitration shall take place in USA and shall proceed in accordance with the Rules of Conciliation and Arbitration of the International Chamber of Commerce.”*

The weak part or defect of this arbitration clause is the usage of the term “may”. It is not clear why parties chose this term. It seems that parties left some place for a choice: state courts or arbitration. Such a term may lead to intervention of the state court, which will have a task to interpret the term “may” and find out the true intentions of the parties. A party, which was hoping to exclude state court intervention and apply to arbitration, would really face some problems if counter party does not agree on arbitration and seeks to submit dispute to state a court.

US District Court was faced with this language and determined that such a clause provides for permissive arbitration until one of the parties chooses to invoke the arbitration clause<sup>75</sup>. When such an election is made by a party, in the US District Court's view, then the arbitration becomes mandatory for the parties<sup>76</sup>. This is one of the possible solutions in cases when a term “may” is used in arbitration clause, however this solution is not absolute, because courts of other countries may decide otherwise depending on how favourable they look at arbitration.

In comparison with Eisemann's four essential functions, the clause is particularly dysfunctional with regard to the first and second essential functions, because it fails at producing mandatory consequences for the parties in the absence of state court intervention. The wording also does not help with leading to the best conditions of efficiency and rapidity for the rendering of the award, therefore Eisemann's fourth function is undermined too.

Second example<sup>77</sup>, investigated by Maleville, Marie-Helene also contained the term “may”. Within the same clause of an agreement entered into by French and an Austrian company there was a clause stipulating that disputes must be resolved amicably and if this is impossible, *“each of the contracting parties may call upon an arbitrator to resolve the dispute... in a definitive and obligatory manner for the two contracting parties”*. In this case we also see an option to choose between arbitration and presumably state courts. Such a clause would cause

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<sup>75</sup> Ibid. P. 3.

<sup>76</sup> Cravat Coal Export Company, Inc. v. Taiwan Power Company, USDC Eastern District of Kentucky, Civil Action No. 90–11, (March 5, 1990).

<sup>77</sup> Maleville, Marie-Helene. Pathologies Des Clauses Compromissaires // International Business Law Journal. 2000, Int'l Bus. L.J. 6, P. 69.

almost the same problems for the parties as the first example clause. A note could be given regarding second example. Although Eisemann's first function is respected ("*...arbitrator resolves dispute in a definitive and obligatory manner...*"), it means arbitration agreement would produce mandatory consequences for the parties. However this would only happen if parties choose arbitration, because term "*may*" gives an option to choose. Second and fourth functions are still disrespected, because such a situation would not avoid state court intervention and this arbitration clause would not lead to efficiency and rapidity to the rendering of an award that is susceptible of judicial enforcement.

### 5.1.2. Misnaming arbitral institution

Some of arbitration clauses have a substantial imprecision in the designation of the institution by the parties. One case was where the word 'official' replaced 'International': "*Both parties, in recognition of good faith and mutual understanding in which this agreement has been executed, relinquish their right to have a dispute litigated in their respective jurisdiction. In the event any disputes fail to be settled amicably, both parties agree to arbitrate their difference before the official Chamber of Commerce in Paris, France, and to apply Arkansas, USA law...*"<sup>78</sup> Faced with such a clause, a recalcitrant defendant could and would argue that the International Chamber of Commerce is not the competent institution, further, whenever the claimant sought to bring arbitration at another institution in search of the 'official' Chamber of Commerce (such as the *Chambre Arbitrale de Paris* or the *Chambre Officielle Franco-Allemande*), the same argument might be run the other way to attempt to exclude the jurisdiction of the other arbitration centre<sup>79</sup>. One of the parties applied to the French state court (*Tribunal de Grande Instance of Paris*) in order to help with the interpretation of words "*official' Chamber of Commerce*"<sup>80</sup>. The judge of the French court sitting on the urgent matter held that, in the above clause, the parties had designated the International Chamber of Commerce. The judge's reasoning (translated from the original French) is instructive: "*Whereas the parties, by the clause in dispute, have unequivocally manifested their will to have recourse to arbitration to settle all the difficulties arising from the performance of their agreements. That if there does not exist in Paris an 'Official Chamber of Commerce' the International Chamber of Commerce, a private organization, manifestly constitutes the arbitration centre recognized in Paris in the practice of*

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<sup>78</sup> B.G. Davis. "Pathological Clauses: Frédéric Eisemann's still vital criteria" // *Arbitration International*. 1991, Vol. 7, No 4. P-4.

