SELECTING THE SEAT: CROSSING A MINEFIELD IN THE FOG

SELECIONANDO A SEDE: ATRAVESSANDO UM CAMPO MINADO NA NÉVOA

Pierre A. Karrer[1]

ABSTRACT

To select the seat of an international arbitration one should avoid surprises. One should avoid popular misconceptions and consider dozens of points, some obvious, but many easily overlooked – a complex exercise discussed in this practice-oriented article.

Keywords: Seat of international arbitration; criteria to select a seat; arbitration agreement; procedure law; Convention on the Recognition and Enforcement of Foreign Arbitral Awards.

RESUMO

Para selecionar a sede de uma arbitragem internacional deve-se evitar surpresas. Deve-se evitar equívocos populares e considerar dezenas de pontos, alguns óbvios, mas muitos facilmente esquecidos - um exercício complexo discutido neste artigo orientado para a prática.

Palavras-Chave: Sede de arbitragem internacional; critérios para selecionar uma sede; convenção de arbitragem; direito processual; Convenção sobre o Reconhecimento e a Execução de Sentenças Arbitrais Estrangeiras.

Many say, and they have a point, that the simplest arbitration clause is the best. But one should not exaggerate. Yes, one could just write. "arbitration", the magic word. This would be a valid arbitration clause. But, in an international context, how would the Arbitral Tribunal be set up? France might help. But normally you will specify the seat.

"Ah, no need", some will say: If the Parties just choose an arbitral institution, that will take care of picking the seat. Yes, if you choose an arbitration institution, you actually choose arbitration rules, and they often have a default seat. For instance, in

[1] Dr. iur. (Zurich), LL.M. (Yale), FCI Arb; Hon. President, ASA Swiss Arbitration Association; former Vice President, Stockholm Institute; former Vice President, LCIA; former Member, International Court of Arbitration of the ICC; former Chairman, Arbitration Commission of Swiss National Committee of the ICC; www.pierrekarrer.com

the Vienna Rules the default seat is – surprise, surprise – Vienna. If you choose the ICC, the ICC Court itself shall pick the place of arbitration, as the ICC Rules provide. Then, you may be in for a surprise. If you pick the UNCITRAL Rules, the result will also be hard to predict.

So, even with institutional arbitration, and anyway in *ad hoc* arbitration, the Contract Parties themselves should *specify* the seat expressly in their clause. Incidentally, they should specify a city, not just a country. Some countries do not have a provision for a default seat in the capital city or to be set by a state court.

Normally all this is in the interest of *both* Parties. A winning Counter-Claimant in an arbitration will often be interested in having an Award on the merits against the losing Claimant recognized or enforced. A Respondent should also not forget costs which may be substantial.

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First, an easy one: To obtain an enforceable Award, avoid a seat in the few countries that do not have the New York Convention.

Mind you, you will not need the New York Convention if you want to enforce the Award at the seat. But to enforce the Award elsewhere, you will normally need the New York Convention.

But why do you then need the New York Convention also at the seat? Because some members of the New York Convention opted for the standard reciprocity reservation: They will enforce foreign arbitral Awards, or recognize them under the New York Convention, *only* if they were made in a fellow New York Convention country.

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How do the Parties *in reality* choose their seat in international arbitration? They worry little about the law. They overoptimistically believe that the case will settle. They are also often led by other unreasonable nostalgic or romantic ideas. Many believe that the hearings will necessarily be conducted at the seat. Because they believe this, they like to choose places where they were in their youth, during their student years. There, they were young and happy, and they hope to feel young and happy again in a nostalgic setting.

Some countries are favoured for more general cultural or historical reasons. What is the language spoken locally at the seat? Often the capital of a former large Kingdom or Empire is popular: London, Paris, Vienna, Stockholm, but neither Istanbul nor Bejing nor Madrid. Or then, the parties prefer a city in a neutral country that *never had* an empire: Geneva, Zurich. But political neutrality is quite irrelevant.

The parties sometimes also ask themselves: What is the quality of the banking system? Is that city easily accessible by plane? Do you need a visa? For instance to travel to the United States? How nice are the hotels? The restaurants?

