Arbitration Clauses Pitfalls: A Warning

by Partners Niall Clancy and Beau McLaren

Picture this: the celebratory fanfare as a new project commences–a symbol of celebration and anticipation of success. The parties are brimming with enthusiasm, and the future looks promising. As the project progresses, a disagreement arises, and the parties, for the first time, scrutinise the arbitration clause in their contract. It is at this moment, much like the reflection after a grand celebration, that the heart sinks.

This is the arbitration clause that, upon initial glance, appears to be the epitome of sophistication and detail, but upon closer examination, reveals itself to be lacking in substance and clarity. It is a clause that was celebrated too early, without due diligence, and now, when it is needed the most, it fails to deliver. In the realm of dispute resolution, arbitration stands as a beacon of autonomy, allowing parties to resolve their disputes privately, efficiently, and away from the public eye. However, a recent matter I was involved in serves as a stark reminder of the pitfalls of poorly drafted arbitration clauses.

The clause in question, ticked some essential boxes: it identified the seat of arbitration, the number of arbitrators, and the language to be used. Yet, it stumbled on a critical aspect - it referred to a non-existent set of arbitral rules. This oversight has the potential to derail the entire dispute resolution process, highlighting the importance of the four pillars of a valid and enforceable arbitration agreement: a defined legal relationship, a clear arbitration clause, the parties' intention to arbitrate, and a smooth and effective process.

The Middle Eastern courts, increasingly known for their pro-arbitration stance, often step in to salvage such defective clauses, striving to interpret the parties' true intention and uphold the agreement. In this case, the courts may infer that the parties intended to exclude judicial intervention, favouring arbitration as their dispute resolution mechanism. This is where the court's interpretative role becomes pivotal, potentially considering any arbitration regulations or local institutional rules as a substitute. The uncertainty bred by such a clause can lead to increased time, costs and anxiety for the parties involved.

Ideally, the respondent will adhere to the arbitration agreement, agreeing to a set of institutional rules to govern the arbitration. If not, the claimant may find themselves approaching the courts for support.

The courts' approach to interpreting such clauses is to give effect to the arbitration agreement wherever possible. They may employ various interpretative methods, such as referring to the closest analogous set of rules or even applying general principles of arbitration law. Alternatively, where there is no way of interpreting the clause as referring to a specific arbitral institution and rules, courts may default to ad-hoc arbitration, recognising the clear intent to arbitrate despite the ambiguity in the institution and rules. However, there is no guarantee that the courts will always succeed in upholding the arbitration agreement through interpretation. In the worst-case scenario, the clause may be deemed so defective that it cannot be enforced as an arbitration clause at all.

This brings us to the crux of the matter: the drafting of arbitration agreements. It is imperative that parties meticulously draft these clauses, clearly identifying not only the seat and language of the arbitration but also the arbitral institution and the rules that will administer the arbitration, along with the supervisory court. Clarity in these elements is the linchpin of a robust arbitration agreement.

Moreover, the enforceability of any arbitral award is a paramount consideration. Parties must be cognisant not only of the seat of the arbitration but also of the public policy considerations in the jurisdictions where the award may be enforced. There lies the risk that foreign awards enforcing terms that contravene public policy may not be recognised or enforced, rendering the entire arbitration exercise futile. It is crucial for parties to remain vigilant about changes that could affect the enforceability of their agreements after the contract is signed. A recent case in Louisiana serves as a stark reminder of the potential complications. In this case, the District Court of New Orleans, Louisiana refused to enforce an award from the Dubai International Arbitration Centre (DIAC) because the original contract stipulated arbitration under the auspices of the now-defunct DIFC-LCIA Arbitration Centre.

This case underscores the perils of neglecting to update arbitration clauses following significant institutional changes, such as the dissolution of an arbitral body. The crux of the issue lay in the parties' oversight in not amending their arbitration clause after the DIFC-LCIA ceased operations. The enforceability of an arbitration agreement is fundamental to its effectiveness, and such an oversight can lead to significant legal challenges. The decision of the Louisiana court raises questions about how similar situations will be handled by courts in other jurisdictions, including the UAE, Qatar and Saudi Arabia, which may well have different legal perspectives and principles.

To mitigate these risks, parties whose contracts currently include references to the DIFC-LCIA should proactively seek to amend their arbitration clauses. Mutual agreement to update these clauses can help ensure that the arbitration agreement remains valid and enforceable, avoiding the pitfalls of different legal systems that may not recognise or enforce the original terms.

It is a prudent step to safeguard the intended dispute resolution process and to ensure that the arbitration clause aligns with the current legal and institutional landscape.

In conclusion, the arbitration clause I encountered is a cautionary tale for all practitioners and parties involved in drafting dispute resolution mechanisms. It underscores the necessity of precision and foresight in arbitration agreements. As we navigate the complexities of international contracts, let us take this as a reminder to draft with diligence, ensuring that our arbitration clauses are not only valid and enforceable but also equipped to facilitate a smooth and effective dispute resolution process.

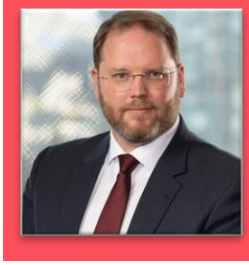
Key takeaways and best practice

- Parties must meticulously draft arbitration clauses, specifying not only the seat and language of arbitration but also the arbitral institution and rules, including the supervisory court, to ensure clarity and enforceability.
- It is essential for parties to remain alert to changes that could impact the enforceability of arbitration agreements, such as the dissolution of an arbitral institution, and to amend clauses proactively to avoid legal challenges.
- When drafting arbitration agreements, parties must consider the public policy of any jurisdiction where they intend to enforce an arbitral award, as awards conflicting with these principles may not be enforceable. Specifically, parties should be mindful of the jurisdiction(s) in which they may seek to enforce their awards. The alignment of arbitration agreements with local legal norms is essential to ensure foreign awards are recognised and enforced by local courts.

For enquiries

Niall Clancy
Partner, Middle East
Construction specialist

E niall.clancy@simmons-simmons.com
T +974 3109 5999



Beau McLaren
Partner, Middle East
Construction specialist

E beau.mclaren@simmons-simmons.com
T +971 4 709 6689