

Dealing with Pandora: The Concept of ‘Merits’ in International Commercial Arbitration

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I. INTRODUCTION

THERE ARE few legal terms that are considered so unproblematic that they hardly ever raise issues of interpretation. This should not come as a surprise, given that the resolution of legal disputes often tends to turn, at least in part, on how a particular legal term or concept should be interpreted or applied in a particular context. The more surprising, then, that there seems to be, at the very core of the conceptual structure of international commercial arbitration, a term that is considered largely unproblematic, if not self-evident. This is the very concept of ‘merits’ – a term commonly used to describe and refer to what a legal case is in substance all about. In short, the case may be understood in terms of its merits – if any.

When searching for reference materials for this short article, I could not find a single law review article devoted exclusively to the subject.¹ Indeed, the concept of merits and its interpretation and application in the context of concrete disputes appears to have attracted only limited interest among legal academics, not to mention legal professionals. This may well be because concepts such as jurisdiction, procedure and merits, which form part of the conceptual structure of any legal system, are presumed to be generally known as a matter of legal education.² In

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¹ Public international law scholars have tended to pay more attention to such conceptual issues. See e.g., the classic contribution of Gerald Fitzmaurice, ‘The Law and Procedure of the International Court of Justice, 1951–54: Questions of Jurisdiction, Competence and Procedure’ in (1954) 34 *Brit. YB Int’l L* 1 at pp. 22–23. It is arguable that, even in the public international law context, the question of how the ‘merits’ of a case should be characterised, and how they should be dealt with, emerged as one of the principal issues of the case only in *Oil Platforms (Iran v. United States) (Judgment on Merits)*, 6 November 2003, available at www.icj-cij.org. For discussion, see Veijo Heiskanen, ‘Oil Platforms: Lessons of Dissensus’ in (2005) 74 *Nordic J Int’l L* 179. The case is discussed in further detail *infra*.

² Accordingly, international commercial arbitration scholars and practitioners have tended to focus more on the boundaries between arbitral jurisdiction, procedure and merits than on the issue of what these terms themselves signify; e.g. the debate about the various meanings of the concept of applicable law (governing law (curial law, *lex arbitri*), procedural law and substantive law) in effect coincides with the broader conceptual distinctions between jurisdiction, procedure and substance. For a recent note dealing with the interface between jurisdictional and substantive issues, see e.g., William W. Park, ‘The Nature of Arbitral Authority: A Comment on *Lesotho Highlands*’ in (2005) 21 *Arb. Int’l* 483.

other words, as part of the shared conceptual framework or universe of the legal profession, they tend to be seen as part of what we argue *with* rather than argue *about*.

And yet, as this article will argue, the concept of ‘merits’, or rather, what we mean or refer to when speaking of the merits of a case, is far from unproblematic and in practice not at all self-evident. Indeed, at the risk of opening a conceptual Pandora’s box (or rather, a Pandora’s *case*),³ I will argue that, when speaking of merits, we tend to confuse two different concepts which, while closely related, should be clearly distinguished: *the merits of the claim* and *the subject matter of the dispute*. While this distinction may seem on its face rather academic since the two concepts are often used interchangeably and may in practice overlap, they do not always coincide – a scenario which, in certain circumstances, may raise important issues concerning arbitration strategy and the methodology of arbitral decision-making, and indeed, the very function of international commercial arbitration.

Relevant questions include: What is the practical relevance of the distinction between the merits of the claim and the subject matter of the dispute, and how might a party exploit this distinction in developing its arbitration strategy? In what circumstances may the respondent legitimately argue that the claimant’s claims, as asserted, do not properly reflect the subject matter of the dispute between the parties? Where the respondent does raise such a defence, and it does not appear to be wholly without merit, should the arbitral tribunal rule first on the claimant’s claims, or should it rather give priority to the respondent’s defence? What are the implications of such a decision in terms of the function of international commercial arbitration as a technique of dispute settlement?

The present article suggests that such questions are not entirely without practical relevance.

II. CONCEPT OF ‘MERITS’ IN INTERNATIONAL ARBITRATION RULES

The concept of ‘merits’, like the related terms of ‘jurisdiction’ and ‘procedure’, appear to be generally considered as unproblematic; indeed, part of the conceptual toolbox lawyers adopt in the course of their academic education and

³ According to the classic Greek legend, Pandora, the first woman, was given by Zeus, as dowry upon her marriage with Epimetheus, a box which she was warned by Prometheus not to open. Despite the warnings she did, and as a result all the misfortunes of mankind were released, including Discord, and not surprisingly, Pandora and Epimetheus had their very first dispute. Fortunately the box also included one good creature, Hope, which was also released, although only after the misfortunes had already escaped. By way of an afterthought, Hope thus became mankind’s sole means to survive amid all the misery caused by Pandora.

