COMMERCIALITY AND *INTERNATIONALITY* IN INTERNATIONAL COMMERCIAL ARBITRATION

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INTRODUCTION

Arbitration, as the dominant method of settling international trade disputes, owes its popularity, *inter alia*, to the perception of its greater neutrality when compared to the state courts. International trade is mostly facilitated through various enactments both domestic and international. With the advent of international commercial arbitration the basic question which arises is the determination of the commercial and international character of these arbitrations. The growth of the economies of various countries is mainly governed by the commercial contracts which these countries maintain with other countries; these contracts are becoming more international in character owing to global integration. Thus, it has become inevitable that the concept of commercial and international character of any international commercial arbitration be determined.

The present paper analyses the terms commercial and international and their applicability through various international and national legislations. Part I of the paper highlights the concept of commerciality and also analyses various transactions which can be termed as commercial. It provides the gradual development of the concept through various domestic and international legal instruments. Part II of the paper analyses the meaning of the term "International" and also provides the tests which were evolved for determining the international character of any arbitration proceeding. It also provides the meaning of the term through various judicial pronouncements. Further, Part III elucidates the comparative analysis of concepts in various countries vis-à-vis Indian position. Section IV concludes the paper, with the intent to provide global and commonly accepted definitions of the terms "commerciality" and "international" so as to facilitate transnational commerce and to provide speedy dispute resolutions to these international commercial disputes.

1. CONCEPT OF COMMERCIALITY

It is a general and accepted notion that the arbitration is a particularly suitable method

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for the resolution of disputes arising out of various business transactions or relationships. These business relations are often concluded by contracts which are further distinguished into domestic and commercial transactions. The term "commercial" has become an accepted term due to its consistent use by various civil law countries. The term "commercial contract" is of importance in civil law as regards arbitration, since in some counties disputes arising only out of commercial contracts may be submitted to arbitration.[1] Different countries have interpreted and defined the term 'commercial' differently. Commercial contracts can be broadly defined as contracts made between merchants and traders in the ordinary course of their business.[2] Such contracts are usually governed by a special code of commercial law apart from general laws of obligation.[3] Apart from these arbitral institutions of many civil law countries are associated with a Chamber of Commerce, such as the Belgium Chamber of Commerce, the Geneva and Zurich Chambers of Commerce and also the International Chamber of Commerce in Paris.[4] With conflicting definitions prevalent in various civil law countries an attempt was made through the UNCITRAL Model Law to reconcile or to provide a definition which could be accepted universally. Gradually a footnote was annexed to Art. 1 of the Model law which provided that the term "commercial" should be given a wide interpretation so as to cover matters arising from all relationships of a commercial nature, whether contractual or not.[5] The intention to include the present definition was to have a definition which can be used by those states which do not have a distinct body of commercial law so that the Model law would be applicable to all aspects of international business. The draft provided a focus on the nature of the transaction rather than the persons involved.[6] The definition got assorted reactions by various countries in terms of its application. Many countries decided to opt for it whereas other countries for various reasons did not include the definition when adopting the Model law.[7] India, on the other hand, has opted for an expressly Indian characterization of

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[1]Redfren & Hunter, *Law & Practices of International Commercial Arbitration* (4[th]edn, Sweet & Maxwell publication 2004) 17.

[2]Anurag K. Agarwal& D. Harsh Jain, 'Commerciality in International Arbitration', W.P. No. 2006-04-10, April 2006, Page 3 <http://www.iimahd.ernet.in/publications/data/20006-04-10agarwal.pdf> accessed on 25th January 2011.

[3]*Ibid*

[4]Six Chambers of Commerce in Switzerland including those of Geneva and Zurich have adopted uniform rules based on the UNCITRAL Arbitration Rules, with effect from January 2004.

[5]David D Caron, *The UNCITRAL Arbitration Rules: A Commentary*, (Oxford University Press New York 2006), 23.

[6]Holtzmann & Neuhaus, *Model Law*, UN Doc A/40/17, paragraph 22;,33.