However, it is just not true that one must physically meet at the seat of the arbitration. The seat of the arbitration is a *legal concept.* One can normally sit somewhere else. Even if the Parties did not specify the venue of hearing, some of us

have sat physically in Istanbul instead of Vienna, in Bangkok instead of Kathmandu, in Larnaka instead of Cairo, and we could go on and on.

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Another misconception is that by choosing the *lex arbitri* one chooses the *procedural law* of the seat that will be applied by the arbitral tribunal in its hearings. This is just not so.

But wait a minute. *Jurisdiction* of the arbitral tribunal *is* a procedural matter, and the *lex arbitri* is quite important for jurisdiction because, on setting aside, the arbitral tribunal's decision on jurisdiction may be reviewed by a local State Court at the seat. Reviewed not just against abuse, but *fully*. One may wonder why fully, but so it is, everywhere.

The *validity and scope* of the arbitration agreement is unfortunately not everywhere governed by the *lex loci arbitri* with its rules of interpretation. So, in your clause choose the law to be applied to your clause.

French International Arbitration Law is excellent, but a French specialty is the Group of Companies Doctrine which extends arbitration agreement to *non-signatories* in a somewhat unpredictable way. One should draft carefully to avoid surprises.

In this connection, one should also study aspects of *res judicata* at the seat, a procedural matter also, and not an easy one.

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Many also believe that an arbitral tribunal will at least proceed according to the *civil procedure* at the seat. Also not true. The *lex arbitri* or the arbitration rules will normally merely provide that the procedure before the arbitral tribunal will be set by the parties' agreement, and if there is none, by the arbitral tribunal itself. Thus, one can perfectly well sit in London and apply Italian civil procedure law, or in Brussels, applying no identifiable civil procedure law at all.

The *lex arbitri* normally will provide nothing more than the requirement that the arbitral tribunal must treat parties *equally* and hear them both, what the French call "*contradictoire*." If you want a shorthand expression for both these requirements, you can call this *due process*.

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But watch out! Unfortunately, in some exotic places, the *lex arbitri* or some particularly zealous nationalistic or religious state court not yet corrected by statute may insist on some surprising special additional civil procedure aspect. These are interesting seats, but seats to avoid. Here are a few examples of *local procedural idiosyncrasies* that one should know:

In some jurisdictions the local court may be asked, as a preventive measure before an arbitration is pending, to find, by a *declaratory judgment*, that the *arbitration agreement* is invalid, or to issue an order to stay arbitration, so no arbitration may be held. Conversely, in the United States of America and some other seats, a party can also go to a state court with a *motion to compel* arbitration.

Some Turkish state courts say that Turks can validly agree on arbitration only in Turkish, not another language, even if the seat is outside Turkey and the contract is in that other language, say Kurdish.

If the *lex arbitri* does not give an arbitral tribunal the power to issue *provisional measures*, the arbitration agreement, or the chosen arbitration rules, which is the same thing, should *expressly* provide for this. However, this may still not be effective, for instance in Italy or China.

In some places *witnesses* must be *sworn in* in a particular way, to the right God, or their testimony will not be valid, and the award will be null and void since it is not based on properly established facts.

A Qatari court says that an award must be *issued in the name of the Ruler*, or it will be null and void.

The *lex arbitri* does not always provide that the arbitral tribunal can itself decide on its own arbitration costs and on the party representation *costs*. The parties should agree on this in the arbitration clause, or the State Courts at the seat will set the arbitration costs, and it will be difficult to find arbitrators who will accept this because they will fear that State court judges may be sometimes jealous of arbitrators.

Another aspect is *value-added tax*, withholding tax or even local *income tax* on arbitrators' fees at the seat.

In some places, arbitrators need a *work permit*.

So beware: Avoid interesting seats, and, incidentally, unknown arbitral institutions. Pick a *popular* seat. Which are the tried and tested popular seats? According to ICC statistics: Paris, Geneva, Zurich, London, Vienna, Stockholm, Singapore, Hongkong, and a few more.

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Now, at last, what are the *relevant criteria* to select a seat in the shortlist of popular seats? The really relevant criteria are often overlooked.

Here is a hidden criterion: In practice, the seat often has a very direct impact on *who will be the arbitrators*, and particularly *who will chair the arbitration*. This is, it is often said, and it is true, the *most important decision* in an arbitration.