<sup>79</sup> *Ibid.* P-4.

<sup>80</sup> *Société Asland v Société European Energy Corporation*, TGI de Paris, reprinted in *Revue de l'Arbitrage*, 1990 No. 2.

*international relations, in France and overseas, to organize the procedures for resolving disputes by arbitration...*”<sup>81</sup> In this case defective arbitration clause was saved by the intervention of a state court, but the outcome might have been different in other countries. Therefore is it strongly advisable to pay necessary attention when designating an arbitral institution and writing its name.

Some more examples of ambiguous arbitral tribunal identity are provided by Maleville, Marie-Helene<sup>82</sup>:

1) a charter party giving jurisdiction to the "Maritime Committee in Paris" to resolve the disputes arising from its performance; the arbitrators accepted the jurisdiction of the Maritime Arbitral Chamber of Paris, the only organism suited and adapted to the wishes of the parties;

2) an arbitration clause inserted in a maritime transport contract giving jurisdiction to the "Tribunal of the Chamber of Commerce of Paris";

3) a clause designating, on one hand, the Portuguese association of transport agents, and on the other hand "its equivalent in France", which does not exist; here the arbitral organization is not erroneous, but non-existent; (references to non-existent arbitration institutions are discussed in more detail in the next subchapter).

In relation to Eisemann's essential functions, the above clauses are dysfunctional with regard to (i) the first function, as it does not clearly create mandatory consequences for the parties due to the lack of specificity as to the arbitral institution, (ii) the second essential function, as state court intervention prior to the award in most cases was needed to cause the matter to proceed, and (iii) the fourth function, because the best conditions of efficiency and rapidity for the rendering of the award were not put in place with such an imprecision.

### **5.1.3. Non-existent arbitral institution**

As an example of a defective arbitration clause referring to a non-existent arbitral institution B. G. Davis provides the following clause<sup>83</sup> :

*“For the settlement of all disputes resulting from the performance of this contract, the parties to this contract establish the following agreement:*

*(a) If the Seller should bring an action against the Buyer, the parties will refer to the jurisdiction of the tribunal at the Chamber of Commerce in the city of the Buyer. If it does not*

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<sup>81</sup> Ibid.

<sup>82</sup> Maleville, Marie-Helene. *Pathologies Des Clauses Compromissaires // Pathologies Des Clauses Compromissaires // International Business Law Journal*. 2000, Int’l Bus. L.J. 6, P 72-73

<sup>83</sup> B.G. Davis. “Pathological Clauses: Frédéric Eisemann’s still vital criteria” // *Arbitration International*. 1991, Vol. 7, No 4. P-13.

*exist, or if there exist several, the parties will refer to the jurisdiction of the Court of Arbitration of the ICC in Paris and take for the decision on the disputes the Rules of this Chamber of Commerce.*

*(b) In the event that the Buyer should bring an action against the Seller, he parties will refer to the jurisdiction of a court of arbitration at the (country) Chamber of Commerce.”*

There are at least three problems arising out of above mentioned arbitration clause: 1) dispute may occur regarding the existence of such a Chamber of Commerce in the city of the Buyer. Parties may have different views, 2) If such a Chamber of Commerce exists, it does not mean, that this institution will necessarily deal with this dispute, because maybe this institution only provides services of mediation and does not deal with arbitration, 3) In case there are several institutions under the name of Chamber of Commerce in the city of Buyer, although it is less probable, this would lead to a question, which one of those institutions has the jurisdiction to take on the resolving of the dispute.

The above stated clause particularly lacks mandatory consequences for the parties (the first essential function) and does not provide the best conditions for an efficient and rapid rendering of the award (the fourth essential function).

Pierre A. Karre has an interesting opinion regarding arbitration clauses referring to non-existent arbitral institutions: *“The clause may refer to an arbitral institution which, even after the most artful interpretation, cannot be found to exist. Such an arbitration clause then fails as an institutional arbitration clause. In my opinion, it should convert into ad hoc clause”*<sup>84</sup>. Basically what author means is that in case institutional arbitration clause refers to a nonexistent institution then such a clause it should be treated as ad hoc arbitration clause. Such a view could really be a solution for this type of defective arbitration clauses. On the other hand question would arise why then the parties identified some kind of institution in their clause if they opted for ad hoc arbitration.

