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# DUTY AND DISCRETION IN INTERNATIONAL ARBITRATION\*

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### A. Introduction

After a long arbitration in New York, a Canadian company wins substantial damages against a British multinational, only to see a federal court vacate the award.<sup>1</sup> Two grounds are given for vacatur: the arbitrator was biased and the arbitrator manifestly disregarded the applicable law. Not deterred by the vacatur, the winning claimant seeks to enforce the award against the defendant's London bank accounts.

What effect (if any) should a court in England give the American award? Should an English court ignore the arbitrator's decision or the federal judge's order? Should the English court make its own investigation into the legitimacy of the vacatur?

Unconditional respect for all foreign annulments will hardly promote efficient arbitration, since an award might be annulled in bad faith or in violation of fundamental notions of justice. Without some deference, however, victims of tainted arbitrations must prove *de novo* the award's defects in every jurisdiction where they either have assets or seek to rely on subsequent awards.

The treaty framework for international arbitration provides no clear guidance on when annulments should have extraterritorial effect.<sup>2</sup> In Paris and Washington, however, courts

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\* Adapted from *Duty and Discretion in International Arbitration*, 93 Am. J. Int'l L. 805 (1999).

<sup>1</sup> The verbs "annul," "vacate" and "set aside" represent different labels for analogous actions, depending on the country, and are used interchangeably in this chapter.

<sup>2</sup> See Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 330 U.N.T.S. 38, 21 U.S.T. 2517, T.I.A.S. No. 6997 (1958) (hereinafter New York Convention). The Convention mandates foreign award enforcement subject to a set of defenses that include vacatur at the arbitral situs. See later discussion.





have recently recognized awards vacated at the arbitral situs,<sup>3</sup> sparking a debate on two rival policies: extending comity toward foreign judgments and enforcing arbitral awards. The proper balancing of these policies depends in large measure on one's conclusions about the nature of commitments to resolve cross-border commercial disputes through arbitration.

Like prisms, these French and American cases help to refract the interaction of three overlapping legal orders: national statutes, international law, and privatized dispute resolution. While lending itself to few elegant dogmas, analysis of award annulment offers insights into how these legal systems interact, and suggests two modest conclusions.

First, courts should defer to annulments that are consistent with procedural fairness and international public policy. Such deference follows not from any explicit treaty mandate, but from the parties' mutual commitments. Merchants who contract for an arbitral situs should be held to the implicit consequences of the bargain, whether this means narrow or broad judicial scrutiny. If the chosen review standards appear problematic on post-dispute reflection, market forces will direct future arbitrations elsewhere. Although this approach occasionally will be inconvenient for some business managers, it provides a better balance of social and economic consequences than other realistic alternatives.

Second, countries that host international arbitration should maintain their traditional role in monitoring the fairness of proceedings conducted within their borders. At the same time, these national legal systems should seek to limit the type of intrusive review procedures that invite disregard of annulments. To this end, the United States should adopt a separate statutory regime for international commercial arbitration, embodying more *laissez-faire* review than might apply to purely domestic cases.

## B. Annulled Awards

### Options

Returning to our opening scenario, several approaches are open to British judges considering enforcement of awards vacated at the arbitral situs. They might (i) never defer to annulments, (ii) always defer to annulments, or (iii) defer to annulments only on certain conditions, such as compatibility with public policy or with English grounds for vacatur.

Traditionally, annulment was thought to uproot an award so as to make it unenforceable abroad.<sup>4</sup> There is no reason, however, that this must be so. An annulled award might well take its legitimacy solely from the enforcement forum, much as a contract void in one nation can be enforced in another.<sup>5</sup> As discussed later, the French and American court cases mentioned in the introduction took exactly this approach.<sup>6</sup>

<sup>3</sup> See later discussion of *Hilmarton* and *Chromalloy* cases.

<sup>4</sup> See Albert Jan van den Berg, *The New York Convention of 1958* § III(4), (5), at 331–58 (1981); Albert Jan van den Berg, "Annulment of Awards in International Arbitration" in R Lillich and C. Brower (eds.), *International Arbitration in the 21st Century* 133 (1994).

<sup>5</sup> See generally Maurice Rosenberg *et al.*, *Conflict of Laws* 536–49 (10th edn, 1996).

<sup>6</sup> A Belgian court also refused to enforce an annulled award rendered in Algiers against the Algerian government's gas exporter. See *Sonatrach v. Ford, Bacon & Davis*, *Trib de 1ère Instance de Bruxelles*, 23 July 1987, *Tribunal de 1ère Instance de Bruxelles*, 6 December 1988, 1990 *Annales de droit de Liège* 267, 7 *ASA Bull.* 213 (1989), 15 *Y.B. Comm. Arb.* 370 (1990), *aff'd*, *Cour d'Appel de Bruxelles (8ème Ch)*, 9 January 1990, 1990 *J. T.* 386. The special facts of the case (New York Convention held not to have retroactive application) make it inappropriate for comparative analysis. See generally Guy Horsmans, *Actualité et évolution du droit belge de l'arbitrage*, *Rev. arb.* 417, 426 (1992).





### Case law

In the many-faceted saga of *Hilmarton v. OTV*,<sup>7</sup> an arbitrator in Geneva denied a claim for consulting fees, erroneously believing that a contract subject to Swiss law violated Switzerland's public policy.<sup>8</sup> After a cantonal court vacated the award on the basis of this mistake, a second arbitral tribunal gave damages to the claimant.<sup>9</sup>

In France both awards were recognized, each in a separate proceeding: first the annulled decision in favor of the defendant,<sup>10</sup> then the award in the second arbitration in favor of the claimant.<sup>11</sup> Ultimately the *Cour de cassation* held that the first judgment, recognizing the annulled decision, prevented recognition of the second arbitral award.<sup>12</sup>

The position of the *Cour de cassation* on *res judicata* is understandable. However, its enforcement of the vacated award is less so. The court's reasoning that international arbitrations are not integrated into the legal order of the arbitral situs<sup>13</sup> is hardly consistent with the fact that French judges annul awards in international arbitrations conducted in France.<sup>14</sup> Moreover, in *Hilmarton* the ultimate result of recognizing the annulled award was that the claimant who prevailed at the bargained-for situs was hindered in obtaining unpaid fees.<sup>15</sup>

In the United States a similar scenario arose in *Chromalloy Aeroservices v. Egypt*,<sup>16</sup> where an arbitral tribunal in Cairo had awarded damages to an American company for Egypt's breach of a military helicopter maintenance contract.<sup>17</sup> The award was then vacated for the arbitrator's failure to apply the correct law, a non-waivable ground for annulment in Egypt.<sup>18</sup>

<sup>7</sup> Rev. Arb. 376 (1997), note by Philippe Fouchard.

