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COMMITTEE ON CONSTITUTIONAL AND LEGAL MATTERS

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Review of Standard Arbitration Clauses in FAO Commercial Contracts

I. Introduction

1. All contracts and agreements of the Organization with commercial counterparts contain a clause, prescribing that disputes will be settled through binding arbitration. Situations where there has been a need to resort to commercial arbitration have remained exceptional. Thus, in the period between 2000 and 2011, only three disputes with commercial suppliers have been resolved through arbitration[1].

2. Experience gained in the proceedings has lead the Legal Office to review the manner in which arbitration proceedings are conducted. The Committee is requested to consider a proposal to modify the standard arbitration clause in contracts of the Organization with commercial suppliers to include provision for the administration of arbitration proceedings by the Permanent Court of Arbitration (PCA) at The Hague, The Netherlands, for reasons elaborated in this document.

II. The Present Arbitration Clause

3. As a matter of standard, the Organization includes in its contracts with commercial suppliers a clause on the settlement of disputes through binding arbitration. Dispute settlement through arbitration is a normal consequence of the privileges and immunities of the Organization, which prevent that it submits to the jurisdiction of national courts, as this would entail a waiver of the immunity of the

[1] A dispute with (1) Equipe '90 Srl., an Italian supplier of maintenance services at the headquarters of FAO in 2000; (2) Granuco Sal, a Lebanese supplier of animal feed provided under the Oil-for-Food Programme in 2009, and (3) Summertime Srl., a provider of travel services to the Organization, formerly at FAO headquarters, in 2011.

Organization. At the same time, the Organization is under an obligation to ensure that it arranges for 'appropriate modes of settlement of disputes arising out of contracts or other disputes of a private character to which it is a party'[2].

4. This is further reflected in the provisions of Article VIII, Section 16 of the Headquarters Agreement between the Government of the Italian Republic and FAO of 31 October 1950, incorporated into Italian law by Law No 11 of 9 January 1951, whereby FAO enjoys immunity from any form of jurisdiction in Italy. In accordance with the provisions of the Exchange of Letters of 16, 19 and 22 December 1986, all disputes arising out of contracts and other disputes of private character are settled through arbitration.

5. The provision for binding arbitration in contracts of the Organization with commercial counterparts therefore discharges the Organization of its explicit international obligations. In fact, arbitration is the standard mode of dispute settlement of all UN agencies in commercial contracts, as well as in a range of other types of agreements, including at times in funding agreements with some donors.

6. The arbitration provision is kept under review, and modifications are made in response to relevant developments or as a result of evaluating the experiences gained in arbitration proceedings. One such review took place following the arbitration proceedings with Equipe '90 Srl., as well as a discussion on arbitration among the Legal Advisors of the United Nations system at a meeting held in Geneva, 7-8 March 2002. On that occasion, some difficulties in arbitration proceedings were considered and a number of observations were made, including on issues such as applicable law, time limits of arbitration proceedings, punitive damages and a mandatory conciliation procedure prior to arbitration.[3]

7. The CCLM, endorsed, at its seventy-third Session, the addition of further elements in the standard provision on arbitration: (1) the requirement of a formal conciliation procedure before resorting to arbitration as a means to introduce an intermediate step before arbitration, and (2) a prohibition of awards for punitive damages. The Committee further requested the Legal Office to continue to keep its contractual provisions under review, taking into account the practice and experience of the United Nations system.

8. In fact, at a later stage, a further modification was made by introducing a time limit applicable to the initiation of formal dispute resolution procedures, since, in one case, the arbitration proceedings were initiated some five years after the contract at issue had been terminated, and the funding of the outstanding claim created a number of issues with the United Nations in the context of the Oil-for-Food Programme. As a result of these experiences, an element of time limitation was introduced to the arbitration clause.

9. In all, the modifications described here have lead to the current version of the standard arbitration clause, which reads as follows:

> *Any dispute between the Parties concerning the interpretation and the execution of this [Memorandum/Agreement/Contract], or any document or arrangement relating thereto, shall be settled by negotiation between the Parties. If the dispute is not settled by negotiation between the Parties, it shall, at the request of either Party, be submitted to one conciliator. Should the Parties fail to reach agreement on the name of a sole conciliator, each Party shall appoint one conciliator. The conciliation shall be carried out in accordance with the Conciliation Rules of the United Nations Commission on International Trade Law, as at present in force.*
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> *Any dispute between the Parties that is unresolved after conciliation shall, at the request of either Party be settled by arbitration in accordance with the Arbitration Rules of the United*

[2] Cf. Article IX, Section 31 (a) of the Convention on Privileges and Immunities of the Specialized Agencies.
[3] Cf. CCLM 73/2; CL 123/5, paragraphs 4-12.

