NOTES AND COMMENTS

SHOULD DE-LOCALISED ARBITRATIONS BE SUBJECT TO ANOTHER DOMESTIC LEGAL SYSTEM?

Abstract

De-localised arbitrations are not a novel phenomenon. Their principal objective is to neutralise arbitrations, but in reality, in most cases, these arbitrations become subject to foreign jurisdictions including their procedural laws unless the governing law of these arbitrations is principles of public international law or the general principles of law recognised by states and their procedural law become a neutral law too. This work attempts to promote a change of the current practice by making foreign domestic arbitrations subject to the laws and procedures as referred to above; otherwise the purpose of delocalising arbitrations – neutralisation – will be defeated.

I Introduction

DE-LOCALISED ARBITRATIONS are not a new phenomenon in the commercial world. They date back to at least the 17th Century, if not earlier. They became a common practice in the commercial world, when it was dominated by the colonial period, but they are still allowed to take place primarily because of two reasons: (i) that the developed countries, in general, do not have faith and confidence in the judicial systems of developing countries, thus, even if the place of performance of the contract happens to be a developing country, one can easily assume that the arbitration under the relevant contract, if it becomes the chosen method of settling disputes, would take place in a developed country, and this has been so, when a private foreign investor, a transnational corporation, belongs to a developed country; and (ii) developing countries, in general, seem to accept the idea of de-localising their arbitrations in the belief that an appropriate dispute-resolution will take place in a more experienced commercial world, which is the West. Thus, a kind of voluntary submission to a foreign and indeed irrelevant jurisdiction has been taking place on this issue although there does not exist any legal justification for it. In this paper an attempt is made to identify the merits and disadvantages of de-localised arbitrations.

II What is a de-localised arbitration?

An arbitration may only be activated in two circumstances: (i) when parties to a contract have provided for arbitration in their contract in the event of a dispute arising under it; and (ii) when no such clause has been incorporated into a contract, but the parties, after a dispute has actually arisen under it, have agreed to refer it to an arbitral tribunal.

Whereas an arbitration may be de-localised, the corresponding contract cannot be subject to de-localisation process simply because contracts are "rooted" to their places of performance. Thus, when a dispute which was supposed to be considered by an arbitral tribunal at the place of performance of the contract but is not done so for the reasons stated above, it is transferred to another jurisdiction by uprooting it from its natural jurisdiction/forum. The process of changing the "locale" of a dispute is described as "de-localisation" of arbitrations. De-localisation of arbitrations can only take place with the consent of the parties concerned. The question remains, how many parties comprehend the legal and financial effect of de-localisation of arbitrations or whether they totally depend on the advice to be given to them by their lawyers. From this standpoint, the "party autonomy rule" becomes a misnomer.

III Merits and disadvantages of de-localised arbitrations

The principal merits of de-localised arbitrations may be summarised:

i. These arbitrations will have the advantage of being considered by very experienced arbitrators who usually become members of arbitral tribunals in the traditional fora, namely, London, New York or Geneva;

ii. Usually, the rules of natural justice – *audi alteram partem* (the accused must be heard) and *nemo judex inpropr insua causa* (nobody shall be a judge in his own cause) are applied, the latter for avoiding bias on the part of arbitrators;

iii. Contrary to the popular belief, like court proceedings, arbitrations in the Western World are particular about local procedures; this seems to provide confidence in the minds of the parties to arbitrations;

iv. Confidentiality of arbitral proceedings particularly in England, proves to be an attractive factor to hold arbitrations at these fora;

v. A high degree of psychological satisfaction seems to persist whereby both the parties feel that their dispute was considered and settled at a most reliable and competent forum in the West.