<sup>8</sup> The consultant successfully helped to obtain a contract for drainage in Algiers. While there was no allegation of bribery, the consultant's activity allegedly ran afoul of an Algerian statute on commercial intermediaries.

<sup>9</sup> The award was rendered in August 1988, and thus subject to challenge for "arbitrariness" under Article 36 of the Intercantonal Arbitration Concordat. Since January 1989 awards in international arbitration would normally be subject to the *Loi fédérale sur le droit internationale privé* (LDIP). Upheld by the Swiss *Tribunal fédéral*, the Geneva court found that the conflict with Algerian legislation did not constitute a violation of Swiss public policy. See Rev. Arb. 315 (1993) (*Court de Justice du Canton de Genève*, 17 November 1989), 322 (*Tribunal fédéral*, 17 April 1990).

<sup>10</sup> Paris *Cour d'appel*, Rev. Arb. 300 (1993), relying on *Nonveau code de procédure civile* (NCPC), Arts. 1498, 1502, which limit appeal against award recognition to grounds that do not include annulment of the award where rendered. The appellate court was upheld by the *Cour de cassation*, Rev. Arb. 327 (1994), with commentary by Charles Jarrosson; English translation in 9 Mealey's Int'l Arb. Rep. E-3 (May 1994); 20 Y.B. Com. Arb. 663 (1995). See generally Vincent Heuzé, *La Morale, l'arbitre et le juge*, Rev. Arb. 179 (1993).

<sup>11</sup> The order of the Nanterre *Tribunal de grande instance*, which recognized the second award (as well as the Swiss court's annulment of the first award), was confirmed by the Versailles *Cour d'appel*, 29 June 1995, Rev. Arb. 639 (1995).

<sup>12</sup> 10 June 1997, Rev. Arb. 376 (1997).

<sup>13</sup> See *Cour de cassation* decision affirming the lower court's recognition of the annulled award, Rev. Arb. 327 (1994) (stating that the Geneva award "n'était pas intégrée à l'ordre juridique de [la Suisse]").

<sup>14</sup> See NCPC, Art. 1502.

<sup>15</sup> A different result obtained across the Channel, where the English High Court recognized the second award, finding that the award offended neither the contract's governing law nor the public policy of the arbitral situs. QBD, Commercial Court, 24 May 1999, reprinted in 14 Mealey's Int'l Arb. Rep. A (June 1999). Since the claimant's performance did not include acts contrary to English public policy, it was irrelevant that an English arbitrator might have decided differently. Compare *Soleimany v. Soleimany* [1998] 3 WLR 811 (refusing to enforce an award that on its face implemented a smuggling contract).

<sup>16</sup> 939 F. Supp. 907 (D.D.C. 1996). See generally Richard Hulbert, *Further Observations on Chromalloy: A Contract Misconstrued, a Law Misapplied and an Opportunity Foregone*, 13 ICSID Rev. 124 (1998).

<sup>17</sup> Text of the award can be found at 11(8) Mealey's Int'l Arb. Rep. C-1 (Aug. 1996) (D.D.C. 31 July 1996).

<sup>18</sup> See Egyptian Arbitration Law of 1994, Arts. 53(1)(d), 54, reproduced in *Smit's Guide to International Arbitration, National Arbitration Laws*, Vol. 1, EGY B1. The contract was subject to Egyptian law, and the Cairo Court reasoned that this meant the civil code.





Despite the annulment, a U.S. federal court ordered enforcement of the award against the defendant's American assets.<sup>19</sup> In an opinion with neither precedent nor progeny,<sup>20</sup> the court reasoned that since the Federal Arbitration Act does not list error of law as a ground for vacatur, the claimant "maintains all rights [to award enforcement] that it would have in the absence of the Convention."<sup>21</sup>

Two aspects of the federal court's controversial reasoning deserve special mention. First, the Egyptian practice of annulling erroneous awards does not differ significantly from the way American courts vacate awards for "manifest disregard of the law" or improper choice-of-law reasoning.<sup>22</sup> Second, to invoke the vacatur standards of the Federal Arbitration Act<sup>23</sup> risks giving the impression that American courts can annul foreign awards, a result at odds with existing law<sup>24</sup> and efficient arbitration.<sup>25</sup>

### C. The Interaction of Treaty and Statute

#### Control mechanisms

Judicial review of arbitral awards constitutes a form of risk management designed to safeguard against perverse arbitrators and shameless intermeddlers.<sup>26</sup> Such public scrutiny of arbitration is inevitable when the winners ask courts to recognize awards by seizing assets or by denying the losers access to otherwise competent courts.<sup>27</sup>

Inherent in judicial review is a tension between two rival goals of efficient dispute resolution, which underlie most aspects of arbitration law. Finality, promoted by freeing awards from challenge, competes with community confidence in control mechanisms that protect against enforcement of aberrant decisions.

Award finality enhances political and procedural neutrality, which is compromised if the winner must re-litigate the case. Without a reliable alternative to the uncertainty of

<sup>19</sup> Not surprisingly, the Paris *Cour d'appel* also enforced the award. See Rev. Arb. 395 (1997).