#### **5.1.4. Reference to several arbitral institutions**

Certain clauses refer to two arbitral institutions. An example by B. G. Davis stipulates that *“Any controversy or claim arising out of or relating to this Agreement or the breach hereof shall be settled by arbitration in Seoul, Republic of Korea before the Korean commercial Arbitration Tribunal by a single arbitrator in accordance with the Rules of Conciliation and Arbitration of the International Chamber of Commerce. Judgment shall be final and binding on the parties”*. There are three possible interpretations: 1) either the contracting parties envisaged

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<sup>84</sup> Nedim Peter Vogt, Thomas Bär, Robert Karrer. *The international practice of law: liber amicorum for Thomas Bär and Robert Karrer*. Kluwer Law International. 1997, P. 111.

an arbitration before the Arbitration Court of the ICC, in the presence of a sole arbitrator designated by the Korean Arbitration Tribunal, 2) or the expression "before" renders competent the Korean Arbitration Tribunal which will follow the procedural rules of the ICC or 3) finally, the Korean Arbitration Tribunal is only the seat where ICC appointed arbitrator will resolve dispute.

Maleville, Marie-Helene provides following example: *"All disputes or disagreements arising out of the present agreement which cannot be resolved amicably, will be submitted for arbitration before the Chamber of Commerce of Bucarest or the Arbitration Commission of the ICC of Paris"*<sup>85</sup>. Parties might potentially disagree on point which one of the two arbitration institution should have the competence to solve their dispute.

### 5.1.5. Reference to arbitration and state courts

Ambiguity may relate to two distinct dispute resolution techniques, arbitration and state courts, such a mistake would reflect the parties' incertitude with respect to future of the dispute resolution clause<sup>86</sup>. Let's look at examples given by Maleville, Marie-Helene:

1) *"Any disagreement relating to the execution of the present contract shall be submitted obligatorily to arbitration; in the event of a disagreement between the arbitrators chosen by the parties, it is agreed that the dispute will be submitted to the courts"*;

2) *"Disputes shall be submitted to preliminary examination by an arbitrator who shall have the powers to decide ex aequo et bone and shall render an award at first instance, in the event the arbitration fails..., the Regional Court of the seat of arbitration shall be the only court competent to hear any dispute"*;

3) *"Should the defendant party fail to designate one of the arbitrators within time stipulated, the dispute may be brought before the courts of Paris", which, as admitted by the judges themselves, is ambiguous as to the intention of the parties to submit to arbitration"*;

4) *"Any disagreement resulting from the present contract shall be submitted to arbitration of the Arbitration Chamber of Paris which shall finally and definitively resolve same. In the event of disagreement, only the Commercial Court of Provins shall be competent"*.

All these examples show that parties do not trust the effectiveness of arbitration and in case of any failure in arbitration process parties shift jurisdiction to state courts. It seems parties have not clearly decided which one dispute resolution technique suits them best, therefore parties

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<sup>85</sup> Maleville, Marie-Helene. *Pathologies Des Clauses Compromissaires // Pathologies Des Clauses Compromissaires // International Business Law Journal*. 2000, Int'l Bus. L.J. 6, P 73.

<sup>86</sup> Maleville, Marie-Helene. *Pathologies Des Clauses Compromissaires // International Business Law Journal*. 2000, Int'l Bus. L.J. 6, P. 71.

include both of them. This undoubtedly leads to a defective arbitration clause, because the second Eisemann's criterion is undermined (to exclude the intervention of state courts in the settlement of the disputes, at least before the issuance of the award).

B.G. Davis points out the following arbitration clause: *“All claims, disputes and other matters in question between the Contractor and the Company arising out of, or relating to, the Contract documents or the breach thereof, shall at the sole discretion of the Company be decided either under applicable Saudi Arabia law and procedure or by arbitration in accordance with the Rules of Arbitration and Conciliation then obtaining of the International Chamber of Commerce. In the event the Company chooses arbitration, the arbitrator(s) shall apply the substantive laws of the Commonwealth of Virginia, USA, in interpretation of the Contract. The Contractor shall carry on the Works and maintain its progress during any arbitration proceedings, and the Company shall continue to make payments to the Contractor in accordance with the Contract. Arbitration shall be held in Paris, France. The language of the arbitration proceedings shall be English.”*<sup>87</sup> US Court concluded that the parties agreed to resolve all substantive disputes, other than those involving local matters to be governed by Saudi law, by arbitration under the rules of the International Chamber of Commerce. Nevertheless this clause is highly defective, because mandatory consequences are not clear, state court intervention prior to the award was likely and necessary, and efficiency and rapidity are undermined.

