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International Arbitration Report

Validation Principle May Increase Number Of Future Arbitrations

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New York

A commentary article reprinted from the May 2014 issue of Mealey's International Arbitration Report

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Commentary

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Introduction

The New York Convention on Convention on the Recognition and Enforcement of Foreign Arbitral Awards ("New York Convention")[1] is directed to contracting States' courts, and not to arbitral tribunals. Arbitrators have, nonetheless, adopted its rules when deciding on the validity of the arbitration agreement.[2]

Article V of the New York Convention lists the "procedural defenses" against enforcement of arbitral awards within contracting States. Subsection 1(a) provides that recognition and enforcement may be denied if the parties were under some incapacity "*under the law applicable to them*". In applying this rule, courts have repeatedly offered different interpretation as to which law has to be considered governing the issue of the validity of the arbitration agreement. While courts in the United States have tended to apply forum law to this purpose,[3] courts in foreign countries have opted to favor the law of the place of arbitration.[4] Another group of courts have considered applicable the law chosen by the parties as the law governing the contract, or, in absence of an express clause, the law that would apply to the contract under a conflict of law analysis.[5] Lastly, there is also who promotes the use of anational law like the *lex mercatoria* as it would reduce fragmentation of the law and possibility of conflicting decisions.[6]

This plurality of jurisdictional orientations leads to a significant degree of uncertainty for the practitioner that faces the task of representing a party in an arbitration proceeding in which jurisdiction and the validity of the arbitration agreement are contested. The interim award on jurisdiction reported below, offers an example of the application of the "validation principle", a legal theory that purports to solve the problem at least in part.[7]

Case Background

A Canadian company ("**Vendor**") and a New York Company ("**Buyer**") entered into a contract for the sale and purchase of goods. The contract had a clause titled **Arbitration**, stating that any dispute had to be submitted to arbitration to be held in New York under rules of the International Chamber of Commerce ("**ICC rules**"). The same provision indicated that the laws of the United States were to prevail. Another clause in the contract was labeled **Governing Law**, and identified ICC rules together with English law as the law governing and interpreting the contract.

The contract was successively assigned by vendor to a Panamanian company ("**Assignor**") which undertook

the obligation to deliver the goods to New York following the transfer of the contract price to an escrow agent by Buyer. A dispute arose when the escrow agent released the funds to Assignor without receiving the appropriate shipping documents from it. The goods were never delivered to the Buyer.

In initiating the arbitration proceeding, Buyer asserted that: (a) the sale contract and the assignment were valid; (b) the dispute was properly submitted to the jurisdiction of the arbitral tribunal, and (c) New York law was the law that applied to the dispute. Assignor replied that it was not bound to the assignment of the sale contract because the assignment had been negotiated and executed by an individual who, under Panamanian law, did not have authority to act on behalf of Assignor. The invalidity of the assignment implied the invalidity of the arbitration clause with respect to Assignor, and therefore the arbitral tribunal had no jurisdiction over the Assignor.

The arbitrator was bestowed with the task to determine which law governed respectively:

1. The issue of validity of the arbitration agreement;
2. The issue of corporate agency and authority to receive the assignment of the sale contract;
3. The actual arbitration proceedings;
4. The subject matter of the contract.

The task was indeed daunting, given the multiple "choice of law" clauses and their apparent inconsistency, and we believe that the decision is worth to be analyzed in depth.

The Award

The Arbitrator decided that Panamanian law applied to the issue of the authority the agent to bind Assignor to the contract, as the issue was closely related to corporate authority principles in Panama. In this sense, she held that although the agent lacked formal attribution of power of attorney by the Panamanian company, under Panamanian law he would still considered able to bind the Assignor under a theory similar to the one of apparent authority in the United States.

With respect to the substantive law of the contract, the arbitrator held that the clauses addressing the choice of law contained in the sale contract were conflicting, and did not express a valid agreement between the parties. As a consequence, she ruled that Art. 21(1) of the ICC Rules gave her discretion in the choice of the law applicable to the dispute.[8] Citing to the Second Circuit ruling in *Brink's v. S. African Airways*, she considered: the place of contracting; the places of negotiation and performance, and the domicile or the place of business of the contracting parties.[9] As a result, she indicated New York law as the law the law to apply to the merits of the dispute. Interestingly, the arbitrator also mentioned she applied the validation principle to reach this conclusion. Although she did not expand further in her analysis on this point, we consider it to be an acknowledgment that deserves to be pointed out.