A lawyer may justifiably argue (although this is no doubt debatable) that the myth of Pandora’s box (or case) is in fact a story of the very first dispute, and thus the very first case, and that the Law is the sole good creature that mankind has been given to deal with this particular type of misfortune. (Although, like Hope in the legend, Law always has a lot of catching up to do, since just as Hope was released only after the misfortunes had already escaped, Law is invoked only after the dispute has already arisen. Then again, this should not come as a surprise, since ‘Epimetheus’ means ‘hindsight’ ...) For discussion of the myth of Pandora, see e.g., Thomas Bullfinch and Richard B. Martin (eds), *Bullfinch’s Mythology: The Age of Fable or Stories of Gods and Heroes* (1991), vol. I.

professional training. This hypothesis seems confirmed by standard textbooks and treatises, which devote little, if any, attention to these concepts, including that of ‘merits’. A standard legal dictionary defines ‘merits’ in the following terms:

Merits. As a legal term, refers to the strict legal rights of the parties ... The substance, elements, or grounds, of a *cause of action and defence*. See Judgment on the merits.⁴

‘Judgment on the merits’ is defined in turn as follows:

Merits, judgment on. One rendered after argument and investigation, and when it is determined *which party is in the right*, as distinguished from a judgment rendered upon some preliminary or formal or merely technical or procedural point, or by default and without trial. A decision that was rendered on the basis of the evidence and facts introduced. Normally, a judgment based solely on some procedural error is not a judgment on the merits. The latter kind of judgment is often referred to as a ‘dismissal without prejudice’. A party who has received a judgment on the merits cannot bring the same suit again. A party whose case has been dismissed without prejudice can bring the same suit again so long as the procedural errors are corrected (*i.e.* cured) in the later action.

For *res judicata* purposes is one which determines *the rights and liabilities of the parties* based on the ultimate facts as disclosed by the pleadings or issues presented for trial.⁵

These definitions use the term ‘merits’ in a broad sense, covering both the rights asserted by the claimant and the defences raised by the respondent. Thus, it is implicit in these definitions that there are two aspects to the concept of merits, in a broad sense of the term: an aspect that relates to the merits of *the claim* brought by the claimant, and an aspect that reflects the subject matter (or substance) of *the dispute* between the parties, as resulting from the defences raised by the respondent. These two aspects of the concept are closely related and indeed functionally intertwined. However, they are not synonymous and in practice they may or may not coincide. The fact that the two concepts may in fact coincide appears to explain why they are often confused or at least not strictly distinguished. However, the fact that they may not, and sometimes do not, coincide arguably justifies making a careful distinction between them.

The two terms, the merits of the claim and the subject matter (or substance) of the dispute, are often used interchangeably in international arbitration materials. Thus, art. 28 (Rules applicable to substance of the dispute) of the UNCITRAL Model Law on International Commercial Arbitration provides:

1. The arbitral tribunal shall decide the dispute in accordance with such rules of law as are chosen by the parties as applicable to the *substance of the dispute*. (emphasis added)

It is arguable that the term used in the Model Law, ‘substance of the dispute’, could easily be replaced by the term ‘merits of the claim’ or the ‘merits of the case’ without its meaning being affected in any way.

⁴ *Black’s Law Dictionary* (6th edn), pp. 989–990 (emphasis added).

⁵ *ibid.* pp. 843–844 (emphasis added).