[7]Kaplan, 'The Hong Kong Arbitration Ordinance, Some features and Recent Amendments',1 Am Rev Int'l Arb 25 (1990) 29; provides the list of nations which have not included the definition and also provide Hong Kong's Justification for not including the definition with the argument that the delimitation is incompatible with the nature of common law.

the commercial dispute.[8] Further, those countries that have not opted for the Model law definition make reference to commercial laws and transactions as developed in the national law.[9] Also under the 1925 US Federal Arbitration Act the word commerce has been made synonymous to the word "cross border."[10]

The concept of commercial contracts was internationally recognized first under the Geneva Protocol of 1923 wherein the distinction was provided between commercial and other matters further, emphasis was provided in the above differentiation by the stipulation in the protocol that each contracting state may limit its obligation "to the contracts that are considered as commercial under their national law."[11] The scope of the term "commerciality" was given a new verve in the year 1958 where forty-five countries participated in the U.N. conference that culminated into the Convention on Recognition and Enforcement of Foreign Arbitral Awards, 1958 (the New York Convention). The New York Convention allows for a distinction to be made between commercial and non-commercial arbitration. But the application of the New York Convention is varied since the convention provides for the second reservation[12] wherein the states can restrict the applicability of the convention. This entitles the contracting states to declare that they will only apply the convention to differences arising out of legal relationships, whether contractual or not, "which are considered as commercial under the national law of the state making such declaration".[13] The effect of this reservation has narrowed down the scope of application the convention.[14] The reservations provided under the convention made it difficult for the application of the convention collectively. The fact that each contracting state must determine for itself what relationship it considers to be commercial has created certain problems in the application of convention. The complexity pointed out is evident from the Indian case of *Indian Organic Chemical Ltd v. Subsidiary 1 (US) Subsidiary 2 (US) and Chemtex Fibres*

[8]See India, Arbitration Ordinance section 2(1)(f).

[9]For eg.Section 2 of the Finland Arbitration Act 1992; also the French NCPC Art. 1492 refers to "International Commercial Arbitration"

[10]Sec 1 FAA defines means of commerce among the several States or with the foreign nations or in the territory of the United States or in the District of Columbia or between an y such territory and another or between any such territory and any State or Foreign nation, or between District of Columbia and any State or Territory or foreign nation.

[11]The so-called concept of "commercial reservation" was observed under the Geneva Protocol of 1923; Art. 1.

[12]Convention on the Recognition and Enforcement of Foreign Arbitral Awards (adopted on 10th June 1958), (New York Convention)art 1.3.

[13]*Ibid* 13.

[14]Out of 137 contracting states, which are signatory to the Convention, only 44 states have adopted the *commercial reservation*; see <http/ www.uncitral.org/uncitral/en/uncitral/NYConvention> Accessed on 30th December 2010 .

Inc. (Parent Co.) (US)[15] wherein the Bombay High Court observed that by ratifying the New York Convention the State of India had entered the commercial reservation and in order to invoke the provisions of the convention it is not enough to establish that an agreement is commercial. It must also be established that it is commercial by virtue of a provision of law or an operative legal principle in force in India. However the Supreme Court of India in *RM Investments & Trading Co Pvt. Ltd. v Boeing Company & another*[16] observed that the term 'commercial' should be given a liberal construction and should be broadly construed having regard to the manifold activities which are integral part of the trade. Also Tunisian courts have construed commercial reservation so broadly that it has excluded the enforcement of an award relating to the obligations arising under a contract for professional services.[17]

In the year 1987 Amman Arab Convention on Commercial Arbitration provided that the convention will apply to commercial disputes between natural or legal person of any nationality linked by commercial transactions with one of the contracting states or one of its nationals, or which have their main headquarters in one of these states.[18] Similar is the scope of the Inter-American Convention on International Commercial Arbitration.[19] Thus to ascertain a commercial transaction, regard should be given to the international character of a convention and the need to promote uniformity.