Alan Redfern provides further example, reflecting reference to both arbitration and state courts: *“In case of disputes (contestation), the parties undertake to submit to arbitration but in case of litigation the Tribunal de la Seine shall have exclusive jurisdiction”*<sup>88</sup>. In this case there is also no clear intention to apply only to arbitration, both arbitration and litigation possibilities are included, therefore this arbitration clause is defective. The same Eisemann's criteria are disrespected as discussed above.

To draw summarizing conclusion regarding third chapter it could be said, that there is a variety of curable defective arbitration clauses with respect to different elements of arbitration clause. In most cases arbitration clauses mentioned in third chapter are cured by arbitral tribunals or state courts. However the curability of defective arbitration clause is relative matter, depending on the policy of a given country.

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<sup>87</sup> B.G. Davis. “Pathological Clauses: Frédéric Eisemann's still vital criteria” // *Arbitration International*. 1991, Vol. 7, No 4. P. 10.

<sup>88</sup> Alan Redfern. *Law and practice of international commercial arbitration*. Sweet & Maxwell. 2004, P. 173.

## **5.2. Hardly curable defective arbitration clauses**

Defective arbitration clauses falling under this category have low chances of being cured, because existing defects related to essential and important elements of arbitration clause put arbitral tribunals or state courts to a difficult position to interpret the real intentions of the parties.

Hardly curable defective arbitration clauses for the purpose of convenience were provided in chapter 3 with essential arbitration clauses. To repeat these are: a) floating arbitration clauses, b) defective appointment procedure and c) reference to different types of dispute resolution.

Drafters should pay attention when drafting arbitration clauses and not omit any essential arbitration clause elements in order not to end up with hardly curable defective arbitration clause.

## **6. Drafting guidelines of correct arbitration clause**

### **6.1. Initial considerations regarding arbitration clause**

There are a number of factors which determine the enforceability of arbitration clause and which should be taken into account in the first place before going on to the questions of construction of arbitration clause.

#### **6.1.1. Ad hoc or Institutional arbitration**

After agreement to refer to arbitration as a type of dispute resolution parties have to decide on the type of arbitration: ad hoc or institutional. Each of these types has their advantages and disadvantages. The advantage of ad hoc arbitration is that the parties avoid the administrative fees charged by arbitral institutions, which can be substantial in some cases. The disadvantages of ad hoc arbitration are that national courts are more likely to intervene when there is no administering institution and, in the absence of an administrator, the parties may have to apply to the courts to resolve procedural problems on which they cannot agree. In case of institutional arbitration parties do not have to worry about organizational matters. Usually arbitral institutions provide arbitration rules to be following during arbitration, this eliminates potential disputes on various details e.g. appointment procedure of arbitrators between the parties.

### 6.1.2. Arbitrability of disputes

There is no consensus as to what matters are arbitrable. Arbitrability relates to the issues in the dispute and whether they are capable of settlement by arbitration<sup>89</sup>. Traditionally particular areas are reserved only for State courts. Selection of those reserved areas having in mind principles of public order and public policy basically depends on nation's view whether one or other matter may be arbitrated. There is no definite list of arbitrable disputes, because each country has its own approach. Each country has a different balance between the policy of reserving matters of public interest to the courts and the public interest of encouraging arbitration in commercial matters<sup>90</sup>. Article II (1) of the New York Convention obliges each of the contracting States to the convention to "*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 subject matter capable of settlement by arbitration*". There are three essential elements to this article of the New York Convention. First, there must be an agreement in writing; secondly there must be a defined legal relationship; and thirdly the subject matter of the dispute must be capable of settlement by arbitration. The phrase "defined legal relationship" is one which is found within numerous statutes<sup>91</sup> and arbitration rules<sup>92</sup>. What constitutes a defined legal relationship will differ from country to country. It is common to find that the words "defined legal relationship" are interpreted broadly. In *Hi-Fert Pty Ltd and Cargill Fertilizer Inc v Kiukiang Mairitime Carriers and Western Bulk Carriers (Australia) Ltd*<sup>93</sup> the Federal Court of New South Wales had to consider whether an arbitral tribunal had jurisdiction to hear claims arising from breach of the Trade Practices Act. The court considered whether a claim for breach of statutory duty arose from a breach of a "defined legal relationship". The court stated that as the expression "defined legal relationship" was followed by the words "whether contractual or not" these words indicated that the type of dispute that could be referred to arbitration reached beyond the contractual relationship established within the underlying contract. The court also held that the expression "in respect of" also indicates that a broad approach should be taken to the nature and extent of the relationship. The "legal relationship" can, on this approach, be