Similarly, art. 13(1) of the UNCITRAL Arbitration Rules provides:

1. The arbitral tribunal shall apply the law designated by the parties as applicable to the *substance of the dispute*. (emphasis added)

Article 17(1) of the ICC Rules of Arbitration, interestingly, mixes the two terms in a compromise formulation:

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*. (emphasis added)

Similarly, art. 22.3 of the Arbitration Rules of the London Court of International Arbitration (LCIA) provides:

The Arbitral Tribunal shall decide the parties' dispute in accordance with the law(s) or rules of law chosen by the parties as applicable to *the merits of their dispute*. If and to the extent that the Arbitral Tribunal determines that the parties have made no such choice, the Arbitral Tribunal shall apply the law(s) or rules of law which it considers appropriate. (emphasis added)

The Convention on the Settlement of Investment Disputes between States and Nationals of Other States (the 'ICSID Convention') adopts a similar approach: arts 41 and 42 refer to 'the merits of the dispute' or simply 'the dispute'.⁶

Article 28(1) of the International Arbitration Rules of the American Arbitration Association (AAA) similarly refers to the law applicable to 'the dispute',⁷ whereas the Swiss Rules of International Arbitration use the terms 'the case' and 'the dispute'.⁸

It is arguable that the some of these formulations, insofar as they refer to 'the merits of the dispute', are not wholly felicitous. While claims may or may not have 'merit', disputes arguably do not. Disputes may have a subject matter, or a substance, but properly speaking they do not have any 'merit'.

However, *defences* asserted by the respondent may have at least some merit, and it is perhaps the fact that one may speak in terms of both the merits of the claim brought by the claimant and the merits of the defence asserted by the respondent, which explains the slight ambiguity in some of the Rules cited above. In other

⁶ See art. 41(2) of the ICSID Convention ('Any objection by a party to the dispute that that dispute is not within the jurisdiction of the Centre, or for other reasons is not within the competence of the Tribunal, shall be considered by the Tribunal which shall determine whether to deal with it as a preliminary question or to join it to *the merits of the dispute*'; and art. 42(1) ('The Tribunal shall decide a dispute in accordance with such rules of law as may be agreed by the parties. In the absence of such agreement, the Tribunal shall apply the law of the Contracting State party to the dispute') (emphasis added).

⁷ See art. 28(1) of the International Arbitration Rules of the AAA ('The Tribunal shall apply the substantive law(s) or rules of law designated by the parties as applicable to the dispute. Failing such designation by the parties, the tribunal shall apply such law(s) or rules of law as it determines to be appropriate').

⁸ See art. 32(1) of the Swiss Rules of International Arbitration ('The arbitral tribunal shall decide the case in accordance with the rules of law agreed upon by the parties or, in the absence of a choice of law, by applying the rules of law with which the dispute has the closest connection').

words, the reference to the ‘merits of the dispute’ in these Rules may be understood as a reference to the ‘merits’ of the respondent’s defence.

In any event, despite the effort that has gone into the drafting of the various Arbitration Rules, it does appear that those who drafted them did not pay much attention to the distinction between the merits of the claim and the subject matter of the dispute, or at least, did not consider that making a strict conceptual distinction between them had to be addressed on the level of the Rules. This may well be the case, and indeed it appears that no particular harm or confusion is created if the two terms are used interchangeably on a general level, *i.e.* outside the context of a concrete case.

III. MERITS OF THE CLAIM VERSUS THE SUBJECT MATTER OF THE DISPUTE

(a) Preliminary Considerations

The concept of ‘merits’, as used in the Arbitration Rules cited above, harbours within itself two different concepts that may or may not overlap in practice. The first is the concept of ‘merits’ in the narrow (and proper) sense of the term, which refers to the legal merits of the claim brought by the claimant – its legal ‘value’ so to speak, both in terms of law and facts. The second is the concept of the ‘subject matter of the dispute’. Unlike the concept of merits, which is largely dependent on how the claimant chooses to argue its claims, the subject matter of the dispute is effectively defined by the respondent when drawing its principal line of defence. Whether or not these two concepts in fact coincide depends on how the parties choose to argue their case.

If defined in terms of merits, the purpose of the arbitral process is to arbitrate the merits of the claimant’s claims: the extent, if any, to which the claims can be sustained in terms of both law and fact. The respondent, in defending itself against the claims brought by the claimant, may choose to challenge the merits of the claimant’s claims as its principal line of defence, arguing that the claims are lacking merit either in terms of fact or law, or both. If the respondent chooses this arbitration strategy, there is, in substance, no difference between the merits of the claim and the subject matter of the dispute. The two effectively coincide, since what the respondent chooses to challenge is, precisely, the merits of the claimant’s claims.

However, the respondent may also choose to focus on a substantive (as opposed to preliminary or jurisdictional) issue other than the claimant’s claims; it may choose to draw its principal line of defence elsewhere, on a substantive issue that is not directly related to the merits of the claimant’s claims in terms of fact or law. The respondent may choose to argue that the claimant’s claims do not reflect what is really at stake in the dispute between the parties; that the actual difference between the parties lies elsewhere; and that, indeed, the claims are simply a result of creative lawyering, developed solely for the purpose of the arbitration.

