Some Problems in International Commercial Arbitration with Developing Countries*

Byung-Sun Oh**

I. Introduction

In recent years on the international level, there has been a dramatic increase in the number of arbitration proceedings undertaken to settle transnational commercial disputes.¹ This trend has encouraged the development of new and increasingly sophisticated arbitration tools and techniques. In the past, arbitration proceedings tended to be simple informal affairs, handled primarily by small groups of commercial lawyers in cities such as Paris or London who had little, if any, litigation experience. The modern international commercial dispute submitted for arbitration usually resembles a highly complex commercial litigation case, involving millions or even hundreds of millions of dollars, and is often handled by the trial section of a major U.S. or foreign law firm.²

Proponents of arbitration often point to its advantages of speed and economy.³

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* This paper was originally written as a term paper at New York University Law School but slightly revised here for the publication purpose. The author would like to thank Professors Theodor Meron and Martin Domke for providing stimulating intellectual support and highly useful criticism.

** Manager of Legal Section, Planning Dep't, Korea Exchange Bank.

(1) The International Chamber of Commerce (ICC) in Paris has seen a substantial rise in the number of cases heard by its Court of Arbitration. From an average of ten cases a year in the late 1940's and early 1950's, the Court now arbitrates between 150 and 200 disputes every year. Thompson, "The Procedure under the Rules of the ICC", in International Commercial Arbitration 180 (C. Schmitthoff ed.: 1974).


(3) See, Joseph T. McLaughlin, "Arbitration and Developing Countries", 13 Int'l Lawyer 211 No. 2 (Spr. 1979).
These benefits may be illusory, because an obstructive party can make expenses and wasted time accumulate in any dispute. However, arbitration does have other unique advantages. Party-appointed arbitrators are often experts in the commercial field involved in an arbitration, and thus may be more sensitive to the factual concept of the dispute than a judge would be. Procedure in arbitration is generally more flexible than in a lawsuit, and the entire proceeding including award, is usually private. When the parties wish to maintain their commercial relationship, as is often the case in long term transactions, arbitration is less likely to disturb the framework of the arrangement than full scale litigation.\(^4\) Furthermore, if a spirit of cooperation does exist, arbitration will usually be quicker and more economical than a lawsuit.\(^5\)

However, despite the many positive attributes of arbitration and its widespread use throughout the world, arbitration does not provide the definitive answer to all international disputes. Many developing countries are reluctant to resort to international arbitration.\(^6\) Latin American countries have long viewed arbitration with misgivings. Many of these countries continue to adhere to the Calvo doctrine which severely restrains the creation of third party adjudicative devices for resolving disputes.\(^7\) Originally formulated as a defense against European intervention, the doctrine has long been regarded as a major hindrance to the flow of trade in Latin America.\(^8\)

Also it is observed that almost all countries in sub-Saharan Africa have adopted modern arbitration statutes and are parties to the Treaties of Friendship, Commerce and Navigation.\(^9\) Many of these countries hesitate to enforce


\(^6\) Joseph T. McLaughlin, supra 215.


\(^8\) Ibid.

awards of foreign arbitral tribunals or to accept the application of foreign law to the resolution of conflicts involving a state entity. Under such circumstances, such countries prefer to resort to their national courts.\(^{(10)}\)

Despite the view of some developing countries, arbitration clauses have become the usual practice in most international trade contracts and are almost invariable rule in contracts involving East-West and U.S.-China trade.\(^{(11)}\)

But while there is acceptance of the fact that arbitration is the preferred method for settling disputes, businessmen wishing to include an arbitration clause in an international contract find themselves faced with a bewildering choice of alternative rules, administrative organizations, appointing authorities, and applicable laws. As a result, there are move throughout the international business community to seek some common principles and procedures for the conduct of international commercial arbitrations.\(^{(12)}\)

There are now in existence a number of international conventions which serve to enforce the recognition of arbitration agreements and the enforcement of awards. Among them following two are of the greatest importance.


The Convention on the Settlement of Investment Disputes between States and National of other States of 1965 (1965 World Bank Convention)\(^{(14)}\)

The importance of the 1958 New York Convention is demonstrated by the fact that almost all the important trading nations are parties to it.\(^{(15)}\) Under

\(^{(10)}\) Joseph T. McLaughlin, supra 215.


\(^{(12)}\) Ibid.


the Convention, the parties making arbitral agreements must still allow for the possibility that their award might be held invalid on general public policy grounds. This gives a wide degree of latitude to the local courts, especially when the case will have an important effect upon the national interests of the host country. It is hoped that this escape clause will not be used indiscriminately but the possibility remains open.\(^{(16)}\)

1965 World Bank Convention facilitates the resolution of disputes arising between States and foreign investors doing business within those States. The Convention establishes the International Center for Settlement of Investment Disputes at the World Bank Headquarters in Washington, to which parties can voluntarily submit their difference for binding arbitration.\(^{(17)}\)

Before entering into next main sections, let’s see briefly the development of Korean system of international commercial arbitration. After Korea introduced a system of international commercial arbitration by having enacted the Arbitration Act on May 16, 1966, it became a member country to the 1958 New York Convention on May 9, 1973.

By that, Korea began to gain international effect (of recognition and enforcement) on its award rendered in its arbitral tribunal from other member countries to the above Convention, also it began to be guaranteed for foreign arbitral award to be recognized and enforced in Korea.

Upon entering into the 1958 New York Convention, Korea declared two reservations, namely, the principle of reciprocity and restriction on commercial nature; that is,

By virtue of paragraph 3 of Article 1 of the (said) Convention, the Republic of Korea declares that it will apply the Convention to the recognition and enforcement of arbitral awards made only in the territory of another Contracting State. It further declares that it will apply the Convention only to differences arising out of legal relationships, whether contractual or not, which


\(^{(17)}\) See, supra note 14.
are considered as commercial under its national law.

In the meantime, Korea signed and ratified the 1965 World Bank Convention with other 85 trading IBRD member states.

Recently in Korea, we can see an increasing trend in number of international trade claims and arbitral awards rendered on those disputes along with rapidly expanding international business transactions contributed by the Government’s export drive policy.