<sup>20</sup> In *Baker Marine Ltd. v. Chevron Ltd.*, 191 F. 3d 194 (2nd Cir. 1999) the court refused to enforce two awards rendered in Lagos but vacated by a Nigerian court. Nigerian award published in 14 Mealey's Int'l Arb. Rep. D-3 (Aug. 1999). In addition, the Second Circuit has held that a district court should wait to enforce an Italian award until after judicial review in Italy. See *Europcar Italia v. Maiellano Tours*, 156 F. 3d 310, 317 (2nd Cir. 1998).

<sup>21</sup> 939 F. Supp 910.

<sup>22</sup> On review of choice-of-law methodology, see *Mastrobuono v. Shearson Lehman*, 514 U.S. 52 (1995), which interprets the proper scope of a New York choice selection clause.

<sup>23</sup> *Chromalloy* looked to 9 U.S.C. § 10 in Chapter I of the Federal Arbitration Act, which applies to domestic awards. However, foreign awards are subject to Chapter II. See 9 U.S.C. § 208.

<sup>24</sup> See *International Standard Electric Corp. v. Bidas Sociedad Anonima Petrolera, Industrial Commercial*, 745 F. Supp. 172 (S.D.N.Y. 1990), holding that the Federal Arbitration Act did not allow vacatur of an award rendered in Mexico even if the merits of the dispute were to be decided under New York law.

<sup>25</sup> In theory, parties might stipulate that an arbitration will be conducted in one country subject to the procedural law of another. Article V(1)(e) of the New York Convention speaks of awards set aside by a competent authority "of the country in which, or under the law of which, the award was made" (emphasis added). Thus two Israelis might elect to arbitrate in New York subject to the arbitration law of Israel. In such rare situations, however, it would create unnecessary conflict if Israeli courts were to attempt to vacate the resulting award, since courts in New York might also set aside a local award that violated the mandatory American norms.

<sup>26</sup> A decision-maker cannot be an arbitrator unless the person alleged to have waived court jurisdiction has in fact authorized the relevant individual to decide the disputed issues.

<sup>27</sup> See generally W. Michael Reisman, *Systems of Control in International Adjudication and Arbitration* (1992).





third country tribunals<sup>28</sup> and the other side's "home-town justice,"<sup>29</sup> many transactions will remain unconsummated, or be concluded at increased prices to cover the risk of biased adjudication.<sup>30</sup>

The second goal of efficient arbitration, community confidence that aberrant decisions will not be enforced, implicates judicial scrutiny of an arbitration's basic procedural fairness.<sup>31</sup> Fidelity to the parties' shared expectations in this regard is as important as speed and economy.

Courts monitor the arbitral process in two distinct modes, depending on whether the reviewing forum has jurisdiction over the parties' assets or serves only as a convenient arbitral situs.<sup>32</sup> In the latter case, review occurs before any attempt to enforce the arbitrator's decision, as courts simply pronounce an award void upon a motion to vacate, or valid upon a motion to confirm. By contrast, enforcement actions call for more dramatic judicial behavior, typically attachment of property or refusal to hear a claim allegedly covered by the arbitrator's decision.

In domestic transactions the distinction between these two types of review will rarely be important, since both occur in the same legal system, often pursuant to simultaneous motions to confirm and to vacate. In cross-border disputes, however, pre-enforcement scrutiny and enforcement actions can occur in different countries. Understanding the interaction of these two jurisdictions requires a brief look at the New York Convention.

## The New York Convention

### *Framework*

The New York Convention operates on two levels to promote the international currency of commitments to arbitrate. First, the Convention requires deference to valid arbitration agreements.<sup>33</sup> Second, courts must enforce foreign awards<sup>34</sup> as they would domestic ones.<sup>35</sup> Award recognition, however, is subject to several defenses. One group furthers the losers' right to a fair arbitration, by allowing courts to reject awards tainted with excess of authority

<sup>28</sup> In seeking recourse to third country courts, uncertainties result from factors such as *forum non conveniens*, lack of subject matter jurisdiction and the absence of comprehensive jurisdiction and judgments treaties. See William W. Park, *International Forum Selection* (1995); William W. Park, "When and Why Arbitration Matters" in G. Beresford Hartwell (ed.), *The Commercial Way to Justice* 73 (1997); William W. Park, *Bridging the Gap in Forum Selection*, 8 *Transnat'l L. & Contemp. Probs.* 19 (1998).

<sup>29</sup> The reality of litigation bias may be less significant than the perception that such prejudice exists. In federal civil actions in the United States, foreigners actually fare better than domestic parties, perhaps because fear of bias causes foreigners to continue to judgment only with particularly strong cases. See Kevin Clermont and Theodore Eisenberg, *Xenophilia in American Courts*, 109 *Harv. L. Rev.* 1122 (1996).

<sup>30</sup> See generally William W. Park, *Neutrality, Predictability and Economic Cooperation*, 12(4) *J. Int'l Arb.* 99 (1995).

<sup>31</sup> Commercial actors are unlikely to retain confidence in a dispute-resolution system allowing arbitrators to roll dice, flip coins or consult the entrails of disemboweled poultry. Nor do business managers expect arbitrators to deny one side the opportunity to present its case, or to decide issues never submitted to them.

<sup>32</sup> See W. Michael Reisman, *Systems of Control in International Adjudication and Arbitration* 113 (1992), distinguishing between "primary" and "secondary" control.

<sup>33</sup> New York Convention, Art. II(3) requires national courts to "refer parties to arbitration" in respect of matters covered by an agreement to arbitrate.

<sup>34</sup> Although its principal focus is on foreign awards (i.e. awards rendered in a country other than the one where enforcement is sought), the Convention also covers awards "not considered as domestic." This latter category includes awards arising from disputes that directly implicate international commerce.

<sup>35</sup> New York Convention, Art. III provides for award enforcement "in accordance with the rules of procedure of the territory where the award is relied upon," leaving open a theoretical possibility of onerous conditions on all arbitral decisions, domestic and foreign. Such abuse of rights would violate the Convention, just as onerous state arbitration laws violate the Federal Arbitration Act. See *Doctor's Associates v. Casarotto*, 517 U.S. 681 (1996).





and procedural irregularity.<sup>36</sup> Another set of defenses protects the forum's own interest in withholding support for awards that deal with non-arbitrable subjects or violate public policy.<sup>37</sup>

The Convention's effectiveness depends largely on each country's national arbitration law.<sup>38</sup> Arbitration agreements must be enforced if not "null and void," essentially a notion of local contract principles.<sup>39</sup> More significantly, the Convention says nothing about proper or improper annulment standards, but leaves each country free to establish its own grounds for vacating awards made within its territory.