Application Of The Validation Principle To The Issue Of Choice Of Law

The validation principle supports the view that an international arbitration agreement has to be considered valid and enforceable if it would be so considered under at least one of the national laws potentially applicable to the agreement.[10] Originally a doctrinal elaboration, the principle has been recognized in some jurisdiction and translated into binding rules. Swiss courts, namely, would uphold an arbitration agreement if it satisfies any one of the following laws: the law chosen by the parties, or the law governing the subject-matter of the dispute, in particular the main contract, or Swiss law.[11]

Some authors argue that Art. V(1)(a) of the New York Convention favors the applicability of the validation principle to international arbitration agreements between signatory states.[12] Article V(1)(a) states that:

> "recognition and enforcement of the award may be refused, at the request of the party against whom it is invoked, only if that party furnishes to the competent authority where the recognition and enforcement is sought, proof that:(a) The parties to the agreement referred to in article II were, under the law applicable to them, under some incapacity, or the said agreement is not valid under the law to which the parties have subjected it or,

> failing any indication thereon, under the law of the country where the award was made."[13]

A judicial decision from a U.S. court asked to enforce an arbitration award that cited and applied the validation principle to rebut a challenge on the validity of the arbitration agreement could represent a major step in favor of international arbitration. The more are the laws that can be considered by the arbitrator to assert the validity of the arbitration agreement and its jurisdiction over the dispute, the more difficult it would be for a party to escape arbitration by invoking national law provisions. The validation principle, in fact, requires only one out of all the national laws that could apply to the dispute recognizes the validity of the arbitration agreement, for the latter to be valid and binding.

In the interim award on jurisdiction in analysis, the reference made by the arbitrator to the validation principle can be understood as meaning that:

1. while the issue of the existence of the agency relationship between the Assignor and the individual who received the assignment was to be decided under Panamanian law,

2. the issue of whether the contract was validly assigned was to be decided by applying the law that granted its validity.

In other words, once resolved under Panamanian law the matter of the existence of the power to receive the assignment, the actual exercise of that power and the conclusion of the assignment contract had to be adjudicated under that law which allowed for the assignment to be valid. This would be the only way to reconcile both the enunciation of the validation principle, and the choice of Panamanian national law to decide the issue of authority to receive the assignment.

Once asserted the validation principle (and therefore indirectly acknowledged that the arbitration agreement was binding upon Assignor if the assignment was valid under at least one of the applicable national law), the arbitrator correctly chose the law of New York. The permissive approach that New York law has with respect to assignment of contracts,[14] and the strict contact the facts of the case had with New York the choice all the more logical.

If this reading is correct, the award would represent a significant step in favor of an international recognition of a principle that would render issues of validity of arbitration agreements more certain and less victim of capricious national law.

Endnotes

1. Convention on the Recognition and Enforcement of Foreign Arbitral Awards, June 10, 1958, U.S.T. 2517, 330 U.N.T.S. 38.

2. Silberman, L., "*The New York Convention After Fifty Years: Some Reflections on the Role of National Law*", 38 Ga. J. Int'l & Comp. L. 25, 43 (2009).

3. Rhone Mediterranee Compagnia Francese Di Assicurazioni E Riassicurazoni v. Achille Lauro, 712 F.2d 50, 52-55 (3d Cir. 1983).

4. Silberman, *supra*, at 42.

5. Born, G. International Commercial Arbitration, 475-476 (2009).

6. Hook, M., "*Arbitration Agreements and Anational Law: A Question of Intent?*" 28 Journal of International Arbitration 174 (2011).

7. Born, G. International Commercial Arbitration. at 497-504.

8. ICC, Art. 21 (1) and (2): Applicable Rules of Law (1) The parties shall be free to agree upon the rules of law to be applied by the arbitral tribunal to the merits of the dispute. In the absence of any such agreement, the arbitral tribunal shall apply the rules of law which it determines to be appropriate. (2) The arbitral tribunal shall take account of the provisions of the contract, if any, between the parties and of any relevant trade usages.

9. *Brink's Ltd. v. S. African Airways*, 93 F.3d 1022, 1030 (2d Cir. 1996).

10. Born, G. International Commercial Arbitration, 494 (2009).

11. Art. 178 (2) Swiss Loi Fédérale sur le Droit International Privé (LDIP). Original text: "*Quant au fond, elle est valable si elle répond aux conditions que pose soit le droit choisi par les parties, soit le droit régissant l'objet du litige et notamment le droit applicable au contrat principal, soit encore le droit Suisse*."

12. Born, G. International Commercial Arbitration. at 500.

13. Art. V (1)(a) Convention on the Recognition and Enforcement of Foreign Arbitral Awards, June 10, 1958, U.S.T. 2517, 330 U.N.T.S. 38.

14. Under New York law, "No particular words are necessary to effect an assignment; it is only required that there be a perfected transaction between the assignor and assignee, intended by those parties to vest in the assignee a present right in the things assigned." *Leon v. Martinez*, 638 N.E.2d at 513 (1994). ■

MEALEY'S: INTERNATIONAL ARBITRATION REPORT
edited by Lisa Schaeffer
The Report is produced monthly by

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Telephone: (215)564-1788 1-800-MEALEYS (1-800-632-5397)
Email: mealeyinfo@lexisnexis.com
Web site: http://www.lexisnexis.com/mealeys
ISSN 1089-2397