Disadvantages of de-localised arbitrations

i. It derogates from the established principle of jurisdictional law, namely, the place of performance of the contract determines the jurisdiction;

ii. By virtue of choosing a foreign jurisdiction (especially a jurisdiction in the Western World) the costs of arbitrations, including the related costs, usually become extremely high and these costs have to be paid for in a hard currency;

iii. It proves to be very costly to enable arbitrators and experts to visit the place of performance, particularly, in construction cases, or cases entailing negligence or for ascertaining the extent of damages;

iv. All witnesses have to brought over to the foreign location of arbitration, which can be costly; and

v. At least one party, if not both of them, may not be familiar with the local procedural law, where the arbitration takes place

IV The circumstances in which de-localisation of arbitrations may not derogate from the established principle of the place of performance

The party autonomy rule shall be applied in choosing the locations of arbitrations; thus, from a theoretical standpoint, if the parties concerned choose a foreign jurisdiction for settling their dispute by arbitration there, the basis for de-localising an arbitration may not be questioned. Indeed, in the cases of ad-hoc arbitrations, de-localisation of arbitrations has become a common phenomenon. Take for example, the arbitrations to which the Government of Libya was the respondent: (a) British Petroleum – Libya;[1] and (b) Texaco – Libya.[2] There is hardly any point in going into details of these disputes in the context of this work. Suffice to say that each of these arbitrations was concerned with acts of "illegal taking" of foreign assets by then government of Libya. In each of these cases, the parties agreed to refer their dispute to ad-hoc tribunals, and each tribunal was composed of one arbitrator. Each of them was concerned with the same issue (for the purposes of this work) whether taking of assets of the private foreign investors by then Libyan Government was legal. The tribunals in each case, found that the manner in which the assets of these private foreign investors were taken by the government of Libya was illegal and contrary to the principles and standards of international law: the principle of state responsibility and the international minimum standard. By relying on article 2(C) which provided, *inter alia*, that:

> To nationalise, expropriate or transfer ownership of foreign property, in which case appropriate compensation should be paid by the State adopting such measures…

Libya maintained that it had no obligation to paying compensation to the owners of the assets; Libya also failed to establish before the tribunals that the act of taking of foreign assets was prompted by the need for protecting the public interest. The ad-hoc arbitral tribunals relied on paragraph 4 of the United Nations General Assembly Resolution entitled Permanent Sovereignty over Natural Resources, 1962 which provides, *inter alia*, that:

> Nationalisation, expropriation or requisitioning shall be based on grounds or reasons of public utility, security or the national interests which are

1 See International Law Reports, vol. 53 (1979).

2 *Id.* at 389.

> recognised as overriding purely individual or private interests, both domestic and foreign. In such cases the owner shall be paid appropriate compensation…

However, de-localisation of the disputes in these cases was consented to by all parties concerned, and the foreign parties did not have sufficient confidence in the judicial system of Libya at the material time. Based on these arbitrations, it may be concluded that de-localisation of disputes would be permissible in the following circumstances:

i. that the parties concerned have consented to it for whatever reason(s);

ii. that when a party may not have sufficient confidence[3] in the judicial system of the location at which the contract was being performed;

iii. that the dispute requires an application of the principles of public international law and the compulsory standard (the International Minimum Standard) for the protection of the interests of private foreign investors in a host state; and

iv. that the party would not like to see that the dispute should be subject to the law of the local jurisdiction including procedures thereto

It is to be re-iterated that de-localisation of disputes takes place in disregard of one of the fundamental principles of the law of contract – the place of performance, unless the dispute entails an application of the principles and standard of public international law, but even then, the arbitral tribunal may be composed of arbitrators qualified in public international law and may also be located there for the inherent advantages that the location provides during arbitral proceedings. The reasons for the shift from localised arbitrations to de-localised arbitrations have already been identified and explained.

V De-localised arbitrations before the arbitral tribunals of the international centre for settlement of investment disputes (ICSID)

Before going into the details of de-localised arbitrations under the auspices of ICSID, it would be apposite to briefly discuss the reasons for setting up ICSID. As the title of the organisation clearly indicates that it was set up exclusively for dealing with disputes pertaining to "investment". However, the convention (The International Convention on Settlement of Investment Disputes, 1965) has not defined the term "investment" which, on reflection, would appear to be the most appropriate decision made by the drafters of the convention, although in most of the disputes before ICSID tribunals

3 This will include issues such as, composition of the tribunal, bias, the prospects of enforcement of the arbitral award in the jurisdiction concerned *etc.* On bias, see, C Chatterjee, "Bias in Arbitration and Bias against Arbitrators" 3 *The Journal of World Investment* (2002) among others.