The reality is that very often somebody from the seat will be taken to chair the arbitration because this person, it is expected, will know the *lex arbitri* very well and will also be helpful for many other functions at the seat. So, if you choose London, it will be very difficult to avoid having an English person chairing. Unfortunately, with an English chair, you will soon also see English solicitors and barristers, normally QCs, appear, and the arbitration will then likely become very English. Regrettably, your arbitration will last *at least twice as long and cost at least twice as much* as at another good seat. The English call this the Rolls Royce approach. If you want to avoid this, avoid London, and go somewhere else. Say, you would prefer a Swede. Go to Stockholm.

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Another aspect often overlooked: The parties should specify the *applicable law* in the contract. The seat has an impact on this.

This is more complex than appears at first glance. One should not forget that, depending on the seat, some questions are characterized not as substantial, but as procedural. What is substance, what is procedure? The answer depends on the seat.

In reality, moreover, there is not just *one* applicable law. Which law will apply to the Statute of limitations, to company law questions, to severance payments? To penalty claims, to the calculation of damages, to security for costs, the effect of bankruptcy of a Party, and, above all, to the interpretation of contracts?

And will one be able to simply argue on what the applicable law provides, or will one have to prove its content? How?

If the Parties have not agreed on the law applicable to a question, if arbitration rules are chosen, these will have choice of law rules of their own. Or then the *lex arbitri* will come in with its own conflict of laws, different from the conflict of laws applied – so-to speak across the street – by the State Courts of the seat. In all cases, however, fortunately the *lex arbitri* will *follow* the choice by the parties. So, specify the applicable law and avoid sophisticated conflict of laws arguments, perhaps even with law professors testifying as experts. In any event, study the *lex arbitri*, and find out which law is likely to be applied at a particular seat to a particular question.

To sum up: Is it a good idea to say early: "You choose the applicable law, and we will choose the seat?" Yes. If you do not know where the seat will be, you are up in the air. Once you *know* what the seat will be, you can predict the applicable law to a particular question. You can then draft inside that law, or against it.

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What else *does* the *lex arbitri* really and *openly?* We will now focus on the popular seats just mentioned.

The *lex arbitri* deals with the *relationship* between arbitral proceedings and the *State Courts at the seat*. Unfortunately, the state courts at the seat proceed in their own local language. They often will require translation of important and large documents.

State court proceedings may be swift or cumbersome *in three other respects:*

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The *first* ubiquitous aspect is this: If a respondent fails to nominate an arbitrator, the chosen institution or then a State Court at the seat will nominate that arbitrator. If the two co-arbitrators cannot agree on a presiding arbitrator, that person will be picked by the arbitral institution or a State Court. Avoid the State Court's choice because it will tend to select a former state judge or a local law professor.

An arbitral institution is likely to make a better choice. However, that is all many arbitral institution do. They are just launching systems. Once the arbitration ship is launched out of the harbor, it sails on its own.

In most seats, the choice of arbitrators made by the arbitral institution, if there is one, is unfortunately subject to *second-guessing* by the State Court at the seat. By

contrast, in Switzerland, the State Court will intervene only by default. If an arbitral institution has been chosen and has nominated arbitrators, this will not be second-guessed at the seat in Switzerland.

If successfully challenged *pendente lite*, an arbitrator is removed and replaced by another arbitrator, and, not surprisingly, by default, this happens almost always exactly the same way as the original nomination. Your replacement arbitrator may be just as bad as the former arbitrator.

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The *second* function: An arbitral tribunal, once set up, has the power to issue *provisional and conservatory measures* as provided in the *lex arbitri* or in the arbitration rules. These often deal with this because the *lex arbitri* says nothing or too little about this.

Arbitration rules also make it possible to appoint emergency arbitrators before the arbitration starts. Otherwise, before the arbitration starts, and even *pendente lite*, a State Court at the seat may intervene to lend the arbitral tribunal *a helping hand*. For instance, a witness must be heard by the arbitral tribunal, but does not appear before the arbitral tribunal voluntarily. It is then possible to have this witness heard by a State Court at the seat. Or the State Court at the seat may send letters rogatory to a State Court abroad, for instance at the residence of the witness to question the witness there.