2. MEANING OF INTERNATIONALITY

There has been certain ambiguity or difficulty to determine the use of the term "international" under International Commercial Arbitration. Often the definition given by one state differs from another. Several legal systems have special rules for domestic and international arbitration.[20] The term "international" is used to mark the difference between arbitrations which are purely national or domestic and those which are

[15] Vol IV (1979) Yearbook Commercial Arbitration 271.

[16] Reported in Vol. XXII (1997) Yearbook Commercial Arbitration 770 (Supreme Court of India 10 February, 1994).

[17] *Societed'Investissement Kal v Taieb Haddad and Hans Barett*, XXII 901 Yearbook Commercial Arbitration, 770 (1998).

[18] The Amman Arab Convention on Commercial Arbitration (adopted on 14th April, 1987), art. 2.

[19] Art. 1 of the Convention states that; "An Agreement in which the parties undertake to submit to arbitral decisions any differences that may arise or have arisen between them with respect to a commercial transaction is valid".

[20] For example,. Australia, Bermuda, Canada and also the US Federal Arbitration act applies to the international and interstate arbitration; whereas in England, France has adopted the International Commercial Arbitration Act.

transnational.[21] The term international commercial arbitration construed with the term 'international' in its simplest sense means any arbitration which takes place in a given state, but contains elements external to that legal system is generally treated as international arbitration. The term international or transnational is the product of many sources including natural law, *jus cogens*, and the norms of justice universally applied in most nations today.[22] According to Art 1(3) of the Model Law[23] provides for the international character of an arbitration proceeding. If the parties agree that the subject matter of the arbitration is relevant to more than one country, the Model Law directs that the dispute become "international" in character.[24] On the other hand the New York Convention confines its application to foreign awards, but does not make any *attempt to provide a definition for International arbitration. But the European Convention* enumerates that international arbitration is for the purpose of settling disputes arising from international trade between physical or legal person having, when concluding the agreement, their habitual place of residence or their seats in different contracting states.[25] There are three criteria for establishing the international character of arbitration; (a) its subject matter or its procedure or its organization is international, (b) parties involved are connected with different jurisdiction or, (c) there is a combination of both.[26] The subjective matter or the procedural criterion focuses on the subject matter of the dispute and the applicable procedural laws underlying the transaction. Hence the fact that the dispute is referred to the genuinely international arbitration institutions like

[21]The term was coined by Judge Jessup; it governs the contracts, relationship or transactions across the borders; see Jessup "Transnational Law", *Storrs Lectures on Jurisprudence* (Yale Law School, 1956).

[22]Okezie Chukwumerije, *Economic Globalization: the challenge for arbitrators choice of law in international commercial arbitration*, Vanderbilt Journal of Transnational Law, January, 1995; 28 Vand. J. Transnat'l L. 173.

[23]Art 1(3) provides that an arbitration is international if;

(a) the parties to an arbitration agreement have, at the time of the conclusion of that agreement, their places of business in different state; or

(b) one of the following places is situated outside the state in which the parties have their place of business:

(i) the place of arbitration if determined in, or pursuant to the arbitration agreement

(ii) any place where a substantial part of the obligations of the commercial relationship is to be performed or the place with which the subject-matter of the dispute is most closely connected; or

(iii) the parties have expressly agreed that the subject matter of the

[24]*Ibid* 23 at p. 15.

[25]European Convention on International Commercial Arbitration (adopted on 21st April 1961), art. I(1)(a)

[26]Fouchard, 'Quand un arbitrage est-il international', RevArb 59 (1970) 64.