In international commercial arbitration this may happen in various ways, but whenever such a difference between the ways in which the parties approach the case arises, the arbitral tribunal is inevitably faced with a challenging task. Indeed, in such circumstances, where there is a fundamental disagreement between the parties as to how the case in fact should be characterised in substantive terms, the arbitral tribunal may face complex issues relating to the methodology of arbitral decision-making, and, indeed, the fundamental question as to the very function of international commercial arbitration.

Despite the importance of the issues raised by such defences, jurisdictional issues, or issues relating to the limits of arbitral authority, are usually not among them: arbitration clauses often (although not always) provide that both 'claims' and 'disputes' (or 'controversies') arising out of the contract fall within the jurisdiction of the arbitral tribunal.⁹ In these circumstances the respondent normally cannot challenge the jurisdiction of the arbitral tribunal on the basis that the tribunal's jurisdiction is limited to 'disputes' and does not extend to 'claims'. Moreover, even where there is a formal basis for making such an objection (*i.e.*, because the arbitration clause refers only to 'disputes' and does not specifically mention 'claims'), such an objection would no doubt be considered wholly frivolous by the tribunal and dismissed as such. An arbitral tribunal is unlikely to conclude that, when agreeing to an arbitration clause that refers only to 'disputes' and not 'claims', the parties intended to introduce and endorse the highly technical (albeit important) distinction between the merits of the claim and the subject matter of the dispute, and thus exclude all legal claims (in the technical sense of the term) from the arbitral tribunal's jurisdiction. Moreover, in the unlikely event that such an objection were found *prima facie* to have some

⁹ See *e.g.*, the model arbitration clauses of the United Nations Commission for International Trade Law (UNCITRAL) ('Any *dispute, controversy or claim* arising out of or in relation to this contract, or the breach, termination or invalidity thereof, shall be settled by arbitration in accordance with the UNCITRAL Arbitration Rules as at present in force'); the International Arbitration Rules of the AAA ('Any *controversy or claim* arising out of or relating to this contract, or the breach thereof, shall be determined by arbitration administered by the International Centre for Dispute Resolution in accordance with its International Arbitration Rules' or 'Any *controversy or claim* arising out of or relating to this contract, or the breach thereof, shall be determined by arbitration administered by the American Arbitration Association in accordance with its International Arbitration Rules'); the Swiss Rules of International Arbitration ('Any *dispute, controversy or claim* arising out of or in relation to this contract, including the validity, invalidity, breach or termination thereof, shall be settled by arbitration in accordance with the Swiss Rules of International Arbitration of the Swiss Chambers of Commerce in force on the date when the Notice of Arbitration is submitted in accordance with these Rules') and the Arbitration Institute of the Swedish Chamber of Commerce ('Any *dispute, controversy or claim* arising out of or in connection with this contract, or the breach, termination or invalidity thereof, shall be finally settled by arbitration in accordance with the Rules of the Arbitration Institute of the Stockholm Chamber of Commerce') (emphasis added).

See, however, the model arbitration clauses of the ICC International Court of Arbitration and the LCIA, which only refer to 'disputes' (ICC: 'All *disputes* arising out of or in connection with the present contract shall be finally settled under the Rules of Arbitration of the International Chamber of Commerce by one or more arbitrators appointed in accordance with the said Rules'; LCIA: 'Any *dispute* arising out of or in connection with this contract, including any question regarding its existence, validity or termination, shall be referred to and finally resolved by arbitration under the LCIA Rules, which Rules are deemed to be incorporated by reference into this clause') (emphasis added).

merit, it could not be considered a ‘preliminary’ objection in the proper sense of this term: such an objection is closely related (indeed, inextricably linked) to the merits of the claim and therefore should be, as a matter of due process, joined to the merits.¹⁰

The fact that defences relating to the distinction between the merits of the claim and the subject matter of the dispute do not usually raise jurisdictional issues means, in practical terms, that such issues cannot be brought before the local court on the basis of excess of jurisdiction or breach of a fundamental rule of procedure, or as a defence against the enforceability of the arbitral award. As a result, they tend to be settled, finally and with prejudice, by international arbitral tribunals without any interference or second-guessing by state courts; a consequence that may explain why, to date, there has been very little published materials or academic or professional discussion on the issue.