Thus many businessmen and government officers began to show a great concern to international commercial arbitration as an efficient scheme for settling the international trade disputes.

In the following sections, I’d like to see, first, the major systems of international arbitration. And then I will examine some acute problems in international commercial arbitration which has particular relevance to the developing countries. They are, first, the choice of forum and the choice of law problems. Next one is the problem arising in host state’s guarantee not to repudiate contractual agreement in the long term economic development contract, namely, the problem of applicability of international law principle with respect to the host state’s unilateral repudiation of contractual guarantee. Finally, I’ll deal with the public policy defense problem which might be possible loophole in international arbitration as to the matter of recognition and enforcement of foreign arbitral awards.

II. Major Systems of International Arbitration

If a party in a developing country does not insist (or have the bargaining power to insist) an arbitration or traditional litigation within its borders, it can choose from a variety of recognized international arbitration systems. These systems differ in many respects, including the amount of administrative costs and arbitrators’ fees, the method of selecting arbitrators, the procedural and evidentiary rules, and the form and content of the arbitral award.
Recognizing the multiplicity of available arbitration systems throughout the world, it is still possible to identify some of the more prominent systems of international arbitration as follows:18

1. The Rules of the International Center for the Settlement of Investment Disputes ("ICSID")

ICSID Arbitration

The ICSID is an intergovernmental agency created in 1966 by the Convention on the Settlement of Investment Disputes between States and Nationals of Other States. The Center's authority is limited to investment disputes in which one of the parties is a state ("host state").19 Signatories to the Convention included the industrialized Western nations and many of the developing countries of Africa, Asia, the Middle East and the Caribbean.20 The ICSID was designed to facilitate investments in developing countries by providing a specialized mechanism of investment dispute settlement. It offers facilities for arbitration and/or conciliation of disputes.21 The Center’s decision is not subject to review by the courts of the Contracting State. The decision of the Arbitration Panel is binding on the parties and enforceable under the rules of international law.22 The Center acts as supervisor of the proceedings and provides certain procedural rules.23

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(18) See, Joseph T. McLaughlin, supra 221-222. He deals with Rules of the Arbitration Institute of the Stockholm Chamber of Commerce ("SCC") (1976) in addition to above four systems.
(19) See, the Convention, Art. 25(1), (2).
(20) As of March 1978, there were 76 signatories to the Convention.
(21) See, the Convention, Art. 1(2).
(22) See, Ibid., Art. 53,54. Thus, some writer says, ICSID awards are truly "supranational". Peter S. Smerdresman, supra 306.
(23) See, Ibid., Art. 3, 62, 63.
The ICSID is particularly appealing to the developing countries. A state is not obligated to use its facilities even after it has signed the Convention. The state consents to the Center’s jurisdiction when the dispute arises. Once consent is given, it may not be withdrawn unilaterally.\(^{(24)}\) The state may also require that the investor resort to its local courts\(^{(25)}\) as a prerequisite to invoking the jurisdiction of the ICSID.\(^{(26)}\) Moreover, unless the parties agree to the contrary, the law to be applied in the arbitration of the disputes is that of the host country.\(^{(27)}\)

It is proposed to consider the operation of the arbitration clauses under the Convention in the case of the investor who, having carried political risk insurance, suffered a loss as a result of an action by the host state covered by the insurance, presented a claim against the insurer, and was indemnified.\(^{(28)}\)

Assuming that the insurer was subrogated to the rights and claims of the insured investor, can the insurer benefit from the arbitration clause and bring proceedings against the host state?

The Convention is silent as to the assignability of ICSID arbitration agreement and there is no reason to consider that assignment is not permitted, as long as the assignee or successor has the status of a private entity and a national of another Contracting State required by the Convention.\(^{(29)}\) But a difficult question arises where the insurer is an agency or an institution of the State (such as Overseas Private Investment Corporation in the U.S. or the British Export Credits Guarantee Department).

A State (including an agency or an institution of the State) could not be party to the arbitral proceedings, even when appearing as subrogee, because of the explicit and strict jurisdictional limits laid down in the Article of the

\(^{(24)}\) Ibid., Art. 25(1).
\(^{(25)}\) Ibid., Art. 27.
\(^{(26)}\) Ibid., Art. 26.
\(^{(27)}\) Ibid., Art. 42.
\(^{(29)}\) Ibid., at 306.
Convention. (30)

One way of resolving the above problems raised by the issue of subrogation taken by OPIC in relation to an ICSID arbitration is to provide in the bilateral agreement between the host country and the government of the investor, both for the subrogation of the Government of the investor to the rights of the investor following remittance of the insurance payments and, more importantly, that such payments shall not affect the rights of the insured investor to proceed before an ICSID arbitration. (31)

In sum, the ICSID arbitration is very closely administered and supervised arbitration which contains many safeguards, having particularly in mind the position of States which are parties to proceedings. (32) It is significant to note that even the ICSID, which seems to provide sufficient safeguards to allay fears of an institutionalized Western bias, has been unable to attract Latin American countries to accede to the Convention. (33) This may in part be explained by Article 42(1) of the World Bank Convention which suggests that, although the parties are free to choose whatever law they wish to govern the arbitration, the law chosen may be overridden by the Center’s application of the standards of international law. Some Latin American countries believe this Article raises the possibility of Western bias in the ICSID. (34)

2. The ICC Court of Arbitration

In contrast to the ICSID, the ICC provides a non-specialized mechanism for

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(30) A body such as the U.S. OPIC, an agency of the U.S. Government (under the policy guidance of the Secretary of State) to stimulate private investment in developing countries through guarantees of American investors, created under the Foreign Assistance Act of 1969, would be clearly ineligible as a party. See, ibid., at 307, footnote 3.


(32) Joseph T. Mclaughlin, supra 22/.

(33) Latin Countries have consistently refused to become parties to international arbitration conventions. Only Ecuador and Mexico have ratified the 1958 New York Convention. No Latin countries are parties to the 1965 World Bank Convention. As of yet, no states have ratified the 1975 Inter-American Convention on International Commercial Arbitration.