The Convention will not deprive interested parties of the right to rely on awards to the extent allowed by an enforcement forum's own law.<sup>40</sup> Therefore the structure of national arbitration law becomes significant. For example, the French arbitration decree relevant in *Hilmarton* requires courts to recognize foreign awards unless contrary to international public policy,<sup>41</sup> and permits appeal of recognition orders only on limited grounds that do not include annulment.<sup>42</sup> By contrast, the Federal Arbitration Act explicitly ties into the New York Convention, calling for confirmation of foreign award if no treaty reasons exist to deny recognition.<sup>43</sup> Since vacatur at the arbitral situs is one ground for non-recognition under the New York Convention, some observers consider *Chromalloy* to be wrongly decided.

*Convention Article V(1)(e)*

**Text** The analytic architecture for much of the dialogue about annulled awards lies in that part of the New York Convention providing that awards set aside at the arbitral situs lose the benefit of the treaty's enforcement scheme. The English version of Article V(1)(e) reads: "Recognition and enforcement of the award may be refused . . . if . . . [the award] has been set aside or suspended by a competent authority of the country in which, or under the law of which, that award was made."<sup>44</sup> The French text lends itself to a more

<sup>36</sup> New York Convention, Art. V(1)(a)–(d) deals with invalid arbitration agreements, lack of due process, arbitrator excess of authority and irregular composition of the arbitral tribunal. See also Art. V(1)(e), concerning annulled awards, discussed later.

<sup>37</sup> *Ibid.* Art. V(2). A growing consensus urges a narrow application of the public policy defense to award enforcement. See Audley Sheppard, *Public Policy as a Ground for Refusing Enforcement of Foreign Arbitral Awards*, International Law Association, Committee on International Commercial Arbitration, Taipei Conference (1998). See also Homayoon Arfazadeh, *L'Ordre public du fond et l'annulation des sentences arbitrales internationales en Suisse*, 1995 Rev. suisse Dr. int. and Dr. Européen 223.

<sup>38</sup> For one attempt at achieving uniformity in arbitration law, see United Nations Commission on International Trade Law (UNCITRAL) Model Law on International Commercial Arbitration, adopted 21 June 1985, UN Doc. A/40/17, Annex 1 (hereinafter UNCITRAL Model Law). See generally Howard Holtzmann and Joseph Newhaus, *Guide to the Uncitral Model Law on International Commercial Arbitration* (1989).

<sup>39</sup> New York Convention, Art. II(3). In the United States the validity of arbitration clauses is generally determined by state law principles governing contract formation. See *First Options v. Kaplan*, 514 U.S. 938, 943 (1995). Only rarely does one find invocation of supranational standards for the validity of arbitration agreements.

<sup>40</sup> See New York Convention, Art. VII.

<sup>41</sup> NCPC, Art. 1498.

<sup>42</sup> *Ibid.* Art. 1502 permits appeal of recognition orders for (i) lack of a valid arbitration agreement, (ii) irregular composition of the arbitral tribunal, (iii) excess of authority, (iv) failure to respect due process ("principe de la contradiction") and (v) violation of international public policy.

<sup>43</sup> 9 U.S.C. § 207.

<sup>44</sup> Under New York Convention, Art. XVI the treaty's Chinese, English, French, Russian and Spanish texts are "equally authentic." On the comparison of treaty texts with different meanings, see Vienna Convention on the Law of Treaties, Art. 33(4), 23 May 1969, UN Doc. A/Conf. 39/27, which provides for adoption of the "meaning which best reconciles the texts having regard to the object and purposes of the treaty." See generally Georgios Petrochilos, *On the Mechanics and Rationale of Enforcing Awards Annulled in their State of Origin under the New York Convention*, 48 Int'l & Comp. L.Q. 858 (1999).





forceful interpretation,<sup>45</sup> while the Chinese, Russian and Spanish versions comport with the permissive English.<sup>46</sup>

Some scholars argue that under the Convention annulment triggers a universal effect, making an award unenforceable in all places where presented for enforcement.<sup>47</sup> According to one view, the Convention contains an implicit understanding that the arbitral situs will monitor an arbitration's procedural integrity, in exchange for which other countries will recognize awards that pass muster where rendered.<sup>48</sup> This power to uproot an arbitrator's decision would mean that the place of arbitration could invalidate a defective award once and for all.<sup>49</sup>

Other commentators read the Convention as allowing enforcement courts discretion in dealing with annulled awards.<sup>50</sup> They rely on the Convention's permissive language (enforcement "may" be refused), as well as the "more favorable law" provision in Article VII, which in some circumstances permits national law to override more restrictive Convention terms.<sup>51</sup> Under this view, the latitude allowed judges depends on the structure and content of national arbitration law.<sup>52</sup>

**Context** For better or for worse, the New York Convention was not designed to address the over-enforcement that occurs when annulled awards are recognized. Rather, it was intended to deal with the under-enforcement of awards that resulted from the cumbersome "double exequatur" requirement of an earlier arbitration treaty, which called for judicial recognition at both the arbitral situs and the enforcement forum.<sup>53</sup>

In response to the unsatisfactory state of prior law, the International Chamber of Commerce proposed a new treaty that aspired to make arbitration "completely independent of national laws."<sup>54</sup> The United Nations Economic and Social Council, however, rejected broad notions of autonomous "international" awards, in favor of simply making "foreign" awards more transportable from one country to another.<sup>55</sup>

The middle course eventually taken in drafting the New York Convention was one that reduced, but did not eliminate, the role of the arbitral situs. Confirmation at the place of

<sup>45</sup> The French text provides that "recognition and enforcement will not be refused unless the award . . . was annulled where rendered". This future indicative was given a mandatory reading in *Clair v. Berardi*, Paris *Cour d'appel*, 20 June 1980, Rev. Arb. 424 (1981), note Mezger, discussed in VII Y.B. Com. Arb. 319 (1982), a case that would be decided differently today under the 1981 Arbitration Decree. See also Philippe Fouchard, *La Portée internationale de l'annulation de la sentence arbitrale dans son pays d'origine*, Rev. Arb. 329 (1997).

