SIXTH CROATIAN ARBITRATION DAYS
NEW ARBITRABILITY LIMITS
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TRACING ONE INTERNATIONAL *AD HOC* ARBITRATION

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1. INTRODUCTORY REMARKS

Most disputes in international arbitration practice are resolved before institutional arbitration courts. Less is known about *ad hoc* international arbitration. The professional public engaged in arbitration theory and practice ought to be better informed about this area of arbitration. The case analyzed in this article includes issues of arbitration proceedings, the rendering of a partial award, the legal standard for recognition and enforcement of the partial award and other matters that might contribute to arbitration practices.

2. BASIC DATA OF THE DISPUTE

In this particular arbitration case, the parties in dispute were one Croatian company (claimant, later on counter-respondent) and one Bulgarian company (respondent, later on counter-claimant). The proceedings lasted for five years, starting from May 1993 to August 1998 before an *ad hoc* arbitration tribunal with the seat in Bern, Switzerland.

The arbitration dispute arose from four contracts on investment projects abroad. All of them contained the following arbitration clause:

1. The contracting parties shall make efforts in direct informal negotiations to achieve an amicable solution of any dispute or controversy arising from this contract or order.
2. In case an amicable solution of any dispute or controversy could not be reached within a period of three months from the commencement of informal negotiations, each party is entitled to request final resolution of the dispute by arbitration.
3. The arbitration proceedings shall be conducted in accordance with the UNCITRAL Arbitration Rules as now in force.
4. The number of arbitrators shall be three, appointed in accordance with the said Rules. The seat of arbitration shall be in Bern, Switzerland. The language of the proceedings shall be English."

The claimant raised several claims in the Notice of Arbitration, including the payment of invoices and liquidated damages as well as return of its equipment, so that the amount in dispute was USD 1,510,000.00. In the course of the proceedings, the respondent filed a counter-claim, in which it demanded the return of the pre-paid amount and the compensation of damages, altogether amounting to USD 1,475,000.00. Consequently, the total amount in dispute was, without calculating ancillary expenses, USD 2,985,000.00.

At the end of proceedings, the claimant succeeded with its claims in the amount of USD 1,274,000.00, withdrew the request for USD 165,000.00 and was denied claims in the amount of USD 71,000.00. The respondent's counter-claim in the amount of USD 1,475,000.00 was denied in its entirety. Therefore, the claimant received 92% of its claims, and the respondent succeeded in countering 8% of the claim. The arbitration

tribunal determined the distribution of arbitration costs according to these percentages, not including the expert fee, which were USD 170,000.00. The expert fee amounted to USD 55,000.00 and the respondent/counter-claimant was obliged to bear them in total, and to compensate the claimant/counter-respondent for costs in amount of USD 179,000.00

3. ARBITRATION PROCEEDINGS

Prior to the commencement of the arbitration proceedings in May 1993, the claimant initiated informal negotiations in accordance with the arbitration clause. The respondent did not respond to the invitation for informal negotiations, so the claimant, in accordance with Art. 3 UNCITRAL Arbitration Rules, submitted to the respondent a Notice of Arbitration upon which the arbitration proceedings commenced.

In accordance with Art. 7(1) UNCITRAL Arbitration Rules, the claimant appointed a Croatian citizen as one of the arbitrators in the Notice of Arbitration. The respondent should have appointed the second arbitrator, but failed to do so within 30 days after receipt of the claimant's notice on appointment of the arbitrator. Considering that the parties had not determined the appointing authority in the arbitration clause, the respondent caused a delay in the constitution of the arbitration tribunal. At the claimant's request, the Secretary General to the Permanent Arbitration Court in the Hague, acting according to the authority vested by Art. 7(2)(b) UNCITRAL Arbitration Rules, appointed a Swiss attorney as the appointing authority. The claimant requested the appointed authority to appoint the second arbitrator. He did so by appointing, at his discretion, a Swiss citizen. Immediately after this appointment, the two arbitrators appointed a German citizen as the third arbitrator, who acted as the presiding arbitrator. Finally, ten months after commencement of arbitration, the arbitration tribunal was constituted in March 1994.

