Pathological clauses in international commercial arbitration

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Abstract. This article analyses the arbitration clauses, called in doctrine and in international commercial jurisprudence "pathological" clauses, which are drafted poorly, being likely to impede the proper conduct of international commercial arbitration due to incomplete, imprecise, unclear or contradictory stipulations. The remedies for the affected clauses depend on the nature and severity of the pathology affecting each clause, and, often, the deficiencies of these clauses are removed, as far as possible, by applying the various methods of interpretation of the contractual clauses, which have crystallized in national legislations, uniform law and comparative jurisprudence. The courts and arbitral tribunals give various decisions, depending on the legal regulations and the international commercial customs that they consider applicable in the case, the jurisprudence in this field being different.

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Concept of pathological arbitration clause

A primary condition of arbitration, the arbitration clause is the contractual stipulation that represents a procedural agreement made between the contracting parties that is the basis of the vesting of arbitrators with the power to judge disputes referred to arbitration. The Model Law of the United Nations Commission on International Trade Law on International Commercial Arbitration of June 21, 1985, with the amendments as adopted 2006 defines the arbitration convention as 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 (art.7) [1].

The eminent French jurist Frédéric Eisemann, former Secretary General of the International Arbitration Court of the International Chamber of Commerce in Paris (hereinafter – ICC), established four functions of the arbitration clause: (1) produces mandatory consequences for the parties; (2) excludes the intervention of State courts in the settlement of the disputes, at least before the issuance of the award; (3) gives powers to the arbitrators to resolve the disputes likely to arise between the parties; and (4) implements a procedure which fosters the best conditions of efficiency and speed resulting in a final award that is susceptible to judicial enforcement. [2].

Carefully drafted dispute resolution clauses in an international commercial contract are crucial to facilitating transactions between parties, however are often neglected in the negotiation process. Parties and their counsel invest significant time and resources to define their commercial relationship in their agreements, but sometimes fail to give the same care when drafting a mechanism for resolving disputes [3]. These clauses are also called "midnight clauses"[4], because they are usually the last clauses to be considered in contract negotiations, sometimes late at night or in the early hours of the morning.

When the arbitration clauses are drafted improperly, "being liable to disrupt smooth progress of the arbitration"
[5, p.262], due to incomplete, imprecise, unclear or contradictory stipulations, in doctrine and in comparative jurisprudence it is referred to as „pathological arbitration clauses“, term introduced by Frédéric Eisemann, [6]. Another well-known author, Professor Fernández Rozas, states that we are in the presence of a pathological clause whenever the clause is ambiguous in terms of the will of the parties to submit to arbitration, in the identification of the competent arbitral institution or in terms of the certainty of waiver to the state jurisdiction [7]. The questions that arise in relation to these are mainly the following: did the parties really wish to derogate from the jurisdiction of the state court in order to assign jurisdiction to an arbitral tribunal? Is it possible for their agreement to be enforced?

**Categories of pathologies**

Scholars and practitioners have identified several categories of pathological arbitration clauses. For example, Frédéric Eisemann divides pathological arbitration clauses into two main categories: 1) 1st degree pathological clauses and 2) pathological clauses in the second degree.

1st degree pathological clauses, even though they do not directly contradict the essential functions of the arbitration agreement, cause difficulties with regard to (a) the appointment of arbitrators and (b) procedure and choice of law.

The pathological clauses in the second degree are subdivided into (a) arbitration agreements where the appointment of arbitrators requires a new agreement or the intervention of the courts; (b) arbitration agreements that set inoperable limits to the arbitral tribunal proceedings and (c) agreements that have been so poorly drafted that they cannot even be designated as arbitration agreements – "hyperpathological" clauses [6].

Synthesizing the various studies carried out in the doctrine on the classification of pathologies affecting arbitration clauses [8], in general, two main categories of pathologies can be highlighted: on the one hand, there are those in which the deficiencies refers to the very will to resort to arbitration (pathologies that affect the very principle of resorting to arbitration), and, on the other
hand, there are those pathologies in which the will to resort to arbitration is certain, but its implementation methods remain confused (pathologies that affect the modalities of resorting to arbitration).