(34) Alden F. Abbott, supra 138–139.
dispute settlement. Any type of international dispute may be submitted. The ICC Court of Arbitration provides the rules of conciliation or arbitration and supervises the application of these rules by the arbitrators.\(^{(35)}\)

The rules of procedure in ICC arbitration are somewhat vague. The parties often embark on an ICC arbitration totally unaware of matters such as the permissible scope of discovery, if any, the right to a complete transcript of the oral proceedings, the right to present witnesses, both lay and expert, and the right to both direct and cross-examination of such witnesses.

The drafting and execution of the terms of reference are required by the ICC Rules.\(^{(36)}\) This document is designed to aid the arbitrators in their assessment of the questions presented for resolution, but the preparation of the terms of reference is an expensive and time-consuming procedure which may become, in effect, a “mini-arbitration”.\(^{(37)}\)

3. The American Arbitration Association

The facilities of the AAA offer yet another alternative to parties engaged in international commerce. The AAA rules of procedure, in sharp contrast to those of the ICC, are quite, specific.\(^{(38)}\) A description of claims and defenses, proofs and witnesses must be provided by both parties. Power to decide what evidence may be introduced is shared by the parties and the arbitrators. Such choices are not within the sole discretion of the arbitrators. Unlike the ICC, the AAA Rules do not provide for the preparation of terms of reference. The parties may submit, however, statements clarifying the issues involved.\(^{(39)}\)


\(^{(36)}\) Ibid., at 27. See, the Rules. Article 9(3), (4).

\(^{(37)}\) Joseph T. McLaughlin, supra 226.

\(^{(38)}\) AAA is the only organization in the U.S. which is not limited as to trade, geographical area or type of case. Most international cases are administered by the AAA under its Commercial Arbitration Rules. See, Howard Holtzmann, “United States of America: The American Arbitration Association”, E. Cohn, M. Domke and F. Eisemann (ed.), supra *Handbook*, pp. 251–272.

\(^{(39)}\) Ibid., at 261.
The broad public policy in the United States favours and encourages amicable settlement of all disputes by the parties themselves, rather than resorting to judgments of courts or awards of arbitrators. The AAA Rules reflected this policy and provide that "if the parties settle their dispute during the course of the arbitration, the Arbitrator, upon their request, may set forth the terms of the agreed settlement in an award" (§43).\(^{(40)}\)

4. Arbitration under the UNCITRAL Rules

The United Nations Commission on International Trade Law (UNCITRAL) promulgated comprehensive arbitration rules which were adopted by the General Assembly of the United Nations on December 15, 1976. The UNCITRAL Arbitration Rules are designed for worldwide use. They are intended to be acceptable in both capitalist and socialist systems, in developed and in developing countries and in Common law and Civil law jurisdictions.\(^{(41)}\)

Where parties have agreed in writing that disputes relating to their contract shall be referred to arbitration under the UNCITRAL Arbitration Rules, then such disputes will be settled in accordance with these Rules, subject to such modifications as the parties may agree upon in writing.\(^{(42)}\) The Rules were designed to facilitate the arbitration of disputes arising out of international trade transaction. However, they do not attempt to prohibit their use outside this field.\(^{(43)}\)

The Rules (like other arbitration rules) provide that the parties may designate the law applicable to the substance of the dispute. In the absence of such a designation, the arbitral tribunal shall apply the law "determined by the conflict of law rules which it considers applicable".\(^{(44)}\) The UNCITRAL Arbitration Rules, reflecting the latest developments in the field of international commercial

\(^{(40)}\) Ibid., at 265-266.
\(^{(42)}\) UNCITRAL Rules Art. 1(1).
\(^{(44)}\) UNCITRAL Rules, Art. 33(1).
arbitration, may also have a harmonizing effect on other arbitration rules. Indeed, this has already occurred. For example, the new Arbitration Rules of the Inter-American Commercial Arbitration Commission follow almost word-for-word the text of the UNCITRAL Arbitration Rules.\(^{(45)}\)

These four systems vary significantly with respect to numerous issues and, before selecting a particular system, they should be compared in detail. Even after the selection of an institutional system is made, however, the draftsman should be aware that the arbitration rules selected will not answer every question which may arise. Thus, careful thought should be given to restructuring or adding rules, where appropriate, to conform to the needs of the parties. Of course, each system has positive and negative aspects which must be weighed in order to determine what is best suited to the needs of particular parties.

III. Some Problems in Arbitration with Developing Countries

1. Choice of Forum

The initial concern when drafting a transnational agreement is to determine first, the forum for resolving disputes related to the agreement, and secondly, the law governing its validity, interpretation and performance. Preselection of forum and of law provide reasonable predictability of the law that will be applied in the event of a dispute.\(^{(46)}\) In modern-day drafting, rights and obligations are generally specified within the written agreement, yet, this does not dispense of the need for a choice of law clause. Rights and obligations, even if detailed, cannot be construed in a vacuum. The chosen law will determine their validity and effect and the forum selected by the parties will ensure that their choice of law is upheld and applied.\(^{(47)}\)

\(^{(45)}\) Pieter Sanders, supra 467-468.


An investor contemplating arbitration as a dispute resolution mechanism in a contract governing an international transaction with a party located in a developing country must recognize that there may be impediments to its use. The choice of an arbitral forum raises highly significant issues. Developing countries are unwilling to see their disputed commercial relations determined by Western-oriented arbitral bodies outside their countries. At the same time, the investor will probably want to avoid resolution of any dispute in the courts of a developing country where nationalistic sentiments may be perceived as militating against a just and impartial decision. The classic solution would be to agree to arbitration in a third country under internationally recognized rules.\(^{48}\) However, when the contracting party in the developing country is the government itself or one of its agencies, it may be adverse to such an arbitration on the grounds that submission to arbitration in a third country would constitute an affront to its dignity as a sovereign. Accordingly, the government may insist on some dispute resolution procedure within its own borders.\(^{49}\)

However, it is generally observed that in the context of international contracts, choice of forum clauses may be extremely useful devices, and consequently their occurrence is relatively common.