(b) *Concept of Merits in Public International Law*

Before considering specific scenarios in which the distinction between the merits of the claim and the subject matter of the dispute may become relevant, it is worth noting that this issue is by no means unique to international commercial arbitration. An essentially analogous issue may arise in a public international law context, and indeed has recently arisen, in a case brought before the International Court of Justice (ICJ).¹¹

The present author has argued elsewhere that a failure to distinguish clearly between the merits of the claim and the subject matter of the dispute lies at the heart of the Court’s confusing judgment in *Oil Platforms*.¹² In this case, Iran alleged that the USA had breached its obligations under the Treaty of Amity between the two states by engaging in use of force against three Iranian offshore oil platforms on the Persian Gulf.¹³ The USA argued, in defence, that the use of force fell outside the scope of application of the Treaty of Amity and that, in any event, Iran had approached the Court with unclean hands, having

¹⁰ The authority of an arbitral tribunal to join issues of jurisdiction to the merits, if appropriate, is confirmed in most important international Arbitration Rules, either explicitly or implicitly. For explicit grants of authority, see e.g., art. 16(3) of the UNCITRAL Model Law; art. 21(4) of the UNCITRAL Arbitration Rules; art. 23(3) of the LCIA Arbitration Rules; art. 15(3) of the International Arbitration Rules of the AAA; and art. 29(4) of the ICSID Arbitration Rules. Cf. art. 79(9) of the Rules of the ICJ, which provides that the Court may declare that a preliminary objection ‘does not possess, in the circumstances of the case, an exclusively preliminary character’ and schedule further proceedings. Such declaration has the same effect as joining the objection to the merits, which was the Court’s practice under the previous version of its Rules. Arguably, a defence which challenges the admissibility of the claimant’s claims on the basis that the subject matter of the dispute is elsewhere can never be considered as possessing ‘an exclusively preliminary character’. For discussion of such ‘*fins de non-recevoir*’ and other preliminary objections (proper and improper), see Veijo Heiskanen, ‘Jurisdiction v. Competence: Revisiting a Frequently Neglected Distinction’ in (1994) 5 *Fin. YB Int’l L* 1.

¹¹ Public international law (rather than domestic law) is here used for purposes of comparative analysis for reasons that become obvious in section III(d) below: like international commercial arbitration practitioners, public international law practitioners operate in a context that cuts across the various legal traditions.

¹² See *supra* n. 1.

¹³ This occurred in 1987 and 1988, in the context of the Iran-Iraq war that raged at the time.

itself previously used force against the USA and other neutral vessels in the Gulf.¹⁴

The Court, while almost unanimously dismissing the claim brought by Iran against the USA, was deeply divided internally on the question of whether the dismissal of Iran's claim or the dismissal of the USA's defence should be presented as the first finding of the Court in the operative part of the judgment, and indeed whether there was any need to make any finding on the USA's defence at all, in view of the Court's dismissal of Iran's claim. The Court ended up dismissing the USA's defence first, and then Iran's claim; an approach that may be justifiably criticised (as was done by many of the judges)¹⁵ because it results in dealing with the respondent's defence before having first adjudicated on the applicant's claim. Obviously, from a claims adjudication point of view, there is no need to address the respondent's defence if the applicant's claim is dismissed on its own merits, which is, however, precisely what the Court did. Such an approach seems simply false in terms of legal methodology and indeed breach of the *non ultra petita* rule.¹⁶

However, if one defines the Court's principal function in terms of the settlement of international disputes (rather than adjudication of claims), the approach adopted by the Court does appear to have some merit. As many of the judges indicated, the subject matter of the dispute between the parties appears to have been as to whether or not the USA had any justification under the Treaty of Amity or international law as applicable between the parties, for its use of force against the Iranian oil platforms, an issue which was not in dispute between the parties.¹⁷ In choosing to focus on the USA's defence first, before considering the merits of Iran's claims, the Court sought to make sure that it addressed the real issue at stake in the case: in other words, the subject matter of the dispute between the parties. In the Court's view, this was whether the USA had any justification for its use of force.