Pathologies that affect the principle of resorting to arbitration

This category includes the most "fragile" conventions, in that they call into question the very decision of the parties to resort to arbitration.

The Swiss Federal Tribunal in *X Holding AG and others v Y Investments NV* (25 October, 2010) rejected a pathological arbitration clause, holding that it did not evidence the parties' intention to arbitrate. In the decision under appeal the lower court came to the conclusion that the arbitration clause in dispute did not allow a clear conclusion that the Parties wanted to rule out the jurisdiction of the state courts and to submit the dispute brought in front of the Cantonal Court to an arbitral tribunal. Even if this were not the case it would remain unclear which arbitral tribunal would have jurisdiction and the arbitration clause failed to meet the requirement of precision thus rendering it an “incurably pathological clause”.

In their contract the parties undertook “(...) to have the dispute submitted to binding arbitration through The American Arbitration Association [hereafter: AAA] or to any other US court. (...) The arbitration shall be conducted based upon the Rules and Regulations of the International Chamber of Commerce (ICC 500).” The Swiss Federal Tribunal stated that “(...) this may easily be understood as meaning that they wanted to submit disputes either to the AAA for an arbitration (“to binding arbitration through the AAA”) or to another optional “US court” (to any other US court). From the wording chosen it is not clear that even the “other US court” to deal with the dispute would lead to an arbitration and not to other proceedings and that with "other US court" another American arbitral tribunal is meant. Under “US court” within the framework of the wording chosen a state court may anyway be understood and only a description like “US arbitral court” would have shown with sufficient clarity that the ordinary state courts were to be excluded".
The Swiss Federal Tribunal also emphasized: "(...) to interpret an arbitration clause one has to heed that the choice of an arbitral tribunal is of great consequence as arbitral proceedings regularly lead to higher costs and judicial remedies are limited as a consequence of renouncing the state courts. Such an intent to renounce cannot be assumed lightly and in case of doubt restrictive interpretation is accordingly called for" [9].

In arbitration jurisprudence and doctrine, the clause that provides for the submission of the dispute to arbitration in an optional manner is also considered pathological (e.g.: "the parties may resort to arbitration"). Although quite problematic, these clauses have sometimes been successfully opposed to the jurisdiction of the ordinary judge seized by one of the parties. As an example, the Court of Appeal of Ontario (Canada) referred the parties to arbitration under an arbitration clause stating that "the parties may refer any dispute under the contract to arbitration" [10].

In the same way, the so-called combined clauses are attributed to this category – those conventions, in which the parties combine the submission of the dispute to arbitration and the designation of a state jurisdiction at the same time. They raise very delicate issues of interpretation of the will of the parties, as shown by the contradictory positions of the various jurisdictions called upon to rule on these clauses. It has sometimes been held that such clauses do not manifest any definite intention and should therefore be considered void [8].

In other cases, in the presence of an apparent contradiction between an arbitration clause and a clause assigning jurisdiction to a state court, priority was given to the first over the second. Thus, the Paris Tribunal of First Instance, by the decision of February 1, 1979 held that "an ambiguous arbitration clause should be interpreted by considering that, if the parties had not wished to submit their dispute to arbitration, they would simply have refrained from mentioning the possibility of doing so; [...] by including an arbitration clause in their contract, they demonstrated that it would be necessary to submit any disputes arising from the contract to the arbitral tribunal to which
they referred” [5, p.270-271].

Pathologies that affect the modalities of resorting to arbitration

The pathological arbitration agreements in this category express a clear choice in favor of arbitration, but in expressing their choice, the parties are often not explicit about the ad hoc or institutional nature of the arbitration, about the ways of setting up the arbitral tribunal, about the designation of the entity that have to ensure the running of the procedure, about the rules of procedure, etc. Such clauses can give rise to difficulties during the implementation of arbitration, and their destiny depends on the interpretation made by the courts (both arbitrators and judges) in terms of clarifying the true intention of the parties [8].