ICC, LCIA and ICSID, would be sufficient for the arbitration to qualify as international.[27] The view was also accepted in the case of *Bergesen v Miller*[28] wherein a Norwegian Shipper sought confirmation of award by a petition in the US District Court in his favour, against a Swiss Company under the New York convention. Later the company contended that the New York Convention did not cover the enforcement of the award made in U.S. because it was neither a foreign award nor a domestic award. The court while rending its judgment referred to drafting history and working party's recommendation and also Art 1.1 of the New York Convention to consider an award to be domestic or not. The court came to the conclusion that the award would not be considered domestic denoting that it was subject to the convention not because it was made abroad but because it was made within the framework of other country. Thus the nationality of the award was determined by the law governing the procedure. The nationality criterion based on the applicable procedural law has been met with favour by part of the doctrine.[29] The German Supreme Court also observed that a foreign award is made when the arbitral tribunal bases its decision on foreign procedural laws.[30]

The preference is further given to the place where the award is made, to determine it character. The problem under this criterion comes when an award is made for a country in another country (e.g. in England when the award is made elsewhere, for instance Turkey then in this case is it a English or Turkish arbitration?) the issue was recognized and was dealt in *Hiscox's case*[31] where the arbitral tribunal having its seat in England decided the case in Paris and subscribed the award thereafter in Paris. The House of Lords held that the award was a French award even when the law was English; the English court had the jurisdiction as 'enforcing courts'.

Thus the international nature of arbitration must be determined according economic reality of the process during which it arises. In this respect, all that is required is that the economic transaction should entail a transfer of goods, services or funds across national boundaries, while the nationality of the parties, the law applicable to the contract or the arbitration and the place of arbitration are irrelevant.[32]

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[27]Julian D M Lew, *Comparative International Commercial Arbitration*, Kluwer International Law, (2001) p. 58.

[28]*Sigval Bergesen v Joseph Muller Corporation*, 710 F2d 929 (2d. Cir.) 1987.

[29]A Migliazza, 'Naturae efficacia dell arbitration internazionale (Nature and effects of International Arbitration)'Riv. Dir. Int. Priv. Proc 1973; 739.

[30]*Ghezzi v Boss*, (Bundesgerichtsh of June 30, 1961) (BGHZ 21, 365) *Yearbook Commercial Arbitration*, Vol.XV 1990, 450.

[31]*Hiscox v Outhwaite*, [1991] 3 W.L.R 297-307.

[32]*Murgue Seigle v Coflexip*, Rev Arb 355 (1991).

3. INTERPRETATION OF THE CONCEPT ACROSS THE GLOBE

The word "commercial" and "international" have been variedly interpreted by various countries across the globe. Different countries have used these words in their own way so as to cater to their own needs and to harmonize their international commercial transactions. The word commercial has been widely interpreted by some countries so as to increase the scope of international commercial arbitration, since many countries only refer the matters to arbitration when there is some commerciality involved. Some of the important jurisdictions are highlighted below:

3.1 USA

The term "commerciality" has got a broad and wide interpretation taking into consideration the US position with regard to ICA.[33] The Uniform Commercial Code delimits a non-exclusive set of commercial transaction.[34] But the 1925 US federal Arbitration Act defines the word "commerce" as being synonymous with cross border transactions. It was observed in the case of *Societe Generale de Surveillance, S.A. v Raytheon European Management and Systems Co*,[35] an American company was involved in a dispute with a French company in a contract for the field testing, inspection, and evaluation of missiles. Even though the contract was strictly a one about services, and not about an exchange of commodities, the court held that it was commercial. The court also observed that there is a strong judicial policy favouring the submission of contractual disputes to arbitration particularly under the provisions of the Federal Arbitration Act (FAA), and the term 'commerce' should be broadly construed. It was further observed that employer-employee relationship, even though it has some degree of a fiduciary relationship, it is also not excluded from the ambit of commerciality.[36] Further the Foreign Sovereign Immunities Act, 1976 (FSIA) defines the term 'commercial activity' as either a regular course of commercial conduct or a particular commercial transaction or an act.[37] The main aim of FSIA is to make the foreign countries immune from its sovereign and governmental activities but not from its commercial activities. The courts have further evolved the Private Person test to identify commercial activities. Under the said test, the court has to satisfy itself as to the proposed activity falls under the scanner of

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[33]I Eliasoph, 'A Missing Link: International Arbitration and ability of Private actors to enforce Human Norms', 10 New England Journal of International and Comparative law, (2003) 4, at 110.