this term has been subject to a variety of interpretations.[4] The meaning and connotation of this term seem to be ever-changing. By 1965, the second decade of the United Nations, it became clear to the World Bank that as a direct consequence of the de-colonisation process, the incidence of taking of assets of private foreign investors (popularly known as multinational enterprises) would be high, which actually proved to be largely true. It was also correctly perceived by the World Bank that to develop the confidence in the minds of the former investors in the developing world, de-localisation of the disputes would be the most appropriate approach to this issue, although the governing article (article 42) of the convention also provides for domestic law. The drafting of this article has also provoked controversies, but aside of all controversies, the ICSID tribunals have, in almost all cases, applied the principles of international law. At this point it would be appropriate to reproduce the relevant part of the text of article 42(1) of the convention:

> The tribunal shall decide a dispute in accordance with such rules of law as may be agreed by the parties. In the absence of such agreement, the tribunal shall apply the law of the Contracting State Party to the dispute (including its rules on the conflict of laws) and such rules of international law as may be applicable.

The provision is quite interesting in that it maintains the "party autonomy rule" in arbitrations which is so deeply rooted in the process of settling disputes. In the hierarchy of the choice of the governing law of a dispute, preference has also been placed on the domestic law of the claimant (in the case of an arbitration, an applicant) which may not receive support from the respondent; thus in the third echelon of the process, provision has been made for the rules of international law, although the word "and" might give one the impression that principles of public international law may be applied in conjunction with the law of the contracting state party to the dispute, but, in reality, the tribunals tend to resolve the disputes by an application of the principles of public international law, at least, in the majority of the cases in which the issue of the "taking of" private foreign assets was the principal issue.[5] This is perhaps with a view to re-assuring the disputant parties of the neutrality of the applicable law for settling their disputes.

When a de-localised arbitration is governed by the principles of international law, it may be regarded as a truly international arbitration. Thus, at the point of negotiating an investment agreement with a private foreign investor, the contracting parties (usually

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4 For the history of the drafting of this Convention**,** see, *The ICSID Convention: A Commentary* C Schreuer (Cambridge University Press, 2001).

5 See, for example, the ICSID arbitrations, in general, particularly when many disputes as regards taking of assets of private foreign entities were "taken" by many newly-born states in the developing world

a public body and a private foreign entity – leading to a state contract) should carefully consider the governing law of an arbitration, bearing in mind that even though a contracting state party is, from a legal standpoint, stronger than a private foreign corporation, the former's law may not be allowed to be applied to the arbitration by the latter in the event of a dispute arising under a state contract. The parties to a contract either choose the principles of public international law or *lex mercatoria*.

VI The de-localisation myth

De-localised arbitrations should not be designated as international arbitrations, if the governing law of these arbitrations are not principles of public international law. However, as disputes transferred over to other jurisdictions, the arbitrations relating to them may at best be called "transnational" arbitrations. A transaction between two different States or parties residing or domiciled in two States does not qualify for being "international". One has to be careful that the term "international" is not abused.

A de-localised arbitration loses its transnational character when the appropriate court in the location in which such an arbitration takes place will have the authority to set aside an award. The setting aside of an arbitral award in such situation is governed by the law of the location in which the arbitration takes place. The majority of countries, except a few, namely, France, Luxembourg and Sweden, operate a system whereby the power of the relevant courts must be recognised to review the awards of arbitral tribunals, when necessary.

Of course, in the contemporary period, a tendency to minimise interventions by the courts where an arbitration takes place has become evident. Under the UNCITRAL Model Law, the power of the municipal courts to intervene in arbitration proceedings has been largely prohibited. Article 5 of the UNCITRAL Model Law states that:

> "In matters governed by this Law, no court shall intervene except where so provided in this Law"

Section 1 of the Arbitration Act, 1996 (English) states that:

> "… the court should not intervene except as provided by… this Act"

Of course, the word "should" in this provision may not apparently make it an obligation, but in the context of the Act, the term has the force of "shall". This is evidenced by the provisions of sections 42-45 and 66-71 of the Act, which clearly suggest that it is only in very limited circumstances that the high court may intervene in arbitral proceedings. Of course, under the former Act, the Arbitration Act 1979, supervision and control by the high court was a common phenomenon, but in order to be in line with the EU civil law practice, the 1996 Act provided for the court's supervision in limited circumstances. A discussion of this issue would be beyond the remit of this article; however, it should be seriously considered whether de-localised arbitrations

should not come under the supervisory powers of the courts of the locations in which these arbitrations take place.