<sup>46</sup> See Richard W. Hulbert, *Further Observations on Chromalloy: A Contract Misconstrued, a Law Misapplied, and an Opportunity Foregone*, 13 ICSID Rev. 124, 144 (Spring 1998); Jan Paulsson, *May or Must Under the New York Convention: An Exercise in Syntax and Linguistics*, 14 Arb. Int'l 227, 229 (1998).

<sup>47</sup> See van den Berg (1994) (n. 4) 133, 137; W. Laurence Craig, *Some Trends and Developments in the Laws and Practice of International Commercial Arbitration*, 30 Texas Int'l L.J. 1, 58 (1995).

<sup>48</sup> See W. Michael Reisman, *Systems of Control in International Adjudication and Arbitration* 113–120 (1992).

<sup>49</sup> See van den Berg (1981) (n. 4) 355–58.

<sup>50</sup> See Jan Paulsson, *Enforcing Arbitral Awards Notwithstanding a Local Standard Annulment*, 9 ICC Bull. 14, 29 (May 1998); Jan Paulsson, *The Case for Disregarding Local Standard Annulments under the New York Convention*, 7 Am. Rev. Int'l Arb. 99 (1996).

<sup>51</sup> See New York Convention, Art. VII.

<sup>52</sup> On the difference between French and American arbitration law, see earlier discussion.

<sup>53</sup> See Convention on the Execution of Foreign Arbitral Awards, Geneva 1927, Art. 4, 92 L.N.T.S. 301.

<sup>54</sup> *Enforcement of International Arbitral Awards: Report and Preliminary Draft Convention*, ICC Brochure No. 174 (1953), UN Doc. E/C.2/373, reprinted in 9 ICC Bull. 32 (May 1998).

<sup>55</sup> UN Doc. E/2704 and Corr. 1 (1955). For comments by governments see UN Doc. E/2822 and Add.1–6 (1956–58). See generally van den Berg (1981) (n. 4) 6–8.





arbitration is no longer necessary, but enforcement of vacated awards may be refused. One consequence of this compromise has been uncertainty about the fate of annulled awards.

**Interpretation** Interpreting Article V(1)(e) should begin with the “ordinary meaning [of the terms of the treaty] in their context and in the light of [the treaty’s] object and purpose.”<sup>56</sup>

Applying this principle, the text might be read simply as an acknowledgment that no treaty violation occurs when annulled awards are not recognized. This reading is favored by the contrast between the mandatory terms of Article III (awards “shall” be recognized) and the permissive language of Article V (annulled awards “may” be refused recognition).

A more energetic reading suggests that the Convention contemplates comity regarding foreign judgments. Stating that enforcement may be refused affirms a positive norm (as in “one may worship as conscience dictates”) rather than a value-neutral choice (as in “one may order either chocolate or vanilla”). Supporting this view is the fact that Article V(1)(e) is nestled among defects that clearly make awards unenforceable, such as void arbitration agreements, lack of due process and excess of authority.<sup>57</sup>

#### Approved annulment standards

Under the European Arbitration Convention,<sup>58</sup> annulment constitutes a ground for non-recognition of awards only if based on approved vacatur standards. These track the first four defenses to award enforcement under the New York Convention: absence of a valid arbitration agreement, lack of opportunity to present one’s case, arbitrator excess of jurisdiction, and irregular composition of the arbitral tribunal. Accordingly, courts in Germany could ignore a French order setting aside a Paris award for violation of “international public policy,” a ground for vacatur in France that is not among the four listed defenses.<sup>59</sup>

The chief difficulty in this approach lies in its promiscuous taxonomy, which indiscriminately mixes both good and bad review standards. While some annulments falling outside the approved grounds impede efficient arbitration,<sup>60</sup> others (such as mechanisms to deal with arbitrator bias or clear legal error<sup>61</sup>) further legitimate interests of the regulating state<sup>62</sup> or the parties.<sup>63</sup>

<sup>56</sup> Vienna Convention on the Law of Treaties, 23 May 1969, Art. 31, UN Doc. A/Conf. 39/27, entered into force 27 January 1980, 63 Am. J. Int’l L. 875 (1969), 81 I.L.M. 679 (1969). Article 32 allows recourse to other elements when the ordinary meaning is “ambiguous or obscure” or leads to “manifestly absurd or unreasonable” results. See generally Paul Reuter, *Introduction to the Law of Treaties* §§142–148, at 96–8 (J.M. and P. Haggemacher (trans.), 2nd English edn, 1995). The Vienna Convention does not apply retroactively (see Art. 4), and thus as a technical matter does not cover the New York Convention.

<sup>57</sup> New York Convention, Art. V(1)(a)–(d). Article V(2) also uses the very same permissive language (recognition “may be refused”) with respect to public policy violations, which almost by definition makes awards unenforceable, notwithstanding recourse to local courts in circumscribing the relevant policies.

<sup>58</sup> See European Convention on International Commercial Arbitration, Geneva, 21 April 1961, Art. 9, 484 U.N.T.S. 349, which was adopted to supplement the New York Convention among residents of member states.

<sup>59</sup> See reference to *ordre public international* as a ground for annulment in France under NCPC, Art. 1502(5).

<sup>60</sup> For instance, requiring that all arbitrators sign awards (a standard abolished by Austria in 1983) gives dissenting arbitrators a tool to sabotage the arbitration.

<sup>61</sup> In some cases, of course, biased behavior and manifest disregard of the law might be characterized as conduct outside the arbitrator’s jurisdiction.

<sup>62</sup> For example, London courts that hear appeals on points of English law (allowed by Arbitration Act 1996 unless the parties agree otherwise) promote the development of a legal system on which many business managers rely.