In the view of the parties to the contract, the usefulness, and therefore the desirability, of a choice of forum provision is obvious: there are numerous inherent uncertainties for all involved when dealing and contracting across national boundaries, and any device which tends to render multinational transactions less uncertain is sure to reduce the complexity of disputes and result in a greater feeling of security on behalf of the parties and more stability in the entire transaction.\(^{50}\)

A choice of forum clause may provide more certainty in several respects.

\(^{48}\) Joseph, T. McLaughlin, supra 217.
\(^{49}\) Ibid., at 218.
First, it can obviate a jurisdictional struggle between the courts of nations which in fact have personal jurisdiction by selecting a single forum to hear and determine all disputes under a given contract. Parties will be well aware of where they will have to go should a disagreement arise and can thus plan in advance.

Second, it is a flexible device which allows parties to tailor the dispute resolution mechanism to their particular situation. They may select a forum which is convenient for both sides; they may choose a forum because of its neutrality, or because of its expertise in the particular subject matter of the contract. Further, a choice of forum clause may act to complement a specific choice of law, thereby permitting the chosen court to interpret and apply its own law, presumably because it is better suited to do so than any other court.\(^{(51)}\)

Since forum selection clauses are desirable from the standpoint of the parties to the international transaction because of the resulting added stability, they also tend to encourage trade by negating the fear of the vagaries of unfamiliar and fortuitous foreign courts. This relative certainty is an extremely important element in the formulation of private international agreements. In fact, we can say that advance determination of the forum is the best method of avoiding jurisdictional controversies in an age which has not yet developed a truly international jurisdiction.\(^{(52)}\)

Now let’s examine the some examples of countries attitude toward contractual choice of forum clauses.

In 1972, the U.S. Supreme Court in the landmark case of M/S Bremen v. Zapata Off-Shore Co.\(^{(53)}\) upheld a forum selection clause in an international maritime towing contract, which selected a London court as the place to resolve future disputes. The Supreme Court gave an approval to all forum selection

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\(^{(53)}\) 407 U.S. 1(1972); 32 L. Ed. 2d 513; 92 Sup. Ct. 1907 (1972).
clauses, but limited its approval to just and reasonable clauses and also noted that:

"For at least two decades we have witnessed an expansion of overseas commercial activities by business enterprises based in the United States. The barrier of distance that once tended to confine a business concern to a modest territory no longer does so. Here we see an American company with special expertise contracting with a foreign company to tow a complex machine thousands of miles across seas and oceans. The expansion of American business and industry will hardly be encouraged if, notwithstanding solemn contracts, we insist on a parochial concept that all disputes must be resolved under our laws and in our courts......"

"In an era of expanding world trade and commerce, the absolute aspects of doctrine of the Carbon Black Case\(^{(54)}\) have little place and would be a heavy hand indeed on the future development of international commercial dealings by Americans. We can not have trade and commerce in world markets and international waters exclusively on our terms, governed by our laws, and resolved in our courts......"\(^{(55)}\)

The Court concluded that the forum clause should control absent a strong showing that it should be set aside.

In 1974, the U.S. Supreme Court decided *Scherk v. Alberto Culver Co.*\(^{(56)}\) and upheld an arbitration clause in an international commercial contract. The Court cited *Zapata* and held:

"An agreement to arbitrate before a specified tribunal is, in effect, a specialized kind of forum-selection clause that poses not only the situs of suit but also the procedure to be used in resolving the dispute. The invalidation of such an agreement in the case before us could not only allow the respondent to repudiate its solemn promise but would, as well, reflect a parochial concept that all disputes must be resolved under our laws and in our courts......"

"We hold that the agreement of the parties in this case to arbitrate any dispute arising out of their international commercial transaction is to be respected and enforced by the federal courts in accord with the explicit provisions of the Arbitration Act."\(^{(57)}\)

\(^{(54)}\) Carbon Black Export v. the S/S Monrovia, 254 F. 2d 297, 300 (5th Cir. 1958) where the court held that it is the universally accepted rule that agreements in advance of controversy whose object is to oust the jurisdiction of the courts are contrary to public policy and will not be enforced.

\(^{(55)}\) 407 U.S. 1, 8, 9 (1972).


Zapata and Scherk have established the guidelines for giving effect to forum selection clauses and arbitration agreements, i.e., the transaction must be truly international and the choice must be just and reasonable.

In England, decisions have upheld the parties contractual designation of a forum of their choice, and it is assumed, in the absence of evidence to the contrary, that the parties intended the laws of the selected forum to govern. In finding a method to give effect to the parties agreement, the English courts preceded the American courts by almost 100 years. Nevertheless, the method of giving effect to choice of forum clauses on the theory that the courts will not participate in a breach of contract absent some overriding public policy or sense of justice is remarkably similar.

In most European countries, the validity of forum selection clauses is recognized as a rule with some exceptions. Such clauses are common in European contracts, and France, Germany, Holland and Belgium recognize their validity, whereas in Italy a choice of forum is held invalid when one of the parties is an Italian national or domiciliary.

The Latin American countries to a large degree follow the old French and Spanish theory of autonomy of will. A basic Civil law principle is “that which is not prohibited is permitted”. Therefore, the contractual selection of a forum is permitted, but it may not be contrary to law, morals, or public policy.

2. Choice of Law

The choice of the governing substantive law in international agreements with arbitration clauses may also present some difficulty. Even in the United States, the Supreme Court has upheld the contractual selection of foreign forum and foreign procedure, but the question remains whether parties can freely

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(59) Ingrid M. Farquharson, supra 99.

(60) Lars O. Lagerman, supra 791.