[34]The Uniform Law Code is the Model law prepared by the American Law Institute and with some amendments, it has been adopted by all US states; see also White & Summers, *Uniform Commercial Code* (5th Edn. West Group Publication 1999).

[35]643 F.2d 863 (1st Cir. 1981).

[36]*Faberge Intern Inc v Di Pino*, 109 A.D.2d 235 (N.Y.App.Div. 1985).

[37]Sec 1603 (d) of the FSIA, 1976.

commerciality or not. The relevant nature of the activity is to be sorted out.[38] Under the test the court has to further identify that whether a private person can engage in the commercial activities or not.[39] On the other hand the term international has been interpreted by special rules by various countries and the U.S. is no exception to it. The term is mostly interpreted in the U.S.A in accordance with the New York Convention. US Supreme Court introduces and uses the objective criteria to determine the nature or the true character of the arbitration.[40] Furthermore, the international character could also stem from some other objective characteristics of the dispute: that one of the parties has property located abroad, or that the performance of the contract is envisaged abroad or the dispute must have some sort of international transaction so as to suffix it as in international commercial arbitration under the US legislation.[41] Thus the U.S. has its own distinct rules as well as the state practices to interpret the words commercial and international.

3.2 FRANCE

European continental law shows that arbitration should not be used in consumer contracts unless under some specific rules.[42] But these are mostly under the domestic arbitration and not under the international arbitration, and domestic commerce and the international commerce are interpreted differently in the European countries.[43] The Paris Court of Appeal in the case of *Kuwait Foreign Trading Contracting and Investment Co. v Icori Estero Spa*[44] the court observed that the "commercial" character of an international arbitration would not be dependent on the nature of the parties, the

[38]It was observed in the case of *MOL, Inc v People's Republic of Bangladesh*, 736 F.2d 1326 (9th Cir.1984); wherein the Co. had certain agreement with the Republic of Bangladesh which was later revoked, the Co sought for the arbitration, to which the govt. of Bangladesh refused; later the Co sought damages through a suit in American court. The court held that the act was a sovereign act and not a commercial one and thus it is immune, this was against the policies incorporated by the FSIA.

[39]The US Supreme Court observed the following in the case of *Republic of Argentina v Weltover, Inc*, 504 U.S. 607; see also J Donoghue, 'Taking the Sovereign' Out of the Foreign Sovereign Immunities Act: A Functional Approach to the Commercial Activity Exception', 17 Yale Journal of International Law (1992) 489, at 505.

[40]*Scherk v Alberto Culver*, 417 US 506.

[41]Edin Karakas, 'International character of disputes as a requirement to the validity of arbitral agreements and awards', International Arbitration Law Review, Int. A.L.R. 2006, 9(2), 42-52).

[42]R David, *Arbitration in International Trade* (Netherlands, Kluwer Publications, 1985) 149.

[43]L Biukovic, *International Commercial Arbitration in Cyberspace: Recent Developments*, 22 Northwestern Journal of International Law and Business, (2002) 319, 330.

[44]Unreported Decision. Case discussed in E. Gaillard, France: *The Commercial Requirement in International Commercial Arbitration*, 1(1) International Arbitration Law Review (1997) at N11-12.

purpose of the contract or the applicable law. Rather it would be commercial when it related to an economic transaction. The law in France in terms of interpreting the essentials of any International Commercial Arbitration is inclined towards the lines of the common law system and various other international legal instruments. The term commercial is given a wide interpretation under the French law. Thus, under the French law International arbitration is governed by rules which are different from those governing domestic arbitration.[45] To determine the character of an international arbitration, the procedure criterion is looked into under the French law.[46] Thus the international character of the arbitration is mostly governed through the common law practice or any other specific enactments.