<sup>63</sup> Some litigants, for example, might see judicial review as enhancing predictability in contract interpretation.





In addition, the line between approved and unapproved grounds for vacatur is not as clear-cut as the European Convention suggests. For example, misapplication of the law (not an approved standard) by arbitrators deliberately rejecting governing legal principles might be interpreted as excess of authority (which is an approved annulment standard).<sup>64</sup>

## D. Comity toward Annulments

### Bad faith and public policy

To end litigation in a way that promotes efficient cross-border economic relationships, many developed legal systems enforce foreign judgments either pursuant to treaty<sup>65</sup> or as a matter of discretionary comity.<sup>66</sup> In much the same way that courts enforce arbitral awards without examining their merits,<sup>67</sup> principles of comity call for recognition of foreign judgments on condition that there be no serious procedural irregularity or violation of public policy.<sup>68</sup>

The soundest policy toward annulment orders is to treat them like other foreign money judgments, according them deference unless procedurally unfair or contrary to fundamental notions of justice.<sup>69</sup> While controversial annulments will arouse the same type of resistance as other problematic judgments,<sup>70</sup> there is no reason that these cases cannot be disposed of within comity's flexible framework.<sup>71</sup>

As an aspirational model, the extension of comity to foreign judgments holds both parties to the consequences implicit in selecting one arbitral situs rather than another.<sup>72</sup> This can be of particular importance when annulment is followed by a second arbitration yielding a decision different from the first.<sup>73</sup> Unless vacatur triggers non-recognition,<sup>74</sup> the annulled award

<sup>64</sup> On the distinction between error of law and excess of authority, see later discussion.

<sup>65</sup> See e.g. European Union Convention on Jurisdiction and Judgments in Civil and Commercial Matters, Bruxelles, 27 September 1968, Art. 27(1).

<sup>66</sup> See generally Ronald A. Brand, *Enforcing Foreign Judgments in the United States and United States Judgments Abroad* (1992); Ronald A. Brand, *Enforcement of Foreign Money-Judgments in the United States: In Search of Uniformity and International Acceptance*, 67 Notre Dame L. Rev. 253 (1991); Dennis Campbell, *Enforcement of Foreign Judgments* (1997); Note, *Predictability and Comity: Toward Common Principles of Extraterritorial Jurisdiction*, 95 Harv. L. Rev. 1310 (1985).

<sup>67</sup> See New York Convention, Arts. III and V, discussed previously.

<sup>68</sup> Factors relevant to comity include the absence of fraud, public policy violations and conflict with a prior judgment or forum selection agreement, as well as the foreign court's impartiality, jurisdiction and granting of due process and proper notice.

<sup>69</sup> The functional similarity between annulments and other money judgments can be illustrated by a contract interpreted under English law by a London court resulting in a judgment that: "Defendant owes nothing to Claimant." Had the contract provided for arbitration in London subject to appeal on points of English law, the same conclusion would have been expressed by annulment of an arbitrator's erroneous award for claimant.

<sup>70</sup> One reason for American interest in a multilateral judgments treaty is that courts do not always enforce foreign judgments. See Hague Conference on Private International Law, Proposed Convention on International Jurisdiction and the Effects of Foreign Judgments in Civil and Commercial Matters (Working Document No. 144 E; synthesis by C. Kessedjian, 1998). See generally Russell J. Weintraub, *How Substantial Is Our Need for a Judgments Recognition Convention and What Should We Bargain Away to Get It?*, 24 Brooklyn J. Int'l L. 174 (1998).

<sup>71</sup> One intriguing variant on the good faith standard suggests that annulments be disregarded if "arbitrary or clearly erroneous." See Gary H. Sampliner, *Enforcement of Nullified Foreign Arbitral Awards: Chromalloy Revisited*, 14(3) J. Int'l Arb. 141, 161-2 (1997). The virtue of this approach is that it points toward the heart of the annulment problem: aberrant judicial behavior. Its drawback is that courts must look at an arbitration's substantive merits.

<sup>72</sup> See later discussion.

<sup>73</sup> Contrast French and English decisions in *Hilmarton*, discussed previously.

<sup>74</sup> In some cases, of course, vacated award will be refused enforcement even without comity, due to overlapping grounds for annulment and non-recognition. For example, if arbitrators in New York disregard their mission, the award could be vacated under the Federal Arbitration Act, § 10; the excess of jurisdiction would also impair recognition in Paris under both NCPC, Art. 1502 and New York Convention, Art. V.





might receive *res judicata* effect at the place where property is located, creating a Gresham's Law of awards in which bad decisions drive out good ones.<sup>75</sup> Such a "first-come-first-served" rule legitimizes a race to the courthouse likely to be won by the party relying on the earlier (annulled) award. The infrequency of such conflicts, like the rarity of arbitrator corruption, does not mean they can be ignored.

If only good faith judgments will be recognized, unflattering comparisons among legal systems will sometimes be made. Yet it is difficult to see a better alternative in a heterogeneous world lacking shared traditions of judicial independence.<sup>76</sup>

Applying a comity standard to *Hilmarton* would lead to enforcement of the second (non-annulled) award. No suggestion was made that the Geneva judiciary lacked integrity or that the cantonal arbitration statute violated international public policy. However, the fate of the award in *Chromalloy* under a comity approach would be complicated by the suspicion in some quarters that the Egyptian government exercised undue influence on the Cairo court. As in other areas of the law where good faith and procedural integrity are relevant, the party challenging the award would have to muster direct or circumstantial evidence of bias or other impropriety.