Nations Commission on International Trade Law, as at present in force. The arbitral tribunal shall have no authority to award punitive damages.

The conciliation or the arbitration proceedings shall be conducted in the language in which the Memorandum/Agreement/Contract is drafted provided that it should anyway be one of the languages of the Organization (Arabic, Chinese, English, French, Russian and Spanish). In cases in which the language of the Memorandum/Agreement/Contract is not a language of the Organization, the conciliation or the arbitration proceedings shall be conducted in English.

The parties may request conciliation during the execution of the [Memorandum/Agreement/Contract] and anyway not later than twelve months after the expiry or the termination of the [Memorandum /Agreement/Contract]. The parties may request arbitration not later than ninety days after the termination of the conciliation proceedings.

Any arbitration award rendered in accordance with the provisions of this Article shall be final and binding on the Parties.

10. The provisions on arbitration include a reference to the Arbitration Rules of the United Nations Commission on International Trade Law (UNCITRAL), which, at present, would be the 2010 version[4]. These are, or tend to the standard arbitration rules throughout the United Nations system. The UNCITRAL Rules provide the procedural framework of an arbitration, covering a large number of procedural aspects, such as the initiation of a proceeding, the appointment of the arbitral panel, the appointment of a third, presiding arbitrator, time limits for submissions, rules of evidence, applicable law, etcetera.

11. The UNCITRAL Rules provide for the establishment of an arbitration panel of three arbitrators, two of which are appointed by the parties in dispute, and the third, presiding arbitrator would be appointed by agreement of the two, party-appointed arbitrators. Failing such agreement, the presiding arbitrator would be appointed by the Appointing Authority, who would be designated by agreement of the parties, or, failing such agreement, by the Secretary-General of the Permanent Court of Arbitration, by way of default.

12. As such, arbitration panels are established on an *ad hoc* basis. In two cases arbitration panels were established on an *ad hoc* basis, and the arbitrators in both cases agreed on the third, presiding arbitrator. In another case, however, the parties could not agree on the appointment of the presiding arbitrator, but agreed that the Secretary-General of the Permanent Court of Arbitration act as Appointing Authority. In addition to designating the Secretary-General of the PCA as Appointing Authority in that case, the parties further agreed that the PCA act as the administrator of the arbitration, and perform administrative, logistical and procedural functions in support of the arbitration proceedings. Drawing on these various experiences it is considered that there would be merit in having the PCA designated as the administration of arbitrations arising from contracts and agreements of the Organization.

III. Practice and Experience of Arbitrations

13. As mentioned, the choice of binding arbitration as a means of dispute resolution is a function of the privileges and immunities of the Organization, and discharges the Organization of its international obligations as a result of its legal status. In addition to being a means of dispute

[4] http://www.uncitral.org/pdf/english/texts/arbitration/arb-rules-revised/arb-rules-revised-2010-e.pdf

resolution that is consistent with the legal status of FAO, arbitration has a number of advantages, including a measure of cost-effectiveness especially in connection with important contracts and quickness. However, arbitration proceedings do have their drawbacks, which generally relate to the relative absence of structure and a resulting degree of unpredictability of arbitrations.

14. Arbitrations take place in an environment that does not provide the same level of structure, oversight and procedural stability as compared with proceedings before national courts. Arbitration panels are not part of a larger judicial structure, bound by a detailed set of procedural rules. In addition, arbitration proceedings are typically not public, which, while contributing to the confidentiality of proceedings, may not assist in establishing a consistent process.

15. A factors that is particularly relevant in this context, however, is the circumstance that arbitration panels are not formally bound by precedent, and that arbitration panels enjoy a considerable degree of discretion in adjudicating a dispute. Arbitration jurisprudence has not, for many reasons, reached a level of stability in comparison with established national judicial systems. Arbitrators are not formally bound by, or held to consider, precedent or jurisprudence. The confidential nature of many arbitration proceedings and awards is a factor in this respect, as this prevents the broader development and dissemination of a body of case law in arbitrations, even as a source of voluntary, non-binding reference.

16. In addition, the UNCITRAL Rules attribute to the arbitrators a relatively large discretion in procedural matters, as well as substantive matters, such as evidence and applicable law. The UNCITRAL rules provide that, subject to the rules a "*tribunal may conduct the arbitration in such manner as it considers appropriate*" (article 17 UNCITRAL Rules). As regards evidence, the tribunal shall "*determine the admissibility, relevance, materiality and weight of the evidence offered*" (article 27 UNCITRAL Rules), and finally, the tribunal "*shall apply the rules of law designated by the parties*" (Article 35 UNCITRAL Rules) [5]. The framework of the UNCITRAL Rules therefore leaves a comparatively large area of discretion to the arbitrators, in areas that in national court systems would be regulated in considerable detail, through explicit procedural law and through jurisprudence.

