

When International Arbitration Becomes Domestic

By **Claudia Salomon and Irina Sivachenko** (November 14, 2018, 2:07 PM EST)

Over the past decade, arbitration has become a popular form of dispute resolution, a default go-to mechanism in cross-border transactions. The rising popularity of arbitration is not surprising. Arbitration is known for giving parties autonomy to shape the dispute resolution process. Parties are attracted to the opportunity to select who hears their dispute, what law applies and where the arbitration takes place. But this autonomy is not without limits. When parties from the same country sign a contract, additional restrictions might apply. Companies relying on boilerplate clauses without checking local laws may find their dispute resolution clauses declared invalid.



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Many global companies prefer to enter into contracts with foreign counterparties through a locally incorporated affiliate. This approach might help streamline business relationships and confer certain tax advantages, but the validity of the arbitration clauses in such contracts rarely has been tested. In contracts between parties from the same country, such as contracts between a local affiliate of the U.S. parent company and a local counterparty, local laws may govern the dispute resolution clause and drastically curtail the parent company's ability to select the governing law, place of arbitration and even application of preferred procedural rules.



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Some countries will treat a dispute between two local parties as a domestic issue and apply local arbitration law. Other countries treat the dispute as international if there is an "international element" in the dispute, a concept that varies country by country. And other countries draw no distinction between domestic and international arbitration. A parent company that simply copies and pastes its standard arbitration clause into all of its local contracts around the globe risks having its selections annulled by local courts.

Is the Choice of Law Valid?

If a dispute is considered domestic under local law, the parties' chosen law might be unenforceable, requiring the parties to litigate in local courts under local laws. Such a scenario may disadvantage the parent company, as the local counterparty is likely more familiar with local courts and procedures.

In China, for example, Chinese law governs any contract involving all Chinese parties. Chinese courts

have found choice-of-law clauses opting for foreign governing law to be void in a contract between a China-incorporated subsidiary of a foreign parent company and a Chinese vendor. India also requires application of Indian law in disputes between all Indian parties — which include locally incorporated affiliates of a foreign company. Colombia has the same requirement: Domestic parties must use Colombian law to resolve their disputes.

Other countries allow domestic parties to choose foreign substantive law, but only if a meaningful or reasonable connection to the selected law can be established. The specific requirements differ, but this approach has been shared by jurisdictions across the globe, from Indonesia to Portugal. Contracts should be reviewed on a case-by-case basis for their compliance with requirements of local arbitration laws to ensure that the parties' dispute resolution clause is valid and cannot be challenged later.

Is the Choice of Seat Valid?

The selection of the seat or place of arbitration is another key consideration. New York, London, Paris, Hong Kong and Singapore are among the most popular choices. However, some jurisdictions do not allow domestic contracts to provide for a foreign seat. Local affiliate contracts, therefore, require special attention to ensure that the local arbitration laws of the country permit the selected seat.

China, for example, requires that an arbitration between a locally incorporated subsidiary of a foreign company and a local counterparty be seated in China. Chinese courts have annulled dispute resolution clauses providing for a foreign seat. Similarly, parties to domestic arbitration in Colombia cannot choose a foreign seat. In India and Turkey, uncertainty exists about whether choice of a foreign seat by two local companies can be defended, if challenged. This uncertainty can expose a foreign parent company to litigating the dispute in local courts.

Other Considerations

Local arbitration laws might also include unique requirements governing domestic proceedings. Global companies entering into contracts through local affiliates should review local arbitration laws to avoid any surprises should a dispute arise. Country-specific requirements vary widely.

China and Kuwait do not allow local parties in domestic disputes to select their own procedural rules. Colombia places several restrictions on parties' abilities to select arbitrators, including the requirement that all arbitrators be Colombian nationals and lawyers qualified to practice in the country. Indonesia stipulates that the default language of arbitration is Indonesian and parties' selection of any other language is subject to consent of the arbitral tribunal. Turkey requires that an arbitral agreement be written in Turkish, though parties can use another language as long as Turkish is also used. And Israel incorporates more than a dozen implied provisions covering disclosure and discovery procedures as well as the use of experts in domestic arbitration. These provisions apply unless the parties explicitly agree otherwise.

Even if not otherwise restricted in the choice of governing law or seat of arbitration, local affiliates may find that business considerations or the bargaining power in negotiations between local affiliates and their counterparties limit their options regarding the governing law and seat of arbitration. In those circumstances, global companies should give careful consideration to the dispute resolution procedures to understand their rights and remedies under local law.

Government Contracts

Many local arbitration laws contain special requirements for contracts with government entities. Global companies should carefully review these provisions to ensure the validity of the arbitration clauses in their contracts. In Saudi Arabia, for example, government agencies are not permitted to arbitrate disputes without first obtaining consent of the president of the Council of Ministers, or unless otherwise permitted by a legal enactment. Similarly, in Egypt an arbitration clause in a government contract requires approval from a head of the government agency, while in Israel a sign-off from the attorney general is required. In Kazakhstan, an arbitration agreement with a state agency or any company in which the state owns more than a 50 percent stake requires the consent of an appropriate regulatory body. Arbitration clauses are invalid without such approval. Dubai requires that, unless a special exception is obtained in advance, arbitration agreements with a local government agency be seated in the Emirate of Dubai and subject to local contract laws.

Conclusion

Arbitration remains a preferred dispute resolution mechanism in cross-border transactions. It gives parties autonomy and flexibility in resolving their disagreements and provides a neutral forum, away from local courts. Arbitration awards are also easier to enforce across jurisdictions than court judgments. To benefit from the many advantages arbitration has to offer, companies should be mindful that arbitration clauses must reflect local requirements, which can vary significantly. There is no one-size-fits-all solution. One possibility includes adding a parent company or other non-domestic subsidiary to a contract, which often renders a dispute “international” and protects selections made in the arbitration clause. This solution, however, can result in tax implications and expanded liability for the parent company. Ultimately, companies drafting a contract — especially one signed by a local affiliate — should ensure the dispute resolution clause and governing law provisions are valid and enforceable.

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