A de-localised arbitration is nothing but a domestic arbitration, which the parties have chosen to be decided at a chosen foreign jurisdiction (transnational) only to be bound by the procedural law of that jurisdiction; unless the arbitration is governed by the principles of public international law the procedural law of which will also be international/neutral. When a domestic arbitration is de-localised for the purpose of "neutralising" it in a foreign jurisdiction, there is no reason why the local courts, for the reasons stated above, should not be allowed to exercise its supervisory jurisdiction.

A de-localised arbitration can fall into another legal trap. The courts of the foreign jurisdiction will have the right to set aside an award according to its local law, if the award-debtor challenges the award; however, if the local courts do not accept the challenge, then the award-creditor will have only two choices to act upon, but neither of them may be of much use for it. First, if both the parties' countries are also parties to the New York Convention on Recognition and Enforcement of Arbitral Awards of 1958, the courts in the award-debtor's jurisdiction may not recognise a foreign award on any of the grounds identified in Article V of that convention let alone enforce it; secondly, if the award-creditor refers the matter to its own courts and if the said court, orders an enforcement of the order, it would be a futile exercise in the event of the award-debtor having no assets in that jurisdiction. Thus, the outcome of a de-localised arbitration may well be zero – a total waste of time and money.[6]

On the other hand, if a de-localised arbitration is governed by the principles of public international law, by a neutral arbitral tribunal chosen by both the parties, then the acceptability of de-localisation of arbitrations awards may become high; such is the case with ICSID arbitrations, although certain other additional factors prompt the parties to accept and enforce the ICSID tribunals awards.

Briefly, if a de-localised arbitration is devoid of neutrality particularly in terms of the composition of the tribunal and the governing law including the procedures attached to it, then the award-debtor will lose faith in this type of dispute settlement process and of course, the applicant may not find it worthwhile to enforce the award.

In principle, awards rendered under de-localised arbitrations are detached from the seat of the arbitration; this was confirmed by the Cour d'appel in Götaverken case[7]

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6 See further C Chatterjee, "Recognition and Enforcement of Arbitral Awards: How Effective is Article V of the New York Convention of 1958?" 36 *International In-House Counsel Journal* (2016) at 1.

7 *Götaverken Arendal AB* v *Libyan General Maritime Transport Co.* [1980] JDI 660; see also J Paulsson, "Arbitration Unbound: Detached from the Law of its Country of Origin" 30 *International and Comparative Law Quarterly* (1981) at 358.

when it decided that by virtue of the award not being a French award, the court had no jurisdiction to set aside the award. But, in reality, if they are subject to the local law and procedures (unless they are governed by the principles of public international law, or a neutral procedural law) it would be difficult to sustain that these arbitrations are international in character; therefore the local courts may not assume jurisdiction when a party to an arbitration may make an application for setting aside the award.

But state practice on this issue still seems to vary from state to state. Lawyers and parties therefore should inform themselves of the state practice prior to their choosing a jurisdiction for a de-localised arbitration. In the Hilmarton Ltd and Omnium de Traitement et de Valorisation,[8] for example, the French Cour de Cassation held that a non-domestic (although it termed it as an international arbitration) award was not integrated in the legal system of the seat of arbitration. Under their agreement, the parties stated that the arbitration would take place in Geneva under the law of Geneva. The award of the arbitral tribunal was set aside by the Supreme Court of Switzerland. Thus, national practices on this issue differ; consequently, the parties would be required to do what may be described as "forum shopping" for de-localisation of disputes.

Provision for an application of the general principles for settlement of disputes by arbitration is not uncommon. In *Texaco* v *Libyan Arab Republic*[9] the Concession provided that: [10]

> This Concession shall be governed by and interpreted in accordance with the principles of Law of Libya common to the principles of international law and in the absence of such common principles then by and in accordance with the general principles of law, including such of those principles as may have been applied by international tribunals.