While injustice sometimes results when a court sets aside an award against a local party (as in *Chromalloy*), this danger can be minimized through the choice of a disinterested arbitral venue with limited review standards. Indeed, the arbitral venue is the one place subject to party control. Careful contract drafting permits selection of an arbitral seat in which neither side has an inside track to the courts. By contrast, the enforcement situs will often be the losing side's home country.<sup>77</sup>

### Enforcing bargains

#### *Implied rules of the road*

Deference to good faith annulments often furthers the very same interests as enforcement of the arbitration agreement and award: holding the parties to their bargain. Just as an agreement to arbitrate in London means driving to hearings on the left side of the road, so it means that proceedings are subject to the English Arbitration Act.<sup>78</sup>

Arbitration clauses implicate several related undertakings, both explicit and implicit, each of which must be interpreted in a way that neither ignores nor distorts the others.<sup>79</sup> In addition to agreeing to settle disputes privately, the parties commit themselves to a specific arbitral

<sup>75</sup> Named for the sixteenth-century British financier, the original Gresham's Law observed that "bad money drives out good." If two coins have equal nominal value but different metal contents, the one with less precious metal remains in circulation.

<sup>76</sup> A different rule would normally obtain in federal systems. See *Fauntleroy v. Lum*, 210 U.S. 230 (1908) (interpreting the "full faith and credit" clause in Constitution, Art. IX).

<sup>77</sup> This point was noted in Jean-François Poudret, *Quelle solution pour en finir avec l'affaire Hilmarton?*, Rev. arb. 7, 22 (1998) ("le juge du siège est en général plus neutre que celui de l'exequatur . . ."), as well as in Dana Freyer and Hamid Gharavi, *Finality and Enforceability of Foreign Arbitral Awards*, 13 ICSID Rev. 101, 113 (1998) ("self-help is available . . . by carefully selecting the arbitral situs").

<sup>78</sup> Section 69 of the 1996 English Arbitration Act, reprinted in 36 I.L.M. 155(1977), allows judicial review on questions of English law if the parties have not agreed otherwise. In all events an award is subject to judicial review for arbitrator excess of jurisdiction and serious procedural irregularity. *Ibid.* §§ 67–68.

<sup>79</sup> For some of the principles applicable to interpreting commitments such as those inherent in arbitration clauses, see generally E. Allan Farnsworth, *United States Contract Law* §6.4, at 130–35 (1991); Steven J. Burton and Eric G. Andersen, *Contractual Good Faith: Formation, Performance, Breach, Enforcement* §1.3.8, at 16–17 (1995); 1 *Chitty on Contracts* §13–006–008, at 621–4 (A.G. Guest (ed.), 27th edn, 1994).





venue, selected by them either directly or through their chosen arbitral institution.<sup>80</sup> Inherent in the understanding about situs is an expectation that proceedings will be subject to that country's mandatory procedural safeguards.<sup>81</sup>

Arbitration rules and contract stipulations providing that awards will be "final and binding"<sup>82</sup> must be read against the background of the arbitration's legal framework. In this context, "finality" means "finality as allowed under relevant arbitration laws," which in some countries subject awards to mandatory judicial control mechanisms,<sup>83</sup> as in *Iran Aircraft Industries v. Avco Corp.*<sup>84</sup> Moreover, in a world where most legal systems do *not* impose merits review, the choice of an arbitral seat that *does* monitor an arbitrator's legal error argues for an intent to select a level of judicial scrutiny different from what is available elsewhere.

Ignoring the implications of the parties' direct or indirect choice of situs permits one side to change its mind about judicial review after seeing who gets the rough edge of the bargain.<sup>85</sup> While many arbitration lawyers favor limited court scrutiny,<sup>86</sup> some business managers opt for a judicial safety net against aberrant results.<sup>87</sup> Fairness requires respect for the degree of review imposed at the selected arbitral venue,<sup>88</sup> particularly since at contract signature all parties are behind a veil of ignorance about the outcome of any potential arbitration.<sup>89</sup>

#### *The ill-advised business manager*

Holding business managers to the consequences of their choice of arbitral situs raises the possibility that ill-advised executives, perhaps lacking competent counsel, might be burdened with an inconvenient level of judicial review. In some instances a manager might accept an arbitration clause only on the insistence of a trading partner with superior bargaining power. Unwise choices, however, form part of the warp and woof of commerce.<sup>90</sup> Contract terms often appear imprudent in hindsight, or are accepted as the price of booking a sale.

<sup>80</sup> In some cases the parties delegate the choice of a situs, like the selection of the arbitrators, to an arbitral body.

<sup>81</sup> For a recent articulation of this view, see *Minmetals Germany GmbH v. Ferco Steel Ltd.* (Q.B., 20 January 1999), [1999] 1 All ER (Comm) 315; reported in *The Times* (London), 1 March 1999, 41.

<sup>82</sup> See e.g. ICC Arbitration Rules, Art. 28(6) (award "binding"); LCIA Rules, § 26.9 (award "final and binding"); AAA International Arbitration Rules, Art. 27(1) (award "final and binding"); UNCITRAL Arbitration Rules, Art. 32(2) (award "final and binding").

<sup>83</sup> See e.g. *M & C Corp. v. Erwin Behr GmbH*, 87 F. 3d 844, 847 (6th Cir. 1996), stating that waiver provisions in the ICC Rules "merely reflect a contractual intent that the issues joined and resolved in the arbitration may not be tried *de novo* in any court" (quoting *Iran Aircraft Industries v. Avco Corp.*, 980 F. 2d 141, 145 (2nd Cir. 1992)), stay denied, 935 F. Supp. 910 (1996), subsequent appeal, 143 F. 3d 1033 (6th Cir. 1998).

<sup>84</sup> *Iran Aircraft Industries v. Avco Corp.*, 980 F. 2d 141 (2nd Cir. 1992); *First National Supermarkets v. Retail Wholesale & Chain Store Employers Union*, 118 F. 3d 892 (2nd Cir. 1997). The English Arbitration Act 1996 allows pre-dispute waiver of appeal on points of law (§ 69), but not waiver of challenge for serious procedural irregularity or excess of jurisdiction (§§ 67–68).

<sup>85</sup> For analysis of when and why the law restrains people from reneging on commitments, see E. Allan Farnsworth, *Changing Your Mind: The Law of Regretted Decisions* (1998). See also Randy E. Barnett, *A Consent Theory of Contract*, 86 Columbia L. Rev. 269 (1986), discussing the reliance, efficiency and fairness notions underlying contract enforcement.