During the arbitration proceedings, the parties presented written statements describing their cases in detail and responded repeatedly to all facts and legal issues relevant to the result of the proceedings. Only three hearings were held, of which two were argued; one was held in Bern, Switzerland, the other in Munich, Germany. Between the two hearings, in accordance with Art. 16(3) UNCITRAL Arbitration Rules, one hearing (an inquiry) was held in Kozloduj, Bulgaria, for determination of facts and collection of evidence for the experts. The arbitration tribunal rendered 22 procedural orders, two partial awards on the substance of the dispute, one supplemental and one final award. All awards were rendered in written form. The procedural orders were signed by the presiding arbitrator. In accordance with Art. 32 UNCITRAL Arbitration Rules, the awards on the substance of the dispute contained a detailed explanation, were signed by all arbitrators, who subsequently, at the claimant's request, authenticated their signatures by a notary's verification. Upon the special request of the claimant, the arbitrators issued a certificate stating that they had personally been members of the arbitration tribunal with the seat in Bern in February 1995, had rendered the first partial award, and that the said award was final, binding and enforceable. The certificate was issued in October 1997 in the Bulgarian language, and the arbitrators' signatures were verified by a Bulgarian notary public.

The first partial award was rendered at the claimant's request after the hearing in Bern in February 1995. By that award, the arbitration tribunal accepted the majority of the claimant's requests for payment, denied two of the respondent's requests and determined that in the further course of proceedings it would decide upon the request for return of the equipment. After the partial award was rendered, the respondent requested permission to submit a counter-claim. Although Art. 19 UNCITRAL Arbitration Rules determines that a counter-claim may be filed in the statement of defence, the arbitration tribunal allowed filing of the counter-claim in March 1995, nine months after the filing of the statement of defence, deeming that circumstances justifying the delay are likely to exist.

The arbitration tribunal rendered the second partial award in September 1995 without holding a hearing. By that award, the tribunal dismissed the two main requests of the respondent/counter-claimant, and continued the proceedings with respect to the remainder of the respondent/counter-claimant's requests for return of the previously paid amount. The proceeding also continued with respect to the claimant/counter-respondent's request for return of the equipment. The arbitration tribunal accepted the request of the respondent/counter-claimant for conducting an expert evaluation to determine the state of the equipment and circumstances under which the claimant/counter-respondent had failed to perform the work for which it received a partial payment.

The evaluation should have been performed by specialists for inspection of nuclear plants and equipment. For that reason, the arbitration tribunal prepared the Terms of Reference for the specialists, on which the parties had repeatedly commented. The arbitration tribunal approached the International Atomic Energy Agency (IAEA) in Vienna for specialists. Since none of the recommended persons accepted the appointment the arbitration tribunal requested the recommendation of the International Centre for Experts at the International Court of Arbitration of the International Chamber of Commerce (ICC). The process of appointing the expert became so drawn out that the claimant/counter-respondent withdrew the request for return of equipment, after which the arbitration tribunal informed the parties that, in accordance with Art. 34(2) UNCITRAL Arbitration Rules, it shall close the proceedings on that issue. The other party did not object to withdrawal of the request for return of the equipment.

The arbitration tribunal appointed the main expert and his assistant in June 1996. The evaluation encompassed the determination of all relevant facts and circumstances under which the claimant/counter-respondent failed to perform the contracted works. The arbitration tribunal submitted to the experts the Terms of Reference, the contracts, the two partial awards already rendered and documents submitted by the parties for expertise. The parties had the opportunity to respond to the experts' questions and reply to the other party's statements delivered to the experts. Since the respondent/counter-claimant requested that the experts perform the evaluation at the nuclear plant where the works were performed, the arbitration tribunal scheduled a special hearing for that purpose in Kozloduj. The tribunal decided that all arbitrators should be present for possible resolution of procedural issues, even though it was not a hearing. At that time, in October 1997, the parties replied to additional questions from the experts and submitted some additional documents. The experts submitted their evaluation to the arbitration tribunal in January 1998 and after the parties had repeatedly responded to the evaluation, the final hearing was scheduled for June 1998 in Munich. At that hearing, the parties and the

arbitration tribunal asked the experts certain additional questions, and the parties gave some additional statements with respect to the subject matter of the dispute.