The Court's task in *Oil Platforms* was complicated by the fact that Iran in fact did not seek any determination by the Court on the issue that the Court defined as the subject matter of the dispute between the parties (which raised the issue regarding the *non ultra petita* rule), as well as by the fact that the USA changed

¹⁴ See *Oil Platforms (Merits)*, para. 23; *Oil Platforms (Preliminary Objection)*, 12 December 1996, para. 18, available at www.icj-cij.org. The USA subsequently brought a counter-claim against Iran arguing that Iran had itself engaged in military activities in the Gulf, including attacking vessels and laying mines, which activities were in breach of Iran's obligations to the USA under the Treaty of Amity; *Oil Platforms Counter-Claim*, Order of 10 March 1998, para. 4, available at www.icj-cij.org. For a more detailed analysis of the ICJ's jurisdictional ruling and its judgment on the merits, see e.g., Heiskanen, *supra* n. 1.

¹⁵ See e.g., the Separate Opinions of Higgins, Buergenthal, Kooijmans, Owada and Parra-Aranguren JJ.

¹⁶ As argued, *inter alia*, by Buergenthal J in his Separate Opinion. See *ibid.* para. 3 (arguing that the finding of the ICJ 'violates the *non ultra petita* rule, a cardinal rule governing the Court's judicial process, which does not allow the Court to deal with a subject in the *dispositif* of its judgment that the parties to the case have not, in their final submissions, asked it to adjudicate').

¹⁷ See e.g., the Separate Opinions of Simma and Ranjeva JJ, who speak of the need to '*percer le voile du différend*' – 'pierce the veil of the dispute'. Separate Opinion of Ranjeva J at para. 3.

its principal line of defence in the course of the proceedings.¹⁸ However, whether the difficulties that the Court faced in reaching its decision were self-inflicted or a result of the change by the USA of its principal line of defence, the case remains important in that it appeared to reveal a deep philosophical divide within the Court as to its principal function. Is that function the adjudication of claims brought by a state against another state, or is it the settlement of disputes between states? In other words, should the Court focus on the adjudication of the merits of the applicant's claims, based on the applicable law and the evidence presented, or should it concentrate on the settlement of what it determines to be the subject matter of the dispute between the parties, as resulting from the respondent's principal line of defence (or indeed as defined by the Court itself)?

Depending on the approach which the majority of the Court adopts to this issue, its decision on the merits – or on the subject matter of the dispute – may differ accordingly. The Court's decision may prioritize the adjudication of the claims brought by the claimant, or it may focus on the settlement of the dispute as resulting from the defences raised by the respondent.

(c) Methodology and Function of Arbitral Decision-making

In the context of international commercial arbitration, a similar issue may arise if the respondent chooses to focus on an issue other than the merits of the claimant's claims as its principal line of defence. As noted above, this may occur, in particular, if the respondent raises a defence that goes "beyond" the issues raised by the claimant's claims; in other words, if the respondent argues that the claims do not reflect what is really at stake in the dispute between the parties. In particular, the respondent may argue that the claims brought by the claimant have never been raised in the business relationship between the parties and, indeed, that they have been invented solely for the purposes of the arbitration.

The following scenarios may illustrate how such a difference may arise.¹⁹

Scenario 1: The parties (one a governmental entity and the other a private party) enter into a share sale and purchase and long-term concession agreement. Various disputes arise between the parties in the course of the execution of the

¹⁸ As noted above, the USA initially argued that the ICJ had no jurisdiction over the dispute because use of force was not governed by the Treaty of Amity, on which Iran based the jurisdiction of the Court. However, after the Court dismissed the USA's objection to jurisdiction, the USA brought a counter-claim against Iran on the basis of the very same Treaty of Amity, arguing that Iran had breached the Treaty by resorting to use of force and that the measures taken by the USA were justified under the national security exception in art. XX:1(d) of the Treaty of Amity. In raising this argument, the USA effectively drew its principal line of defence around the issue of justification.

¹⁹ The scenarios are drawn from cases in which the author has been involved in recent years; however, the facts are streamlined and not all the arguments described in the scenarios were in fact raised. For the avoidance of doubt, it should be stressed that the author has acted in various capacities in these arbitrations, *i.e.* both as counsel for claimant and as counsel for respondent.

agreement; these concern the privileges granted to the private party in two separate articles of the agreement and are debated between the parties. However, the parties are unable to settle the dispute, and the private party submits the dispute to arbitration, asserting four different claims against the governmental party, two based on the articles mentioned above and two on other provisions of the contract. The party has not raised any claims under the two latter articles in the course of the business relationship; they are asserted for the first time in the request for arbitration.