This brings us to more general questions: Is international commercial arbitration well-known and important in practice at the seat or in other relevant jurisdictions? Or is it at best an annex to domestic arbitration? Is there a large number of sophisticated multilingual international practitioners? Are the state courts knowledgeable about and favorable to arbitration? Will the state courts do all in their power to help the arbitral tribunal? At the popular tried and tested seats, generally yes.

Or are the State Court Judges people who think that they know everything better, that they are the real specialists of dispute resolution, which they have been all their lives, though in a limited field, working with a limited group of local lawyers appearing before them? Do the state judges think that arbitrators earn their money too easily for doing a dangerously amateurish job? Secretly, some of these jealous state judges hope to become appointed themselves in a second career. Often they are then not appointed, which will leave them disappointed and sour.

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Now the most important *third* function of the State Courts at the seat of the arbitration, namely *setting-aside proceedings*.

The substantive legal criteria that are applied by the State Courts at the seat in setting-aside proceedings resemble very much those in the New York Convention on refusal to recognize or enforce an arbitral award. The grounds for setting aside are sometimes called differently, as in England, where one talks of "serious irregularity," but the meaning is the same.

Still, the concept of *public policy* means different things in different places. It ranges from local public policy, including local or EU antitrust law, to truly international public policy or transnational public policy.

In the United States of America, there is an exotic special setting aside ground called "manifest disregard of the law." When this applies, and how, is still very much in dispute.

In England, if the applicable law is English substantive law, an "appeal on a point of law" may be allowed, which means that there is then a full review of the way English law was applied. So, with a seat in England, avoid English law!

One should also look closer at *setting-aside* procedure. One will encounter some almost hidden aspects that are important:

Which state courts will become active in setting-aside proceedings at the seat?

Will there be *several tiers*? In many jurisdictions, there will be three tiers, a trial court, an intermediate appellate court, and a Supreme Court. No surprise that such proceedings may take years.

A few countries have only *one* court that will deal with setting-aside proceedings against arbitral awards, namely Austria, Switzerland and Singapore. For speed go to one of these countries.

In a few seats, the parties can in writing expressly and clearly exclude setting-aside proceedings altogether, Sweden, France or Switzerland. This may be attractive, especially if the arbitration is physically conducted in a convenient place, say in Hong Kong, but one wishes to stay away from state courts nearby or far away.

Moreover, do not overlook practical details. *How long* will the proceedings take? To begin with, if you wish to set aside an award, in the countries following the Uncitral Model Law, you will have to observe a three month period to file your setting aside request, and perhaps two extra months for foreign parties. By contrast, Switzerland has only 30 days, non-extendable. The reasons for requesting setting-aside must be given within this same deadline. All in one of the official local languages.

Then, how long does the State Court take, or do their state courts take, one after the other, two or three tiers, to render a decision? The Swiss Federal Supreme Court is the only tier, and it decides setting-aside proceedings more often than not in less than five months, and, almost always, within seven months. The median is five months, the average six. Other courts take far longer.

How much will it all *cost*? Depending on the system, on setting-aside proceedings, a new set of local lawyers will have to appear physically before the State Court, wearing wigs. This will add to time and costs. Austria has one tier only, *but* regretfully for the time being, prohibitive court fees.

So, *costs and time* are hidden criteria, but very important.

Getting good information on costs and time and on statistics is not easy. Why? Local lawyers are seldom eager say that their law is less than perfect. They may even

honestly *believe* that their law is the best. Why? It is simply the best they *know*. Why? Because it is the *only one* that they really know first-hand.

And finally, what are the *chances of success* in setting aside proceedings? Do the state courts at the seat like to intervene because they think that they know better? Here, you need statistics. But study them well. You need to know the type of cases that are taken to setting-aside proceedings. For instance, half the awards that are challenged in Switzerland are in sport arbitration because Switzerland has the foremost sport arbitration seat, Lausanne. International commercial arbitration awards are rarely challenged and set aside.

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For the same reasons, information about the way the New York Convention is *really* applied or not applied is also difficult to gather, but also important, depending on where one will try to enforce a favorable award.

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Because of all these practical matters, many elusive, many hidden, one may simply advise parties and their lawyers as follows: It may be well worth making an early phone call to somebody really knowledgeable about selecting the seat for a particular international arbitration. Those who have read this article, are now well prepared for this phone call.