The tribunal in the Texaco – Libyan Arab Republic arbitration, further maintained that: [11]

> It is not only international case law but also municipal case law which uphold the autonomy or the independence of the arbitration clause whenever the local courts are called upon to decide questions of private international law relating to international commercial arbitration.

At this point, one should consider how de-localisation of disputes takes place and the legal consequences thereof. This was, incidentally, examined by the tribunal in Saudi Arabia and Arabian American Oil Company (ARAMCO) arbitration.[12] Whatever may

8 XXII Yearbook of Commercial Arbitration (1977) 696.

9 See 53 International Law Reports (1979) at 389.

10 *Id.* at 404.

11 *Id.* at 409.

12 See 27 International Law Reports (1963) at 117.

be the governing law indicated in an arbitration clause, when the parties to a contract/ concession decide to de-localise their dispute two situations arise: (a) to subject the dispute to another legal system (from de-localisation to localisation), and (b) but the parties have the option to choose a neutral law including a neutral procedure to settle their dispute. But, in both situations, the same problem will arise – whether the court of the second location will have the power to supervise that tribunal dealing with a so-called de-localised dispute.

What motivates the parties to de-localise their disputes under a contract should be seriously considered; no doubt, they want to neutralise the dispute so that it is not governed by any domestic law; otherwise, they will be taking a leap from "one frying pan over to another."

The purpose of de-localising a dispute is to neutralise it and that can be achieved only by making the principles of public international law as the governing law and the generally recognised procedures of settling disputes as their procedural law. In this context, the opinion of ARAMCO Arbitral Tribunal would be appropriate to refer to, particularly because in most cases of private foreign investments by transnational corporations, the contracts are state contracts, but disputes may also arise under contracts between two private entities.

It should also be emphasised that a public entity may also claim immunity from a jurisdiction, and in that event the entire de-localised arbitral may be conducted *ex parte*. In the arbitration between British Petroleum and the Arab Republic of Libya, the Government of Libya was absent during the arbitral proceedings.

In support of the theme of this work that a de-localised arbitration should not be made subject to any national legal system, it would be apposite to quote *adverbatim* a passage from the ARAMCO arbitral tribunal report: [13]

> Although the present arbitration was instituted, not between States, but between a State and a private American corporation, the Arbitration Tribunal is not of the opinion that the law of the country of its seat should be applied to the arbitration.
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> The jurisdictional immunity of States (the principle *par in parem non habet jurisdictionem*) excludes the possibility, for the judicial authorities of the country of the seat, of exercising their right of supervision and interference in the arbitral proceedings which they have in certain cases. In all civilized States, ordinary Courts possess by law such powers of supervision and interference. The Courts can sometimes appoint the

13 *Id.* at 155.

> arbitrators or the umpire directly by virtue of the law, particularly when one Party violates the arbitration agreement or fails to designate its arbitrator. They can also require that the award, in order to be valid, should be filed with the registry of the court. They can declare the nullity of the award in various circumstances: sometimes the law of the State lays down special grounds for annulment of arbitral awards; sometimes, 'cassation' proceedings are open on the same grounds as in the case of judicial decisions of the Courts; sometimes an appeal can be lodged against arbitral awards, either *ipso jure* or by virtue of a special reservation in the *compromis* or in the arbitral Clause; sometimes a 'revision' of arbitral awards is permitted and the matter is referred back for determination to the arbitral tribunal itself or to the Courts of the State; sometimes a special organ is given the power to declare the nullity of the award. In certain cases, this acknowledged power of the judicial authorities of the State to interfere may go as far as the substitution of the arbitrators chosen by the Parties by such authorities.
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> Considering the jurisdictional immunity of foreign States, recognized by international law in a spirit of respect for the essential dignity of sovereign power, the Tribunal is unable to hold that arbitral proceedings to which a sovereign State is a Party could be subject to the law of another State. Any interference by the latter State would constitute an infringement of the prerogatives of the State which is a Party to the arbitration. This would render illusory the award given in such circumstances. For these reasons, the Tribunal finds that the law of Geneva cannot be applied to the present arbitration.[14]