3.3 ENGLAND

The term 'commercial' finds a place in the common law of England, many countries still apply common law practices in their procedural laws so as to guide their legal principles. In England, delimitation of commercial law can be found in its legislation and in scholarly writings.[47] Under the English laws various commercial courts assume jurisdiction with respect to the commercial disputes.[48] Further, the definition provided under the Model Law has also been adopted by the English law.[49] The difference between the domestic and international scenarios can be carved out by the English Arbitration Act 1979 which defines a domestic arbitration as the arbitration when the parties are domiciled in UK and the seat of arbitration is in UK. This distinction was termed as discriminatory which was opposed by European Commission.[50] Thus the English law with reference to international commercial arbitration is mainly based on the lines of its Arbitration Act and on the Model law.

3.4 INDIA

Unlike the other countries who have adopted the model law structure for construing

[45]Decree May 12, 1981, no. 81-50.

[46]*GotaverkenArendal AB v Lybian General National Maritime Transport Co.*, Court of Appeal Paris, February 21, 1980 Clunet 1980, 660; wherein it was observed that where an award rendered pursuant to a procedure is not that the one prescribed by French law, then it cannot be considered as French Award.

[47]Goode, *Commercial Law* (2ndEdn, Penguin 1995); see also *Supra* note 28 at p. 52.

[48]The jurisdiction is conferred by reading English Civil Procedure Rules, Part 49 along with the English Commercial Court Practices Direction and Commercial Court's Guide.

[49]British Columbia International Commercial Arbitration Act 1986 Art. 1(6).

[50]*Philip Alexander Securities and Futures v Werner Bamberger and others,* (1996) XXII YBCA 872 (1997) (English Court of Appeal)

the words 'commercial' and 'international', India has opted for an expressly Indian characterization of international commercial disputes. The Supreme Court in *Renusagar Power Co. Ltd. v General Electric Co*[51] observed that the word 'commercial' is meant to facilitate International trade and it should be given a liberal construction. It further observed that while construing the word commercial Model law can be taken into consideration and commercial activity or commercial need not always imply an intention to trade.[52] However there have been cases in the Indian courts where narrow interpretations were given to mean that transactions were held to be non-commercial merely because they facilitated the supply of know-how.[53] Further to establish the international character of arbitration proceeding or award the procedural criterion is applied which was observed by the Supreme Court in *Western Company's* case[54] It was observed that the arbitration will not get an international colour if the seat of the arbitration is in some other country and the procedure which is followed in accordance with Indian law.[55] The term International Commercial Arbitration is defined under the sec 2(1)(f) of Arbitration Ordinance.[56]

CONCLUSION

There have been varied or wide interpretations of the words 'commercial' and 'international' in the international legal scenario. The terms have been interpreted by different countries in their own distinct ways or in accordance with some international convention or the Model law, since different countries have distinct legal relationship and there is a problem to construct a global definition for the aforementioned terms. It is to be noted that while construing the terms 'commercial' and 'international', the real nature of the transaction should be taken into consideration. The interpretation provided by the Model Law is in accordance with sound legal principles, whereas the interpretation provided by the New York convention provides for the discretion of the parties which gives way for ambiguous interpretation.

It is a well acknowledged fact that it is a Herculean task to provide a commonly accepted definition for these terms under international commercial arbitration. But the terms

[51](1984) 4 SCC 679.

[52]*Ibid* 17.

[53]*Engg Corp Ltd. v Societe De Traction Et D' Electricity Sociate Anonyme* AIR 1965 Bom 114 at 118; *Josef Meisaner GMBR & Co. v Kanoria Chemicals & Industries Ltd* AIR 1985 Cal 45 at 54.

[54]*ONGC v Western Company of North America,* AIR 1987 SC 674.

[55]*Union of India v McDonnel Douglas Corporation,* High Court Queen's Bench Division, December 22, 1992, Yearbook Commercial Arbitration, 1988, 156-164.

[56]*Ibid* 9.

must be given a global definition since the same will help in bringing clarity and certainty. International commercial arbitration is long recognized and is becoming a speedy and more convenient method for settlement of disputes between parties. Thus, the courts by giving a liberal construction to these words can facilitate and promote the international commercial trade and also help in speedy settlement of the these disputes arising through the arbitration.