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<sup>89</sup> Tweeddale, Andrew. *Arbitration of Commercial Disputes: International and English Law and Practise*. Oxford: Oxford University Press. 2007, P. 107.

<sup>90</sup> A. Redfern and M. Hunter. *Law and practice of international commercial arbitration*. Sweet & Maxwell. 2004, par. 3.21.

<sup>91</sup> e.g. UNCITRAL Model Law on Arbitration art. 7.

<sup>92</sup> e.g. Netherlands Arbitration Institute, 1998 arbitration rules, art. 1.

<sup>93</sup> (1997) 12 Mealey's International Arbitration Report (No 7) C-1-C-9; (1998) Ybk Comm Arbn 606-18.



defined by statute. Therefore, the scope of the arbitration agreement may also include claims in negligence or other torts. The dispute between the parties must be capable of settlement by arbitration. In this regard there will be some forms of dispute which will be seen as falling within the exclusive jurisdiction of the national courts. The rationale for this is that certain matters are considered to be so important to the operation of justice or the running of business that they are reserved exclusively to the control of the courts. In *Zimmermann v Continental Airlines Inc*<sup>94</sup>, for example, the court held that bankruptcy proceedings were not capable of settlement by arbitration because of their importance to the smooth functioning of the nation's commercial activities. The court held that such proceedings were one of the few areas where Congress has expressly pre-empted state court jurisdiction.

Following conclusion could be drawn up in respect of this subchapter: in order for an arbitration agreement to be valid and operable it must deal with disputes, which are not reserved to State courts exclusive jurisdiction and which therefore are capable of being arbitrated.

## 6.2. Miracle arbitration clause

In the end after analyzing various defective arbitration clauses it would be the right time to outline main guidelines, which should be followed by future drafters of arbitration clauses in order to avoid defects in arbitration clauses. R. Doak Bishop said: *"There is no such thing as a single "model", "miracle" or "all purpose" clause appropriate for all occasions. Each clause should be carefully tailored to the exigencies of a given situation, taking into account the likely types of disputes, the needs of the parties' relationship and the applicable laws."*<sup>95</sup> Nevertheless I believe that there are some points, which if considered by the drafters guide to the creation of specifically tailored "miracle" clause for particular situation and needs of the parties.

B. J. Davis puts emphasis on these guiding points<sup>96</sup>:

1) *First, those who draft arbitration clauses should always keep in mind the four criteria of Eisemann. If any of the functions referred to by him is weakened in its fulfilment, the draft should be revised,*

2) *Second, any ambiguity or imprecision should be avoided. Neither too many nor too few words should be used,*

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<sup>94</sup> Tweeddale, Andrew. *Arbitration of Commercial Disputes: International and English Law and Practise*. Oxford: Oxford University Press. 2007, P. 111.

<sup>95</sup> R. Doak Bishop. *Practical guide for drafting arbitration clauses* // *Int'l Energy L. & Tax'n Rev.* 2000, 16. P. 1.

<sup>96</sup> B.G. Davis. "Pathological Clauses: Frédéric Eisemann's still vital criteria" // *Arbitration International*. 1991, Vol. 7, No 4. P. 21.

3) *Third, in any event, the arbitration clause, as Eisemann said, must be kept simple without being simplistic.*

To comment the second point, it is true that neither too many nor too few words should be used. While too many words might lead to a situation called over specify. Sometimes parties draft arbitration clauses with high requirements for arbitrators. John M. Townsend gives such an example: *“The Arbitration shall be conducted by three arbitrators, each of whom shall be fluent in Hungarian and shall have twenty or more years of experience in the design of buggy whips, and one of whom, who shall act as chairman, shall be an expert on the law of the Hapsburg Empire.”*<sup>97</sup> Such high requirements might cause a situation when no suitable arbitrator is found and therefore arbitration becomes impossible. On the other hand too few words might result in floating arbitration clauses, discussed before, when important arbitration clause elements are missing and therefore rendering arbitration clause inoperable.