<sup>86</sup> See Ken Rokison, *Pastures New: The 1997 Fresh fields Lecture*, 14 Arb. Int'l 361, 363 (1998).

<sup>87</sup> See Carroll E. Neesemann, *More Certainty Comes to Arbitration*, N.Y. L.J. 1, col. 2 (26 Mar. 1998); Carroll E. Neesemann, *Party-Chosen Arbitral Review Standards Can Inspire Confidence in the Process*, 5 Dispute Res. J. 18 (Fall 1998).

<sup>88</sup> In addition to the form of judicial review, choice of an arbitral seat implicates court selection of the arbitrators in the event of party default. See e.g. UNCITRAL Model Law, Art. 11(3); English Arbitration Act 1996, § 18; Federal Arbitration Act, § 5; Swiss LDIP, Art. 179; French NCPC, Arts. 1454 and 1455.

<sup>89</sup> On the relationship between fairness and the parties' "veil of ignorance," see John Rawls, *A Theory of Justice* § 24, at 136 (1971).

<sup>90</sup> See *Lapine v. Kyocera*, 130 F. 3d 884 (9th Cir. 1997).





Yet a sophisticated corporate executive's lack of wisdom or bargaining power rarely constitutes a valid excuse for escape from contract commitments.

Choosing an arbitral situs is not unlike selecting an arbitral institution to provide rules and appoint arbitrators. A Chicago entrepreneur who contracts for arbitration under the rules of the International Chamber of Commerce (ICC) cannot disregard an unfavorable award because the ICC procedures appear idiosyncratic in comparison with more familiar American arbitral practices.<sup>91</sup>

The law's normal response to a merchant's second thoughts about an honest bargain, whether in regard to arbitral rules or an arbitral situs, would be to leave the merchant to make better choices in the next transaction. There is no reason to believe that market forces cannot discipline the selection of arbitral venue as they do other contract terms.

### Refusal to vacate

When courts deny motions to vacate, how should an enforcement forum treat the decision *not* to vacate an award?<sup>92</sup> For example, if an American judge rejects allegations that an award was procured by bribery or otherwise violates international public policy, should a London court be bound by this determination if enforcement is sought in England?

Little law exists on the *res judicata* effect of foreign refusals to vacate. Absent conflicting commitments under any relevant treaties for enforcement of foreign judgments, the best approach to such "non-annulments" allows enforcement judges to make up their own minds on whether awards are defective within the context of New York Convention defenses. Comity for foreign judgments should not require violation of an enforcement forum's own public policy.

There is, of course, a lack of symmetry in deferring to award annulments but not to award confirmations. Yet the two types of judgments raise distinct considerations. A judge that defers to English vacatur of a London award does not do more than leave the parties with the consequences of the chosen situs. However, for any court to enforce an award that in its opinion violates fundamental public policy norms would run afoul of its own interest in avoiding active assistance to illicit conduct. The New York Convention contemplates this double standard by providing that awards may be denied recognition if deemed defective by *either* the enforcement forum, on grounds enumerated in subsections (a) through (d) of Article V(1), or the arbitral situs, as provided in subsection (e) of Article V(1), permitting non-recognition to annulled awards.

## E. Conclusion

Constructing an efficient framework for arbitration requires legislators and courts to engage in a process of legal fine tuning that balances a winner's concern for finality against a loser's desire for procedural safeguards. While a golden mean will remain elusive, national

<sup>91</sup> Unique aspects of ICC procedure include "Terms of Reference" (which sometimes bar new claims and counterclaims) and institutional scrutiny of the award (which may cause arbitrators to rethink their decision). Moreover, the ICC does not allow the "non-neutral" arbitrator common in domestic American arbitration (see AAA 1977 Code of Ethics for Arbitrators in Commercial Disputes, AAA Pub. No. 196-20M), but requires all arbitrators to be independent of the parties. See respectively Articles 18, 27 and 7 of the ICC Arbitration Rules, discussed in W. Laurence Craig, William W. Park and Jan Paulsson, *Annotated Guide to 1998 ICC Arbitration Rules* (1998).

<sup>92</sup> A different issue presents itself when the losing party in an allegedly defective arbitration simply fails to invoke remedies available in the arbitration, thereby waiving its right to challenge the award later. See earlier discussion of *Minmetals v. Ferco*.





arbitration law can seek a reasonable counterpoise between arbitral autonomy and judicial control mechanisms.<sup>93</sup>

To this end, the United States should adopt an international arbitration act making clear that the protective review standards appropriate for domestic disputes will not affect cross-border arbitration. This statute should also clarify, with respect to international commercial disputes, critical issues such as the relationship between federal and state arbitration law and the contours of an arbitrator's right to determine his or her own jurisdiction.

Not all nations, however, follow this ideal. Weighing arbitration's costs and benefits differently, some countries impose court scrutiny of a dispute's legal merits, while others allow waiver of all pre-enforcement review. If business managers choose to arbitrate in such jurisdictions, there is no reason to disregard the implications of these choices in an attempt to squeeze the entire world into the same Procrustean arbitral bed. Should commercial actors find a country's review standards burdensome or inadequate, the market will direct their next arbitration to a place more compatible with the desired level of judicial control.<sup>94</sup>

Recognition of vacated awards should depend not on the nature of the annulment standard, but on whether the annulment was made in good faith and comports with fundamental notions of justice. The touchstone for deference to court judgments about arbitration, as to arbitral awards themselves, lies in the absence of fraud and undue influence, and conformity with basic notions of international public policy.

<sup>93</sup> See e.g. Klaus-Peter Berger, *The Implementation of the UNCITRAL Model Law in Germany*, 13 Mealeys Int'l Arb. Rep. 38, 39 (Jan. 1998).

<sup>94</sup> One is reminded of Justice Holmes's comment that "The most enlightened judicial policy is to let people manage their own business in their own way, unless the ground for interference is very clear." See *Dr. Miles Medical Co. v. John D. Park & Sons*, 220 U.S. 373, 386 (1911) (Holmes J., dissenting).