17. An example of the above is the tendency of arbitration panels to adjudicate disputes on an "*ex aequo et bono*", or, equity basis, even if an arbitration panel should be explicitly authorized by the parties to do so. In essence, arbitration panels are often inclined to identify a solution that reflects the interests of both parties involved in a dispute, and apply only what arbitrators consider fair and equitable under the circumstances of a particular case, rather than apply the substance of applicable rules to a set of objective facts and circumstances. In such a context, extraneous considerations such as the relative size and financial strength of the parties enter into view.

18. Furthermore, arbitration awards under the arbitration clause of the Organization are final and binding, and not subject to appeal. There is therefore no recourse in case an arbitration panel errs in the interpretation or application of the UNCITRAL arbitration rules, or the law applicable to the dispute. Clearly, the composition of an arbitration panel, including an arbitrator appointed by the Organization, would offer assurances of an adequate consideration of the positions and perspectives of the Organization. However, errors of any nature by the panel as a whole cannot be excluded, especially since arbitration panels under UNCITRAL Rules decide by simple majority. The circumstance that an opportunity to appeal is absent does place the onus on the Organization to ensure, as much as possible, that the arbitration process itself is stable and predictable.

[5] The provision on applicable law presents some issues in this particular context for the Organization as well as for other UN agencies, in that the Organization's provisions on applicable law are necessarily general in nature, since the status of the Organization prevents the direct application of national law. The standard provision on applicable law reads: "*This contract is governed by general principles of law, to the exclusion of any national system of law. General principles of law are deemed to include the UNIDROIT Principles of International Commercial Contracts 2010*". The UNIDROIT Principles are a set of general contract rules, and a reference to the Principles is added to provide a degree of definition to the notion of ' general principles of law'. To view, please see:
http://www.unidroit.org/english/principles/contracts/principles2010/integralversionprinciples2010-e.pdf

19. The Organization seeks to mitigate some of the disadvantages associated with arbitration proceedings and, drawing on its own comparative experience, proposes to ensure that arbitrations of the Organization are administered by the Permanent Court of Arbitration in The Hague, the Netherlands. The PCA would act as host of an arbitration, and provide a range of services and functions of a logistical and administrative nature, but also provide procedural support to an arbitration panel, as elaborated below. It should be noted that arbitrations of the Organization would not automatically be held in The Hague; parties would still need to agree on the location of an arbitration, and the services of the PCA can be provided in practically any location in the world.

IV. The Permanent Court of Arbitration

20. The PCA is an intergovernmental organization established by the 1899 Hague Convention for the Pacific Settlement of International Disputes that works to facilitate the resolution of international disputes through arbitration and other processes. It has 115 members at the moment. The PCA administers arbitrations involving at least one State, State entity, or international organization, under the UNCITRAL Rules in the case of FAO. Accordingly, disputes involving the FAO would qualify for PCA administration and the various benefits that flow therefrom, which are not available in disputes between purely private parties. The PCA is currently administering over 50 arbitrations under the UNCITRAL Rules, and has administered a significant number of arbitrations in recent years involving international organizations.

21. The PCA is not an entity or agency of the United Nations, and as such, the PCA is a neutral body in disputes involving United Nations agencies. As noted earlier, the UNCITRAL arbitration rules already attribute a number of functions to the Secretary-General of the PCA, by way of default, in cases where parties have not designated an authority to appoint a presiding arbitrator or the appointing authority fails to act within a specified time. Under these circumstances, the Secretary-General of the PCA acts as appointing authority (Article 6, UNCITRAL Rules). In disputes involving international organizations, the PCA is therefore an appropriate entity to serve as registry for the administration of arbitrations of the Organization.

22. The PCA offers a range of services, assisting tribunals in the logistical and procedural aspects of cases. The scope of PCA administration varies between cases, depending on the needs of particular parties and tribunals, and may include:

a) transmitting communications between the parties and the arbitral tribunal;

b) maintaining an archive of filings and correspondence;

c) facilitating agreement between the arbitral tribunal and the parties on the amounts of the arbitrators' fees and the advance deposits to be made by the parties to cover such fees;

d) holding the party deposits and disbursing tribunal fees and expenses;

e) assisting the arbitral tribunal to establish the date, time and place of hearings, and giving advance notice thereof to the parties as the tribunal determines;

f) making available its hearing and meeting rooms in The Hague or elsewhere;

g) making arrangements for transcription, recording, interpretation, translation, catering, or other support associated with hearings or meetings at the Peace Palace or elsewhere;

h) assisting with travel and hotel reservations, as well as procurement of visas; and

i) carrying out any other tasks entrusted to it by the parties or the arbitral tribunal.