(61) Ibid.


select the applicable substantive law. The substantive law which a chosen forum choose to apply is a matter of its domestic choice of law principles. Often, the parties will select both the forum and the applicable law. However, in the absence of an express choice of law the chosen forum is justified in applying its own substantive law. Presumably this is what the parties intended. This, however, should only be a rebuttable presumption.\(^{(64)}\)

Although countries such as Egypt and Algeria recognize the validity of agreements providing for arbitration under the procedural rules of, say, the International Chamber of Commerce, these countries and others often insist upon the application of their own substantive law. Such an approach to the question of the governing substantive law of the contract arises, in part, from the view expressed in many countries located in Africa and Asia, that traditional principles of private international law are somewhat biased in favor of Western industrialized interests. These traditional principles are perceived to have been established at a time when the needs and concerns of developing countries were not fully considered and when an attitude of Western chauvinism characterized most dealings with developing countries.\(^{(65)}\)

With respect to contracts for the transfer of technology, for example, Dr. Humberto B. Sierra has recently observed:

"There is an opposing trend from developing countries which emerges as the project for the Code of Conduct prepared by the UNCTAD by the group called of the 77. One ruling establishes that contracts on technology transfer must be governed by the receiving country's law. This implies distrust of arbitration and, mainly, of the foreign arbitration courts."\(^{(66)}\)

3. Applicable Law in Economic Development Contract (International Contract)

A. Function and Nature of Economic Development Contract

The so-called Economic Development Contract (or "International Contract")

\(^{(64)}\) James T. Gilbert, supra 43.
\(^{(65)}\) Joseph T. McLaughlin, supra 219.
\(^{(66)}\) H.B. Sierra, General Statement Presented at the Sixth International Arbitration Congress, Mexico City (March 1978) at 1, reprinted in, -See, Ibid.
concluded between a state or a state-owned agency and a foreign corporation, for a number of reasons, social, economic as well as legal, has aroused a great deal of interest and controversy. (67) These contracts have proliferated lately with the intensification of international trade and with the emergence of new states desirous of developing rapidly their economy and industry through the promotion of their external trade and the encouragement of foreign investors and technical assistance. (68)

Economic Development Agreement has replaced the more traditional “Concession” which during the nineteenth century had become the standard denomination of agreements for the exploitation of natural resources. The change of name reflects the changed power relationships between capital-exporting and importing states and underlines the important functions of these agreements: to contribute to the economic development of the host country. (69)

They provide channels for the transfer of technology, increase employment and professional training of indigenous workers, stimulate other economic activities and domestic entrepreneurship, and therefore may constitute a major contribution to economic growth. (70)

These Economic Development Contracts have several common characteristics:
(a) They are concluded between the government or other public authorities of the host state on one side and a foreign private contractor on the other.
(b) They are not limited to the carrying out of a single transaction but establish a long-term relationship between the parties which implies a certain degree of confidence and cooperation.
(c) The generally confer on the foreign contractor—at least for a certain

starting period—a preferential position as to imports and exports, foreign exchange and tax exemptions.

(d) They often contain a provision for the settlement of disputes by means of arbitration.\(^{(71)}\)

Undoubtedly the interests of the foreign investor and the host government coincide as to the success and profitability of the undertaking. In other aspects the interests of the parties may be opposite. The company naturally tries to obtain a maximum of return and security of its investment and as much freedom from government interference as possible. The host government, on the other hand, may wish to induce the integration of the foreign enterprise into the national economy, control its future operations and share its profits. During the negotiation of the agreement, the foreign investor who has to assume the initial risk and to commit large funds is in a good bargaining position. The host government, in need of capital, is likely to guarantee the security of the investment and to grant substantial privileges as to taxes, currency and trade regulations. After establishment of the foreign corporation, the balance of power is gradually changing in favor of the government which, in the course of time, may have acquired sufficient operating skills to take over the enterprise.\(^{(72)}\)

This shifting of power is illustrated by the nationalization of the American copper companies in Chile.\(^{(73)}\) These companies, which had enjoyed an unchallenged dominating position in the most vital sector of the Chilean economy for about 50 years, was nationalized in 1971, only a few years after they had, under considerable pressure, agreed to sell 51 precent of their stock to the government.\(^{(74)}\)

Nationalization is only one extreme way of governmental interference with

\(^{(71)}\) Ibid.

\(^{(72)}\) Ibid., at 76.


\(^{(74)}\) Ibid., at 89-93.
concessions granted to foreign investors. The government has more subtle means of bringing about substantial changes or the termination of the agreement; it may, for example, revoke certain advantages or impose additional duties. Modification can be effected by individual action, government measures of general character or a change of legislation.(75)

Now question arises: Can the foreign investor be legally protected against such modification? Are there any limits of government power with regard to its contractual obligations?

In the Anglo-Iranian Oil Company Case,(76) the Iranian Government had agreed that the Concession “shall not be annulled by the Government and the terms therein shall not be altered either by general or special legislation in the future.”(77)

In the Revere Jamaica Alumina, Ltd./Government of Jamaica Agreement, the Government of Jamaica expressly agreed that:

"No further taxes...... burdens, levies...... will be imposed on bauxite, bauxite reserve, or bauxite operations......” “For the purpose of taxation and royalties, the provision of this Agreement shall remain in force until the expiry of twenty five years......”(78)

In both cases, the argument is made that a state can not fetter its future legislative action. In both the legislative acts contrary to the contractual limitation, annulling it and overriding it. In both the municipal law supports the action taken by the executive and the legislature. In both the question is raised whether on an international or transnational level the expressed undertaking of the state can be lawfully repudiated.(79) In order to determine the pertinent rules governing the nonconsensual modification of Economic Development Agreements, we have to examine the question of the applicable law.