The respondent disputes the two former claims on their merits, challenging the claimant's interpretation of the relevant contract provisions, and the two latter claims on the basis that the claims are purely a result of creative lawyering; they have not been discussed before and are raised for the first time in the arbitration. According to the respondent, the claimant must be considered as being estopped from bringing, or as having waived, such claims.

Scenario 2: The parties enter into a long-term sale and purchase agreement of an industrial product. The agreement contains a price revision clause entitling either party to request an adjustment of the price of the product at two-year intervals in case of change of circumstances in the relevant market conditions.

Two years later, the buyer requests price adjustment negotiations based on alleged changed circumstances. The negotiations fail, and the buyer submits the dispute to arbitration pursuant to the arbitration clause of the contract. In addition to the price adjustment claim, the buyer also asserts an additional claim for loss of profit, based on the alleged non-compliance of the product with the contractual quality specifications and the business and other losses sustained by the buyer as a result of such non-compliance. The latter claim has not been raised in the context of the negotiations or otherwise between the parties.

The seller challenges the additional claim on grounds that it has no contractual basis and has not been raised previously in the negotiations between the parties; it therefore has no legitimate commercial basis.

Scenario 3: The parties enter into an engineering, procurement and construction (EPC) contract for a gas processing plant. There are serious delays in the construction works and finally, when first gas is introduced into the plant, various problems arise, including a failure of the coating of some of the pressure vessels. The parties disagree on what caused the failure, but the contractor agrees to procure and install replacement vessels.

After the replacement vessels have been installed, the contractor brings an arbitration case against the owner, claiming compensation for the additional costs it had incurred in procuring and installing the replacement vessels and as a result of the delays in the works. The owner asserts, in defence, that the contractor is not entitled to any compensation for the additional works or for the delay because the failure of the pressure vessels was the contractor's fault, the contractor having failed to take into account, when selecting the coating of the vessels, the chemical composition of the gas as specified in the tender documents. The owner argues that it is in fact the contractor's failure to respect contractual specifications that is the very root cause of the dispute between the parties.

How should an arbitral tribunal deal with such defences, in particular in the first two scenarios?²⁰ Should the tribunal take the approach that, so long as the claims brought by the claimant appear to have an arguable contractual or legal basis, it does not matter whether the claims have also been raised prior to the arbitration as between the parties? In other words, should the tribunal adopt the approach that, if it turns out that the claims have merit in terms of law and fact, they should be granted regardless of whether there was a pre-existing business dispute between the parties with respect to the issues raised by the claims? Or should the tribunal adopt the alternative approach to the effect that the function of international commercial arbitration is to serve the interests of international commerce and, accordingly, that it should focus on settling actual business dispute, *i.e.* disputes that have in fact arisen between the parties prior to the arbitration? That is to say, should the tribunal take the view that it should intervene in the business relationship only if there is a real dispute that the parties have first tried but failed to settle by negotiation and accordingly dismiss any claims that are asserted for the first time only in the arbitration and that therefore cannot be considered 'legitimate' business disputes?

These appear to be rather fundamental questions in terms of the underlying philosophy of the function of international commercial arbitration. Indeed, what is that function, in the first place? Is it the adjudication of claims brought by the claimant on their merits, in light of the applicable law and the evidence on record, or is it the settlement of business disputes that have in fact arisen between the parties prior to the arbitration and that the parties have failed to settle as between themselves? Under the former philosophy, any claims that are established to have merit in terms of the contract and the applicable law and that are adequately supported by facts, must be considered substantively (*i.e.* on their merits) admissible; it is not necessary first to try to settle them by negotiation. Under the latter philosophy, only actual, pre-existing business disputes are considered legitimate and as such substantively admissible; claims that are raised for the first time only in the arbitration, without ever having been raised as between the parties, are considered, to that extent, inadmissible; in essence, fictitious.

The two approaches appear to be based on fundamentally differing assumptions of the purpose and function of international commercial arbitration. The claims-based approach takes effectively the view that international commercial arbitration is not in substance different from litigation before courts: its function is to determine the merits of legal claims, *i.e.* the extent to which the party bringing the claim is able to establish that its claim is supported by both fact and law. The dispute-based approach takes the view that the institution of international commercial arbitration exists to serve the interests of international

²⁰ The third scenario differs from the first two in that the defence asserted by the respondent, while 'displacing' the basis of the claim, does not challenge the claim on the basis that the claim was asserted for the first time only in the arbitration. However, it does raise the question of whether the tribunal should deal with the respondent's defence first, before proceeding to the merits of the claim.