23. In addition, the PCA monitors deadlines and provides appropriate notifications to tribunals and parties in order to promote the efficient progress of each proceeding. Each arbitration administered by the PCA would be assigned at least one PCA Legal Counsel who acts as the point of contact for the arbitration. The assistance of specialized legal counsel would allow for a more stable and efficient proceeding as they may draw upon ample precedent and experience of the PCA to assist the parties and the tribunal, particularly on procedural matters.

24. As noted earlier, a particular arbitration was administered by the PCA. It was the experience of FAO that these proceedings were carried out in a most orderly manner compared to earlier, ad hoc arbitrations, and the overall experience was very positive. The presence of the PCA framework, the knowledge resources of previous arbitrations that it can draw upon and particularly the monitoring and support of PCA legal counsel, imposes a degree of structure and order on the arbitration tribunal that would otherwise be absent. The administration of an arbitration by the PCA does not fully address all issues associated with arbitration in general. However, it does provide a more disciplined environment for an arbitration panel, which contributes towards the stability and predictability of the proceedings. In fact, the presence of a reputable institution such as the PCA, by its very presence, assures a form of quality control over the proceedings.

V. Cost Implications

25. As regards cost implications, it is noted that PCA fees in any registry matter are assessed at an hourly rate based on the work actually performed by PCA staff. Because the PCA is a public institution and partially funded by Member State contributions, it is able to provide administrative services in support of arbitration proceedings at a reasonable cost to parties engaged in disputes, since full cost-recovery, or profits, are not reflected in the fee levels of the PCA. The fees charged by the PCA are attached as Annex 1 to this Document.

26. Tribunals under the UNCITRAL Rules typically charge at an hourly rate for their services as arbitrators, which would normally include a portion of the administrative services provided by the PCA. By assigning these functions to PCA, a reduction of costs can be achieved since the administrative services are charged at significantly lower levels than the typical rates of arbitrators.

27. Furthermore, the PCA does not charge a fee for the registration of a case or for annual yearly administrative fee by way of retainer. It holds deposits of arbitration costs at no charge to the parties. The parties to PCA-administered proceedings pay no fee for use of the hearing and meeting rooms in the Peace Palace in The Hague, or the PCA's facilities in Costa Rica, South Africa, Mauritius, and Singapore. Parties bear the other expenses that arise in their cases, such as costs of court reporters, courier charges, and fees for translation and interpretation.

28. Finally, the Secretary-General of the PCA is also attributed functions in relation to a review of the cost of arbitration and the fees and expenses charged by the arbitrators (Article 41-4(b), UNCITRAL Rules). Upon request by one of the parties, the Secretary-General will make a determination on whether fees and expenses are reasonable in light of the circumstances of the case and the PCA's awareness of prevailing costs of arbitration in comparable cases. In this context, the immediate involvement of the PCA in arbitrations tends to have a downward effect on arbitrator fees.

29. Overall, the involvement of the PCA as administrator of arbitrations would not, normally, contribute to higher cost of arbitration, but is, in fact, more likely to exert a downward pressure on the cost of an arbitration.

VI. Modification of the Arbitration Clause

30. The involvement of the PCA could be provided for by including the following, straightforward language in the standard FAO arbitration clause adding provision for the administration of the PCA:

> " *Arbitrations under this provision shall be administered by the International Bureau of the Permanent Court of Arbitration."*

VII. Suggested Action by the Committee

31. In light of the foregoing, the Committee is requested to note the considerations regarding arbitrations above, and endorse the proposed modification of the standard arbitration clause to the effect of ensuring that arbitrations of the Organization be administered by the Permanent Court of Arbitration.

Annex 1

Schedule of fees and costs (from the PCA website: www.pca-cpa.org)

Schedule of Fees and Costs

This Schedule of Fees & Costs applies to the following PCA services. All amounts are given in euro and are subject to change.

Designation of an Appointing Authority Pursuant to the UNCITRAL Arbitration Rules

Non-refundable processing fee	€ 750

Registry Services provided by the International Bureau

Secretary-General	€ 250/hour
Deputy Secretary-General	250/hour
Senior Legal Staff	175/hour
Junior Legal Staff	125/hour
Secretarial/Clerical	50/hour

The International Bureau can arrange for estimates for the following on request:

verbatim transcription, interpretation, translation, document reproduction, sound and audiovisual equipment, tele- and videoconferencing, etc.

Hearing/Meeting Facilities

Hearing and meeting rooms at the Peace Palace are available free of charge to arbitral tribunals and commissions for which the PCA serves as registry. Ancillary equipment is charged separately.