(75) Rainer Geiger, supra 76.
(77) Ibid., reprinted, See, the Revere Arbitration, Revere Copper Inc. v. OPIC, August 24, 1978, reprinted in 17 ILM 1321 (1978) at 23.
(78) See, Ibid., the Revere Arbitration Award p. 23.
(79) Ibid., at 23-24.
B. Applicability of International Law Principles with Respect to Unilateral Modification Agreements

The problem of the applicable law is easily resolved if the contracting parties refer to a particular legal system. If no such provision is made, the contract, as a general rule, will be governed by the internal law of the host state.\(^{(80)}\) A traditional international law approach has been to leave questions of breach of contract to the municipal law governing the contract.\(^{(81)}\)

In recent years, however, a series of decisions by Arbitration Tribunals, have developed an exception to this narrow approach where contracts fall within a category known as "Long Term Economic Development Agreements". In such cases, the question of breach is not left to the determination of municipal courts applying municipal law. The reason for this is that such contracts are basically international in that they are entered into as part of a contemporary international process of economic development, particularly in the less developed countries. The very reason for their existence is that the private parties entering into such agreements and committing large amounts of capital over a long period of time require contractual guarantees for their security; governments of developing countries in turn are willing to provide such guarantees in order to promote much needed economic development.\(^{(82)}\)

Professor Dupuy as sole arbitrator in the arbitration between \textit{Texaco Overseas Petroleum Company and California Asiatic Oil Company and the Government of the Libyan Arab Republic},\(^{(83)}\) adopting and developing the concept of international contract, rendered opinion that:

\begin{quote}
(In international contract, the contractual nature of the legal relation) is intended to bring about an equilibrium between the goal of the general interest sought by such relation and the profitability which is necessary for the pursuit of the task entrusted to the private enterprise. Thus, the effect of the contract is to ensure to the private
\end{quote}

\(^{(80)}\) Rainer Geiger, supra 80.
\(^{(81)}\) The Revere Arbitration Award, supra 20.
\(^{(82)}\) Ibid., at 20-21.
\(^{(83)}\) \textit{Texaco/Calasatic Case}, or \textit{TOPCO/Libya Award} decided on the merits on January 19, 1977. reprinted in 17 ILM 1 (1978) [Eng. trans.]
party a certain stability which is justified by the considerable investment which it makes in the country concerned. The investor must in particular be protected against legislative uncertainties, that is to say, the risks of the municipal law of the host country being modified, or against any government measures which would lead to an abrogation or rescission of the contract.

Hence, the insertion of so-called Stabilization Clauses: these clause tend to remove all or part of the agreement from the internal law and to provide for its correlative submission to *sui generis*—rules as stated in the *Aramco Award*, or to a system which is properly an international law system.”

In the *TOPCO/Libya Award*, Professor Dupuy also dealt with the relationship between nationalization measures under municipal law and state obligations under contracts subject to international law. With reference to the latter, he said:

“....the state has placed itself within the international legal order in order to guarantee vis-à-vis its foreign contracting party a certain legal and economic status over a certain period of time. In consideration for this commitment, the partner is under an obligation to make a certain amount of investments in the country concerned and to explore and exploit at its own risks the petroleum resources which have been conceded to it.”

“Thus, the decision of a State to take nationalizing measures constitutes the exercise of an internal legal jurisdiction but carries international consequences when such measures affect international legal relationships in which the nationalizing state is involved.”

Further, he decided:

“The result is that a State can not invoke its sovereignty to disregard commitments freely undertaken through the exercise of this same sovereignty and can not, through measures belonging to its internal order, make null and void the rights of the contracting party which has performed its various obligations under the contract.”

4. Public Policy Defense in Recognition and Enforcement of Foreign Arbitral Award

The 1958 New York Convention on Recognition and Enforcement of Foreign

(84) Ibid., at 31 to 36
(85) Ibid., at 50.
(86) Ibid., at 54.
Arbitral Awards was the culmination of the rapid evolution of international support for the use of commercial arbitration.\(^{(87)}\) Although the Convention was a significant step in the recognition of international commercial arbitration, states nevertheless insisted on maintaining their ultimate, sovereign control over the recognition and enforcement of foreign arbitral awards.\(^{(88)}\) The bases upon which a signatory state may refuse to enforce a foreign arbitral award were enumerated in Article V of the Convention, with the public policy defense included as one of two defenses which may be raised _ex officio_ by a court the state requested to enforce an award.\(^{(89)}\) Let’s see the interpretation and application of this public policy defense in the some leading trading countries’ municipal courts.

A. The U.S. Court: In the U.S. the question of what effect a judgment of one state should have in another was resolved, on the Constitutional level, by the clause requiring each state to give “full faith and credit” to the judgments of each other state.\(^{(90)}\) The practical and Constitutional necessity of giving effect to foreign state judgments probably led to a respect for foreign country judgments in the U.S. more generous than that given such judgments in the Civil law systems of Europe.\(^{(91)}\)

Thus far, few U.S. courts have been called upon to enforce international arbitration awards under the New York Convention.\(^{(92)}\) It’s because the New York Convention applies to the recognition and enforcement of arbitral awards which are not “domestic” in the state where their recognition and enforcement

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\(^{(88)}\) Law enforcement is no longer a private matter, but ultimately belongs to the state acting through the courts, in any civilized state.


\(^{(90)}\) The U.S. Constitution. Art. 4 1.


are sought. Nevertheless, there is valuable learning in the first U.S. decisions interpreting the Convention. The leading case to date which considered several of the defenses is *Parsons & Whittemore Overseas Co., Inc. v. Société Générale de L'Industrie du Papier (RAKTA)* (hereinafter *Overseas*). We will discuss how that case treated the defenses raised against enforcement of the particular arbitral awards.

The United States Court of Appeals for the Second Circuit, when first called on to interpret the Convention, provision for a public policy defense in the case of *Overseas*, found that the legislative history of the provision offered no certain guidelines to its construction. Instead the court examined the defense in the historical context of the Convention as a whole. The court determined that "a narrow reading of the public policy defense" should be applied to the factual situation of the case to reflect the general proenforcement bias informing the Convention, and to prevent the development of a major loophole in the Convention mechanism for enforcement. The opinion in *Overseas* expressed a narrow construction of the public policy defense in these words:

Enforcement of foreign arbitral awards may be denied on this basis only where enforcement would violate the forum state's most basic notions of morality and justice. These definitions of the public policy defense, being of an extremely generic, unspecific nature, offer little guidance for a practical understanding or pleading of the defense.