Moreover regarding arbitration clause drafting guidelines John M. Townsend proposes the following steps<sup>98</sup>: *“Step 1: Define what is arbitrable; Step 2: Commit the parties to arbitration; Step 3: Pick a set of rules (and, in this case, an arbitration institution to administer the case); Step 4: Provide for entry of judgment. This is essential to enforcement in the United States; Step 5: Specify the language in which the arbitration will be conducted; Step 6: Specify the location of the arbitration; Step 7: Specify the procedural law that will govern the arbitration. Step 8: Specify the number of arbitrators.”*

Basically the idea is to include all essential and important arbitration clause elements in order for arbitration clause to perform its functions. If parties do not need any additional element it is best to use “model” or “standard” arbitration clauses (discussed in subchapter 5.1.) recommended by arbitration institutions. Such clauses are tested in time and practice, include necessary elements, therefore it is a great way to avoid mistakes in drafting arbitration clauses on your own.

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<sup>97</sup> John M. Townsend. Drafting arbitration clauses: Avoiding the 7 deadly sins // Dispute Resolution Journal. 2003, Vol. 58, No. 1. P. 3.

<sup>98</sup> Ibid. P. 4-5.

## CONCLUSIONS

1. After analysis of relevant doctrine and case-law clauses main features of defective arbitration clause may be outlined: a) ambiguous arbitration clause elements, b) imprecise arbitration clause elements and c) absence of essential or important arbitration clause elements.

2. Arbitration clause must have at least 3 essential elements: “all/any disputes”, “in connection with/relating to this contract”, “finally settled”.

3. A new classification is crystallized, which classifies defective arbitration clauses under the two categories of curable and hardly curable defective arbitration clauses depending on the level of curability of the defective arbitration clause. Different types of defective arbitration clauses are contained in these two categories.

4. There is a variety of curable defective arbitration clauses with respect to different elements of arbitration clause, the curability of which is a relative matter depending of given countries’ policy regarding arbitration promotion.

5. Hardly curable defective arbitration clauses have low chances of being cured, because they lack a number of essential and important elements necessary for proper functioning of arbitration clause.

6. Best way to avoid defective arbitration clauses is to include all essential and important arbitration clause elements in arbitration clause, in case parties do not need specifically tailored clauses, the best choice is “standard” arbitration clauses recommended by arbitral institutions.

7. The hypothesis is confirmed: it is possible to create a perfect arbitration clause, when drafters of arbitration clause take into account all relevant circumstances of a particular situation. Drafters must include all essential and important arbitration clause elements when drafting arbitration clause, this way a proper functioning of arbitration clause will be guaranteed.

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## SANTRAUKA

Dažniausiai rengiant tarptautines komercines sutartis arbitražinė išlyga eina sutarties pabaigoje. Kartais nutinka taip, kad šalys nerodo didelio noro kelti diskusijų dėl to kaip turėtų atrodyti arbitražinė išlyga arba kokius sudėtinius elementus ji turėtų turėti. Šalys gali manyti, kad ginčas mažai tikėtinas, todėl neverta gilintis į arbitražinę išlygą arba dėl laiko stokos įkeliama atsitiktinė arbitražinė išlyga. Pakankamo dėmesingumo trūkumas ruošiant arbitražinės išlygas dažniausiai leidžia kilti arbitražinėms išlygoms su spragomis, kurios esant ginčui priverčia šalis sugaišti daug daugiau laiko ir suvartoja daug daugiau finansinių resursų nei tikėtasi arba išvis paverčia arbitražą kaip ginčų sprendimo būdą šalių atveju neįmanomą.