In this vein, in the Decision of the Plenum of the Supreme Court of Justice of the Republic of Moldova, no. 2 of 30.03.2015, “regarding the application by the courts of the legal provisions to the resolution of some issues in the examination of disputes in which the parties concluded the arbitration agreement” it was ruled: “in cases of an arbitration agreement, with certain inaccuracies or omissions, but which indisputably confirms the will of the parties to settle the dispute through arbitration, the parties are to remove these deficiencies, concretizing its content. If the arbitration institution is not indicated in the agreement or its specification is requested, the parties are to remove these inaccuracies” [11].

The Singapore Court of Appeal explained in the famous case of Insigma v Alstom: “where the parties have evinced a clear intention to settle any dispute by arbitration, the court should give effect to such intention, even if certain aspects of the agreement may be ambiguous, inconsistent, incomplete or lacking in certain particulars (...) so long as the arbitration can be carried out without prejudice to the rights of either party and so long as giving effect to such intention does not result in an arbitration that is not within the contemplation of either party” [12].

On the other hand, the Hamm Court of Appeal in Germany refused to uphold an arbitration clause which provided that “[the Parties] shall proceed to litigate before the
Arbitration Court of the International Chamber of Commerce in Paris with the seat in Zurich\). The Court held that the clause was void because it was ambiguous as to whether the parties’ disputes should be arbitrated under the auspices of the ICC or the Zurich Chamber of Commerce, as each had its own competent permanent arbitration institution [13].

In this context, it should be noted that comparative jurisprudence often shows a lenient attitude towards this kind of pathological clauses. Thus, for example, Singapore is well known for the willingness of its courts to uphold pathological arbitration clauses. The Singapore High Court in HKL v Rizq International Holdings upheld a clause which provided that disputes shall be "[s]ettled by the Arbitration Committee at Singapore under the rules of the International Chamber of Commerce…". It noted that, despite the fact that the clause specified a non-existent institution as the administering institution, it would be open to the parties to approach any arbitral institution in Singapore which would be able to administer the arbitration applying the ICC Rules. The court therefore stayed the court proceedings with the condition that the parties obtain the agreement of the Singapore International Arbitration Center or any other arbitral institution in Singapore to conduct a hybrid arbitration applying the ICC Rules, with a liberty to apply should they fail to secure such agreement [14].

**Remedies for pathological arbitration clauses**

Deficiencies in an arbitration clause do not necessarily invalidate the agreement so constituted; its validity depends on the nature or substance of the deficiency and whether it is remediable. In general, arbitration clauses are held to be valid, irrevocable and enforceable, unless they are affected by generally applicable legal defects such as fraud, duress, or unconscionability on the ground that the dispute is not arbitrable.

As a result, when faced with a poorly drafted or defective arbitration clause, the courts must determine whether the parties agreed to arbitrate the dispute notwithstanding the poor drafting of the clause. In such situations, judges or arbitrators will try to remedy the defective clauses, unless they suffer from incurable pathologies. To do so, courts
analyze all the circumstances surrounding the arbitration agreement to determine whether the parties both had or should have had knowledge of the clause, were capable of entering into the agreement, whether the arbitration agreement suffers unconscionability, whether the forum in the agreement is available, etc. [3].

Remedial of pathological arbitration clauses is most often achieved by their interpretation, using the general rules applicable to the interpretation of contractual clauses; they are included in national civil legislation, for example art. 1100-1107 Civil Code of the Republic of Moldova [15] (hereinafter – Civ. Code RM), as well as in the instruments of uniform law – the Vienna Convention of April 11, 1980 on Contracts of the International Sale of Goods (hereinafter – the Vienna Convention) [16], Principles of International Commercial Contracts edited by UNIDROIT (hereinafter – the UNIDROIT Principles) [17].

First of all, it should be mentioned that the interpretation of the arbitration clauses, like the other contractual clauses, is performed according to the principle of good faith. In a decision of the Swiss Federal Tribunal (2010), it was held: “[t]he interpretation of an arbitration clause follows the general rules applicable to the interpretation of private declarations of will. The concurrent factual understanding of the parties as to the statements exchanged is decisive for the main part. When such factual will of the parties cannot be ascertained, the arbitration clause must be interpreted objectively, i.e. putative will of the parties is to be determined according to that which could and should have been understood by an addressee acting in good faith” [9].