(94) 508 F. 2d. 969 (2d Cir., 1974).
(95) Ibid.
(96) Ibid.
(97) Ibid.
(98) Ibid.
(99) Id. at 974.
(100) Id. It is interesting to note the similarity between the court's narrow construction of public policy, i.e., the "most basic notions of morality and justice", and the Ad Hoc Committee draft definition of public policy which was rejected as too broad, i.e. "fundamental principles of law".
In order to obtain a clearer understanding of the public policy defense, a supplementary examination will be made of those defenses which are closely related to, but not actually part of the public policy defense. In addition to the public policy defense, there are several other defenses which United States courts have founded on basic consideration of morality and justice. These defenses to enforcement of arbitral awards are pleaded on a basis of:

(1) procedural due process;\(^{104}\)

(2) non-arbitrable subject matter;\(^{105}\)

(3) manifest disregard of the law by arbitrator;\(^{106}\)

(4) forum non conveniens;\(^{104}\) or

(5) a conflict with the United States national policy or domestic law.\(^{105}\)

Above defenses no longer lend themselves to pleading under the public policy defense. The procedural due process defense and the non-arbitrable subject matter defense now are pleaded exclusive of the public policy defense under separate provisions in the Convention;\(^{106}\) The United States courts accordingly have considered them apart from the public policy defense.\(^{107}\) A defense of “manifest disregard of the law” is unlikely to be a successful public policy defense because of the difficulties in establishing an arbitrator’s recognition and subsequent disregard of the law, the agreement, and fundamental rationality. Furthermore, pleading “manifest disregard of law” may require a review of the merits of the award, which is prohibited under domestic law and the Convention.\(^{108}\) Although it is not inconceivable that a plea of forum non

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\(^{104}\) An example of procedural due process being considered as separate from the public policy defense appeared in Fotochrome Inc. v. Copal Co. 517 F. 2d 512 (2d Cir. 1975).

\(^{105}\) Examples of such subject matter are antitrust violations, American Safety Equipment Corp. v. J.P. Maguire & Co., 391 F. 2d 821 (2d Cir. 1968), and patent disputes, Belkman Institute v. Technical Development Corp., 433 F. 2d 55 (7th Cir. 1970).

\(^{106}\) See, in San Maritime Compania De Navegacion v. Sagonay Terminals 293 F. 2d 796 (9th Cir. 1961), and Ludwig Hofold Mfg. Co. v. Flexcher, 405 F. 2d 1123 (3d Cir. 1969).


\(^{106}\) Procedural due process is reflected in Article V (1)(b) of the Convention; Non arbitrable subject matter is provided in Article V (2)(a) of the Convention.

\(^{107}\) Joel R. Junker, supra 241.

\(^{108}\) The U.S. Supreme Court in Wilko v. Swan, 346 U.S. 427 (1953) stated that interpretation
conveniens may fall within the boundaries of the public policy matter, such a plea would have a more difficult burden of proof under vague Overseas standards of the most basic notions of morality and justice, than under a test of reasonableness judged in light of particular circumstances.\(^{(109)}\) Finally, a foreign arbitral award even in direct conflict with domestic governmental policies or statutes does not appear to be a violation of public policy. This is simply the product of decisive and unmitigated deference by the courts for international considerations involved in foreign arbitration.\(^{(110)}\) Courts have given the public policy defense strict construction and have circumscribed its use to avoid such problems as a loophole to enforcement, uncertainty in the arbitral process, and destructive retaliation on American arbitral awards in courts of other states.\(^{(111)}\)

B. The German Court

The use of the public policy defense in the Federal Republic of Germany,\(^{(112)}\) however, illustrates that a less restrained application of public policy does not necessarily bring about these deleterious consequences.\(^{(113)}\)

Germany has relatively progressive policies favoring arbitration, and yet retains a broader interpretation of the public policy defense than does the United States.\(^{(114)}\) Public policy as applied by the German courts prevents enforcement of a foreign arbitral award if it offends good morals or the objectives of German laws, and especially if it causes a party to commit an act which is illegal under German law.\(^{(115)}\) The general context for applying public

\(^{(109)}\) Joel R. Junker, supra 244.

\(^{(110)}\) Ibid., at 241, 245: A conflict with domestic law is not a per se violation of public policy. Should a conflict involve statutory law based on basic notions of morality and justice, it is conceivable that the public policy defense would be applicable.

\(^{(111)}\) Joel R. Junker, supra 245.

\(^{(112)}\) The Federal Republic of Germany (henceforth, Germany) acceded to the Convention in 1961.

\(^{(113)}\) Joel R. Junker, supra 247.

\(^{(114)}\) Id.

\(^{(115)}\) German Code of Civil Procedure, ZPO §1044(Foreign Arbitral Awards) (2) The application for a declaration of enforceability shall be denied: 1. . . . . 2. if recognition of the arbitral award would violate ordre public, in particular if the award orders a party to take an action, the taking of which is prohibited under German law.
policy is in the framework of particular circumstances rather than the larger concepts of ‘morality’ and ‘justice’. This approach encompasses the United States standards of basic notions of morality and justice, and in addition, provides a practical contextual guideline for applying general standards of morality and justice to fact situations. (116)

Under the German Code of Civil Procedure, the plaintiff who seeks an enforcement decree for a foreign judgment will be successful on the merits if he can establish that the seven requirements are met. (117) Among them, the sixth statutory requirement is the demand that the foreign country judgment does not violate German ordre public. (118) Although one encounters great difficulty in translating or defining the term ordre public under German law, two separate branches can be identified. First, any act grossly offending the sense of decency prevailing among fairminded persons violates German public policy. Second, any act contrary to the basic elements of the German legal system and its underlying concept of justice contravenes public policy. (119) The German courts enforce arbitral awards in a similarly liberal fashion. This liberal treatment of foreign judgments and arbitral awards responds to the substantial increase in international business transactions in the past decades. The German Code as interpreted by the courts reflects the present trend toward multilateral cooperation in international commerce. (120)

Article 1025(2) of the German Code of Civil Procedure provides that an arbitration agreement will be declared void if it is the result of a commercially strong party applying undue influence upon an economically weaker opponent. (121) A specific statutory delineation of public policy such as this serves as a general preventive solution to the potential problems of undue