There is no reason why this view may not be sustained in respect of arbitrations to which both the applicant and the respondent are private entities. The real reasons for de-localising a dispute should not be lost sight of. In fact, if the judicial system at the place of performance of a contract is deemed to be reliable and has developed confidence in the minds of the international community, there is no need for de-localising disputes. In this connection, one may like to refer to the dispute that arose between the Union of India and Union Carbide Corporation;[15] although a tort-based case, the location theory was upheld by the US courts.[16]

If parties to a contract wish to have their disputes, if any, under the contract, decide to be settled by de-localising their dispute, then the arbitration clause should be drafted

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14 *Id.* at 155-156.

15 Gas claim case no. 113 of 1986, Order of 26 of 1988 of April 4,1988.

16 The report on this case has been reprinted in 25 International Legal Materials (1986) 771.

accordingly, and in particular, the governing law of the disputes and the location where the arbitration should take place. The caution should be entered that the real purpose of de-localising a dispute is to internationalise it. In fact, if an arbitration is governed by the principles of public international law and a neutral procedural law, then there is no need for de-localising the dispute either.

VII Conclusion

De-localised arbitrations have a long history which was allowed to perpetuate owing to the lack of confidence on the part of traditionally known private foreign investors (otherwise known as transnational corporations). Of course, this type of arbitrations can also be initiated by private parties located in either the same jurisdiction or in two different jurisdictions.

As has been explained in this work that this process of settling disputes arising under contracts which are rooted in the jurisdictions of performance violates the basic legal principle of the Law of Contract that the place of performance of contracts should give the governing law and the jurisdiction for settling disputes arising under them. The belief that the developed countries' judicial systems, including arbitral procedures, are more advanced than those of developing countries, in general, prompts parties to have their disputes settled by arbitration in a foreign jurisdiction even though neither party may be familiar with their substantive legal system and the procedures thereof.

As explained in this work that de-localised arbitrations may be re-assuring for Applicants but there does not exist any guarantee that the awards rendered in their favour will be recognised and enforced by the courts in the respondents' jurisdictions, even though both parties have accepted the New York Convention of 1958 and enforcement of awards became a term of the arbitration agreement concerned.

Frustrations emanating from de-localised arbitrations may be avoided by doing the following:

i. that the developing countries should develop confidence in the minds of private foreign investors as to the quality of their judiciaries by rigidly following the rules of natural justice, avoidance of bias in the choice of arbitrators and in arbitrations, and by avoiding delay in settling disputes but this will take a considerable period of time to achieve; alternatively

ii. the governing law of the contract should be a neutral law (the general principles of law or the principles of public international law, and internationally recognised procedures, such as those adopted by ICSID); and

iii. settlement of disputes by arbitration should take place where Respondent has assets.

Uncertainty in enforcing arbitral awards must be avoided as otherwise, non-enforcement of them simply strains business relationship not only between the parties concerned, but eventually between the two respective governments also.[17]

Finally, it is worth mentioning that some of the emerging countries, namely, Brazil, China and India have been investing for some time in both developed and developing countries. In the event of any dispute arising under the investment agreements, would the beneficiary countries accept the law of the country in which their principal corporations are based (unless they are based in tax haven jurisdictions) as the governing law of arbitration or would they take their disputes to the courts in those jurisdictions, although each of these countries is older than many of the developed and developing countries with established judicial systems? The contra-argument would be equally valid, that is, would any investors from the emerging markets accept the law of another developing country as the governing law for settling disputes arising under the investment agreements? Thus, until the developing countries have been able to develop confidence in the minds of private foreign investors and if they do not wish to derogate from the "place of performance" principle, then it would seem sensible to hold arbitrations at the place of performance of the contract but the governing law of it should be principles of public international law and the general principles of law, bearing in mind that the fundamental principles of the law of contract are respected by all legal systems,[18] rather than irrationally maintaining that these principles are vague and thus inapplicable.

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17 See, for example, disputes arising under state contracts.

18 For a detailed analysis of the General Principles of Law recognised by States, see B Cheng, General Principles_of Law as Applied by International Courts and Tribunals, Cambridge, Cambridge University Press (2006).

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