The arbitration tribunal rendered the final arbitration award in August 1998, by which it denied the remainder of the respondent/counter-claimant's claim, decided the costs of the proceedings and determined that the parties should bear costs in proportion to their success in the dispute.

4. PROCESS OF RECOGNITION AND ENFORCEMENT OF THE ARBITRAL AWARD

The process of recognition and enforcement of the first partial arbitral award, rendered in February 1995, was initiated in Bulgaria before the City Court of Sofia at the request of the claimant in November 1995, therefore, while the arbitration proceedings continued with respect to the remainder of the claims. The request for recognition and enforcement was submitted on the grounds of the New York Convention on Recognition and Enforcement of Foreign Arbitral Awards (hereinafter NYC), since Bulgaria is a member of the NYC from 1961. In accordance with Art. IV(1) NYC, the claimant as the party in the process of recognition and enforcement of the award was obliged to enclose with the request:

1)

   a) a duly authenticated original award or duly certified copy thereof;
   b) original of the arbitration agreement or copies which comply with all necessary requirements for its authenticity;

2) translation of these documents in Bulgarian certified by a sworn court interpreter of a diplomatic or a consular agent.

In accordance with the cited provision, the claimant submitted to the competent court the authenticated copies of the following documents:

   a) the first partial arbitral award,
   b) contracts containing the arbitration clause,
   c) excerpt from the Court Registry of the Commercial Court in Zagreb on registration of the claimant.

All copies of the said document were certified by a notary public in Zagreb, whose signature was authenticated by the apostille of the Municipal Court in Zagreb. Pursuant to Art. 1(2) The Hague Convention Abolishing the Requirement of Legalization for Foreign Public Documents, the documents certified by a notary public are considered foreign public documents. The applicant called upon the provision of the Agreement on Mutual Legal Aid between ex FNR of Yugoslavia and NR of Bulgaria of 1956, since the Republic of Croatia and the Republic of Bulgaria agreed to apply all contracts of the ex-Yugoslavia and Bulgaria on the basis of succession until the conclusion of new agreements regulating the same issues.

The counter-party contested the request for recognition and enforcement by raising the following objections:

1. that the enforcement of a partial award may not be requested; that a partial award may not be enforced; that the Arbitration tribunal had not finally decided all requests in the proceedings;

2. that the documents submitted had not been certified by a diplomatic or a consular office as required by NYC;

3. that the arbitration award whose recognition and enforcement was sought had not been duly certified and that pursuant to Art. IV(l)(a) NYC the arbitral award, or the copies thereof should be duly certified;

4. that Art. 193 of the Swiss Federal Law on International Private Law requires that the enforceability of the award is confirmed by the state court of the seat of arbitration, but such certificate had not been enclosed.

The applicant contested all of the objections raised.

The City Court of Sofia in November 1997 denied all objections of the counterparty and accepted the request for recognition and enforcement of the first partial award of the Arbitration Tribunal in Bern on the territory of the Republic of Bulgaria.

In the explanation of its decision, the Court emphasized that it is not disputable that the arbitration is validly conducted in accordance with the UNCITRAL Arbitration rules and that the Award had been signed by three arbitrators, as required by Art. 32, paragraph 4 of the Rules.

The permissibility of the request was considered by the Court within the legal regime of the NYC, ratified in Bulgaria in 1961. Considering that the NYC contains detailed provisions on the procedure, way and grounds of recognition and enforcement of foreign arbitral awards, the Court decided that the provisions of the Chapter XXXII of the Civil Procedure Code - "Recognition and Enforcement of Foreign Judgments" should not apply.

The court further pointed out that there is an Agreement on Legal Aid concluded in 1956 between ex FNR of Yugoslavia and NR of Bulgaria, which is in force between Bulgaria and Croatia on the grounds of succession and that the verifications performed by the notary public in Zagreb and the Municipal Court in Zagreb might be accepted in accordance with that agreement.