(116) Joel R. Junker, supra 248.
(118) ZIVILPROFESSORDUNGEN (ZPO) §§723 (2), 328 (1) (4).
(119) Hans Bertram-Nothnagel, supra 390.
(120) Id.
(121) Joel R. Junker, supra 248.
influence and overweening bargaining power anticipated in the Bremen decision but limited therein to the issues of forum selection clauses and forum non conveniens. German law also has a statutory definition of public policy to prevent its excessive use and to limit its application in a conflict of laws situation to only the cardinal segment of lex fori.\(^{(122)}\)

C. Comparison

The attitude of the United States courts towards the public policy defense is not one which recognizes the defense as a "catch-all" to protect the integrity of arbitration. Rather, the courts have considered the defense mainly as a means by which a forum might escape binding arbitration. Consequently, the courts have given the public policy defense so narrow a construction that it now must be characterized as a defense without meaningful definition. This leaves the defense pragmatically useless if not altogether nonexistent. The public policy defense suffers conceptually from being an expression of ultimate sovereign power in international commercial arbitration, which paradoxically is disfavored by the courts because of its inherently provincial and parochial nature. The defense also suffers the pragmatic weakness of being assigned so unspecific a responsibility as the guarantee of morality and justice. For example, it will not function even to stop enforcement of an award against a business given because that business refused to disobey its government's instructions. Such was the case in Overseas.\(^{(123)}\) Even where a foreign arbitral award directly discourages a party from complying with domestic statutes, such as in Scherk v, Alberto-Culver Co.,\(^{(124)}\) the public policy defense will not prevent enforcement of the

\(^{(122)}\) ZPO § 1025(2), "The German 'Vorbehaltsklausel'...indicates a reservation or an exception and thereby acts as a brake against excessive use of ordre public", See, Id. footnote 115.

\(^{(123)}\) In the rulings in favor of RAKTA, the court found that Overseas' plea of public policy was easily dismissed under a narrow construction of the Convention's public policy defense. The Overseas' equating of "national policy" with the U.S. "public policy" was considered a mere "parochial device protective of national political interests that would seriously undermine the Convention's utility."

\(^{(124)}\) The Supreme Court determined that because the arbitration agreement was truly international considerations and policies other than the Securities Exchange Act were involved, these international considerations were found to outweigh the benefits intended by domestic statutory protections.
award in the United States. As a result of the conceptual and pragmatic shortcomings caused by present interpretations of the public policy defense, it will be difficult for courts, attorneys, arbitrators and businessmen to anticipate the limits on unfairness surrounding international commercial arbitration.\(^{(126)}\)

The success of arbitration in Germany demonstrates that a comparatively liberal use of the public policy defense does not result in detriment to arbitration as a means of dispute settlement or create a threat of unfortunate reciprocation by other states. The role of the public policy defense in German arbitration suggests that a more flexible use of the public policy defense in the U.S. could contribute to the integrity of the arbitral process without creating loopholes in the Convention or destructive reciprocation by courts in other countries.\(^{(126)}\)

### IV. Conclusion

So far, we have examined the major systems of international arbitration and some acute problems in international arbitration arising with respect to developing countries. Arbitration involving parties from developing countries will only work effectively if it is tailored to satisfy the needs and legitimate expectations of all parties. The regionalization of traditional arbitration centers, now located principally in Western Europe, would be an important step in enhancing the image of arbitration in developing countries. Such centers would attract more arbitrators from developing countries and, in this manner, the arbitration panels ultimately selected should be better balanced.

Arbitration's enormous potential for efficient dispute resolution on a truly consensual basis rests, in large part, upon the initial freedom of the parties to choose the substantive and procedural law governing the ultimate proceedings. This unique feature of arbitration can be lost by poor planning and careless

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\(^{(125)}\) Joel R. Junker, supra 245.

\(^{(126)}\) Ibid., at 250.
drafting. Careful planning and drafting, however, make it possible for the parties, including those who identify with the concerns of the developing nations, to avoid many of the pitfalls otherwise associated with international arbitration and to ensure that the consensual nature of arbitration is preserved while its reputation for impartiality is enhanced.

Finally, courts that seek to promote international commercial arbitration should be cognizant of the possibility that the present tenor of decisions on the public policy defense may actually be a deterrent to the use of arbitration. The problems resulting from present judicial interpretations of the public policy defense indicate a need for a more analytic evaluation of the defense of public policy.

Turning to the case of Korean international commercial arbitration, we can find similar provisions in Acts of public policy defense against the recognition and enforcement of foreign arbitral award.

In Article 14 of Korean Arbitration Act, it is stipulated that compulsory execution by an arbitral award may be made only when its lawfulness has been declared by a court (para. (1)), but a judgment of execution under the preceding paragraph may not be made when there exists a ground for requesting cancellation of the arbitral award (para. (2)).

Among grounds for requesting cancellation of the arbitral award, above Act provides in Article 13 a provision concerning the public policy defense.

A party may file a lawsuit for cancellation of an arbitral award when the contents of an arbitral award is asking an action which is prohibited under law (para. (1) 3).

Also there is a provison in Article 5 of Korean Conflict of Laws Act that if, in cases where a foreign law shall govern, the provisions of such law contains matters contrary to good customs and any other social order, such provisions shall not apply.

Thus we can interpret from this provision that, if a foreign arbitral award rendered under foreign substantive law which is contrary to good customs and
social order, it would be refused in recognition and enforcement in Korea.

But it seems to me that there are not many cases concerning applying and interpreting these public policy (law) defenses in Korea.

The public policy defense should become more meaningful if its potential utility were emphasized as much as its potential abuse. Parties to arbitration have a good faith duty not to use the public policy defense as a dilatory of evasive action following an award. Similarly, they should not allege the public policy defense as a pro forma pleading in a defense to enforcement of an award, for meaningless use of the public policy defense would serve only to distract a court from analysis of substantive public policy considerations.

Having examined how the courts have applied public law and public policy to arbitration, we have to ask further the question how arbitrators should apply the same considerations to the disputes before them. Arbitrators who are appointed by the parties are not charged with effectuating the state interests of any particular nation. They are therefore in a better position than any national court to determine which nation's public law, if any, merits application to the dispute.