Another rule of interpretation is the priority of the real will of the parties. This rule, which is found both in national legislation and in instruments of uniform law (art. 1100 (2) Civ. Code RM, art. 8 of the Vienna Convention and art. 4.1 – 4.3 of the UNIDROIT Principles), establishes that the interpretation of the contract is done according to the common intention of the parties, without being limited to the literal meaning of the terms used. For example, in a ICSID decision of 1983 it was ruled that: “like any other
conventions, a convention to arbitrate is not to be construed restrictively, nor, as a matter of fact, broadly or liberally. It is to be construed in a way which leads to find out and to respect the common will of the parties: such a method of interpretation is but the application of the fundamental principle pacta sunt servanda, a principle common, indeed, to all systems of internal law and to international law” [18].

In determining the intent of a party due consideration is to be given to all relevant circumstances of the case, including the nature and purpose of the contract; the negotiations; any practices which the parties have established between themselves; usages; the conduct of the parties subsequent to the conclusion of the contract; the meaning commonly given to terms and expressions in the trade concerned. If the intention of the parties cannot be established, such statements and other conduct shall be interpreted according to the meaning that a reasonable person of the same kind as the other party would give to it in the same circumstances.

One of the principles most often used in the interpretation of pathological clauses is the principle of effective interpretation: contract terms shall be interpreted so as to give effect to all the terms rather than to deprive some of them of effect (art.1104(1) Civ. Code RM, art.4.5 of the UNIDROIT Principles). In an ICC award it was mentioned: “[a] rule of interpretation that is universally recognized provides that in case of two conflicting interpretations or two possible meanings of the same contract term one must, in case of doubt, prefer the interpretation which conserves a certain meaning to these words rather than following an approach which renders them useless or even absurd” [19].

Regarding the application of this principle in order to safeguard the arbitration clause, the Swiss Federal Tribunal also ruled: “when indeed the result of the interpretation shows that the parties wanted to except the dispute from the state courts and submit it to an arbitral decision but some differences remain as to the implementation of the arbitral proceedings, then the so called Utilitätsgedanke applies,
according to which an understanding of the contract must be sought which allows the arbitration clause to subsist” [9].

Conclusions
The multitude of problems caused by pathological arbitration clauses has revealed the difficulties of drafting effective arbitration clauses and has led practice and doctrine to draw more attention to them. The remedies for the affected clauses depend on the nature and severity of the pathology affecting each clause, and, more often than not, the deficiencies of these clauses are removed, as far as possible, by applying the various methods of interpretation of the contractual clauses, which have crystallized in national legislation, uniform law instruments and comparative jurisprudence.

The solutions adopted vary, but the general tendency is rather for the favouring by state jurisdictions and arbitral tribunals of the validity of arbitration clauses affected by certain pathologies, wanting to promote the jurisdictional effect of these clauses whenever possible. However, it also happens that judges take the opposite attitude, considering that saving pathological clauses at all costs is perhaps not the best way to encourage the parties to pay more attention to their drafting. In this dilemma, the courts must seek a balance between the favouring of arbitration as an alternative method of dispute resolution and the control of state jurisdictions over the validity and effectiveness of some defective clauses, by way of clarifying and respecting the real will of the parties expressed in their agreement on how to settle disputes that appeared between them.

As for those who draft international commercial contracts, the recommendation is to draw more attention to the drafting of arbitration clauses, using the various tools and sources, such as model clauses drawn up by permanent arbitration institutions, doctrine, jurisprudence, practical guides, etc. This would avoid the risks of such pathological clauses preventing the proper conduct of arbitration and would contribute to the consolidation and proliferation of this efficient way of settling international commercial disputes. However, in some situations, it is not advisable to take over and insert mechanically model clauses into contracts;
sometimes they must be adapted to the specifics of each contract and to the circumstances in which the relations between the contracting parties take place.

References:
LAW AND INTERNATIONAL LAW