Moreover, all documents submitted satisfy the requirements from Art. IV NYC, which does not require that the award is deposited or that it contains an enforceability clause of the state court of the country of the seat of arbitration or of the law applicable. The Court refers to the English text of the NYC which uses the term "duly authenticated original". Because the NYC does not contain any provisions regulating the law under which the authentication should be performed, the Court took the position that it should be done according to Bulgarian law. According to the Court, the term "duly authenticated" should mean the authenticity of the arbitrators' signatures. Besides, the Court established that the claimant presented the Court with the original of the award at the previously scheduled hearing and the counter-party recognized it as such. The Court decided that there is no reason to apply Art. 305 of the Bulgarian Civil Procedure Code, because *lex specialis* was applicable.

NYC does not refer to the application of Swiss law. Art. 193 of the Swiss Law on International Private Law does not apply because of the system of double *exequatur*. That means that the activities of the state courts of the state in which the decision was rendered and in which the *exequatur* is requested would be duplicated. This request is close to the Geneva Convention of 1927, but is entirely contrary to the requirements of the NYC, which abandoned the term 'final' and substituted it with the term 'binding on the parties'.

The Court considered that the partial award complied with Art. 32 of the UNCITRAL Arbitration Rules, and is final and binding on the parties and therefore may be subject to a request for recognition and enforcement because it contains all the characteristics of a matter adjudicated (**res iudicata**).

The counter-party filed an appeal against the first instance decision of the City Court of Sofia. The Appellate Department of the City Court of Sofia decided upon the appeal and cancelled the first instance decision by its resolution of October 1998 and denied the request for recognition and enforcement of the first partial award in Bulgaria entirely.

The Appellate Department briefly noted that the first instance decision, which allowed recognition and enforcement of the first partial award on the territory of Bulgaria, was incorrect. Namely, the first instance court allowed recognition and enforcement of an award which is partial and not final, and the arbitral award was not verified by award and the court of the state in which the award was rendered, all of which is regulated by Art. 305 of the Bulgarian Civil Procedure Code.

The applicant submitted the appeal against the second instance resolution, upon which the Supreme Court of Bulgaria will decide. The appeal puts forth the same arguments which the City Court of Sofia used to explain the first instance resolution by which it accepted the request for recognition and enforcement of the first partial arbitration award. In addition, the appellant called upon the fact that the file contained the Certificate of the Arbitration tribunal in the Bulgarian language, issued October 1997, certifying that the first partial arbitration award is final, binding and enforceable. And so, the process of recognition and enforcement of the first partial arbitration award continues.

5. FINAL REMARKS

This arbitration case shows that the success and efficiency of arbitration proceedings depend on the whole sequence of connected circumstances.

Arbitration clauses should be very carefully stipulated and should foresee appropriate solutions in case any party acts contrary to *bona fide* principles. The choice of an *ad hoc* or an institutional arbitration should be made with a good understanding of the rules of procedure, organization and method of each and every arbitration, because each type has its own advantages and disadvantages.

In this case, the counter-party managed to successfully obstruct the commencement of arbitration for a longer period of time because the arbitration clause allowed informal negotiations in which the counter-party did not participate. The arbitration clause also failed to determine the appointing authority in advance, but it should have been determined in accordance with the arbitration rules applicable. In an institutional arbitration, the latter deficiency would have been eliminated much faster.

The organization of the arbitration proceedings was not planned in advance, so the arbitration tribunal acted in belief that it would be efficient to clarify the matter factually and legally in writing before holding a hearing. For the most part, it was a good decision, except for the expert evaluation, which could have been performed after hearing oral argument that would clarify whether such an expensive, complex and time consuming process is really necessary for the correct resolution of the dispute.

Furthermore, the arbitration proceedings would have been much more efficiently conducted if the arbitration tribunal had advised the respondent of the possibility to file a counter-claim in the statement of defence. In that way, the filing of the counter-claim after expiry of the deadline regulated by the arbitration rules, without any valid explanation for such delay, would have been avoided. The presentation of the case clearly shows that only the rendering of the first partial award motivated the respondent to file a counter-claim.

There remains a dilemma whether the arbitration tribunal could, under the described circumstances, contribute to higher efficiency of the award recognition and enforcement procedure, since it has been aware of the objections of the counter-party regarding the form, authenticity, certification and delivery of the award already during the proceedings. Or, maybe, it was beyond its responsibility once the award was passed.

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