Magistriniame darbe nagrinėjamos arbitražinės išlygos su spragomis ir siekiama pasiūlyti būdą, kaip parengti taisyklingas arbitražines išlygas. Šiems tikslams pasiekti būtinas nuoseklus užduočių įvykdymas, apimantis: a) pagrindinių arbitražinės išlygos su spragomis bruožų nustatymą, b) pagrindinių taisyklingai parengtos arbitražinės išlygos elementų nustatymą, c) pagrindinių arbitražinės išlygos su spragomis tipų nustatymą, d) arbitražinių išlygų su spragomis klasifikacijos pateikimą, e) būdų išvengti arbitražinių išlygų su spragomis pateikimą ir f) doktrinos bei teismų praktikos analizę ir apibendrinančių išvadų pateikimą. Pirmoji magistrinio darbo dalis glaustai apibrėžia tarptautinę komercinę sutartį. Tokiu būdu geografinės magistrinio darbo objekto ribos yra patikslinamos. Antroji dalis pristato arbitražinės išlygos su spragomis šaknis. Ši dalis apima arbitražinės išlygos apibrėžimą, arbitražinio susitarimo formas, atskirtumo doktriną, arbitražinės išlygos su spragomis bruožus ir Eisemann kriterijus. Trečioji dalis pateikia esminius arbitražinės išlygos su spragomis elementus ir jų atitinkamus potencialius defektus. Esminiai arbitražinės išlygos su spragomis elementai yra arbitražinės išlygos egzistencijos pagrindas, todėl dėmesys taip pat yra skiriamas galimiems defektams slypintiems esminiuose arbitražinės išlygos elementuose. Ketvirtoji dalis analogiškai tiria svarbiuosius arbitražinės išlygos elementus. Svarbieji arbitražinės išlygos elementai nėra būtini arbitražinės išlygos egzistencijai, tačiau yra rekomenduotina šiuos elementus įtraukti rengiant arbitražines išlygas, kadangi jų dėka apibrėžiamos svarbios detalės, pavyzdžiui arbitrų skaičius. Tai padeda išvengti galimų ginčų ateityje. Penktojoje dalyje pateikiama arbitražinių išlygų su spragomis klasifikacija, apimanti „išgydomų“ ir sunkiai „išgydomų“ arbitražinių išlygų su spragomis kategorijas. Šeštoji dalis nustato taisyklingų arbitražinių išlygų rengimo gaires.

Raktažodžiai: tarptautinė komercinė sutartis, arbitražinė išlyga su spragomis, patologinė arbitražinė išlyga, arbitražinės išlygos elementas, „išgydoma“ arbitražinė išlyga su spragomis, sunkiai „išgydoma“ arbitražinė išlyga su spragomis, taisyklinga arbitražinė išlyga.



## SUMMARY

Usually in a drafting process of a contract arbitration clause is left at the end of a contract. Sometimes it happens that parties really do not wish start discussions on how should arbitration clause look like or what details should it contain, because either parties think they would never come to a conflict or they are short in time and leave arbitration clause unconsidered. Absence of proper attention when drafting arbitration clauses is likely to give rise to defective arbitration clauses, which lead to much higher than expected time and money costs or even make arbitration impossible.

Master thesis analyses defective arbitration clause types and provision of a way to create correct arbitration clauses. In order to reach this goal gradual completion of tasks is necessary, which involves: a) identification of the main features of defective arbitration clause, b) identification of the main elements of well drafted arbitration clause, c) identification of the main types of defective arbitration clauses, d) provision of a classification of defective arbitration clauses, e) provision of as much as possible ways to avoid defective arbitration clauses and f) analysis doctrine and case law in this field and result encompassing conclusions. First part of master thesis briefly defines international commercial contract. This way the geographical scope of master thesis object is defined. Second part presents the roots of defective arbitration clause. Second part encompasses definition of arbitration clause, forms of arbitration agreement are given, separability doctrine, features of defective arbitration clause and Eisemann's criteria. Third part provides essential elements of arbitration clause and their respective potential defects. Essential arbitration clause elements are vital for arbitration to exist, therefore attention is paid to possible defects within essential elements, which may render arbitration clause inoperable.. Fourth part analogously focuses on important elements of arbitration clauses and their defects. Important arbitration clause elements are not vital for the existence of arbitration clause. Nevertheless it is strongly advised to include important elements in arbitration clause, because important elements define necessary details e.g. number of arbitrators, which helps to avoid potential disputes. In fifth part a classification of defective arbitration clause is crystallized under the categories of curable and hardly curable defective arbitration clause. At that same time analysis of components is provided. Sixth chapter presents guidelines and solutions how draft correct arbitration clauses.

Keywords: international commercial contract, defective arbitration clause, pathological arbitration clause, element of arbitration clause, „curable“ defective arbitration clause, hardly „curable“ defective arbitration clause, correct arbitration clause.