commerce, and not to intervene in the absence of a proper commercial justification. Its function is limited to the settlement of genuine business disputes which can legitimately be said to exist between the parties at the time the case is submitted to arbitration and that the parties have failed to settle as between themselves. The parties must be considered as being estopped from bringing, or as having waived, any other claims.²¹

While international arbitrators and arbitration practitioners tend to define their task in practical terms and generally tend to eschew conceptual and philosophical issues, it seems that it will be very difficult indeed for an arbitral tribunal to avoid the fundamental question of its function if the respondent (and it is by definition always the respondent) raises the question of the substantive admissibility, or the commercial 'legitimacy', of a claim brought by the claimant. True, the arbitral tribunal may choose not to deal with the issue in express terms in its award, but it cannot avoid taking a decision on the defence raised by the respondent, regardless of whether it chooses to deal with the issue of its function explicitly in the award. In taking a decision on this respondent's defence, the arbitral tribunal is in effect taking a view on the function of international commercial arbitration, whether or not it defines its decision in these precise terms.

While such defences do not always raise squarely the question of the function of international commercial arbitration, they nonetheless tend to displace the 'merits' of the case as defined by the claimant's claims (see the third scenario above) and thus tend to raise the 'lesser' methodological question of whether the arbitral tribunal should deal first with the merits of the claimant's claims or the merits of the respondent's defence. If not only the claimant's claim but also the respondent's defence appear to have *prima facie* some merit, the arbitral tribunal will not only have to decide as to which one of the two to resolve first, but also how to set out its findings in the award.

Thus, for example, in the third scenario above it is at least arguable (assuming the facts support, *prima facie*, the respondent's defence), that the arbitral tribunal should rule on the respondent's defences first, before proceeding to the merits of the claim.²² Once the tribunal has taken a provisional decision on the respondent's defence, it should proceed to consider whether, in light of this determination, the claimant's claims, or any part thereof, can still be sustained. The award might have to be set out accordingly.²³

In such a scenario, the respondent's defence in effect displaces the centre of gravity of the case; in other words, the 'merits' of the case are defined, at least

²¹ This suggests that the distinction between the merits of the claim and the subject matter of the dispute is perhaps not entirely unrelated to the traditional common law distinction between law and equity, or other similar conceptual distinctions (*e.g.* legal remedies and equitable remedies, or law in books and law in action).

²² See *supra* n. 20.

²³ Thus, in classic conflict-of-laws (or private international law) terms, the issue is analogous to a conflict of 'characterisation': should the 'merits' of the case (in a broad sense of the term) be defined (and dealt with) in terms of the claimant's claims or the respondent's defence. For discussion see, *e.g.*, Dicey and Morris on the Conflict of Laws, Vol. 1, 11th ed., 1987, pp. 35–48.

provisionally, by the respondent's defences rather than by the claimant's claim. Whether or not such a scenario materialises in any particular case is, indeed, always a matter for the 'merits'.

(d) *Implications for the Practice of International Commercial Arbitration*

As judges are characterised by their 'judicial philosophy', arbitrators may be characterised by their 'arbitral philosophy' – in terms of the views they hold of the function and purpose of international commercial arbitration. While the issue has not been much debated, it would perhaps not be surprising if the dividing line on this issue coincided with the dividing line between common law and civil law lawyers. This, in fact, appears to be the philosophical dividing line that emerged in *Oil Platforms*, the case discussed above. It is indeed arguable that the Court's internal division, as it surfaced in *Oil Platforms*, reflects the familiar divide between common law and civil law educated lawyers. While the former tend to define the Court's function in terms of adjudication of claims, the latter tend to prioritise the Court's dispute settlement function.²⁴ In other words, common law practitioners tend to focus more on the strict requirements of the law, whereas civil law practitioners tend to focus more on the political realities.

In the world of international commercial arbitration, a similar divide is likely to exist, although it appears it has not fully emerged. This may be at least in part because arbitral awards are rarely published, at least in full, and because academic interest in research into the substantive law of international commercial arbitration has been relatively limited. The matter is not made any easier by the fact that substantive issues in international commercial arbitration vary according to the applicable substantive law and the industry in question. Moreover, since the system of precedent is practically, if not entirely, lacking in international commercial arbitration, it is apparently felt that there is less need to dissect in detail arbitral awards on their merits, with the exception, perhaps, of international investment arbitration (which does raise issues of its own, in particular because the claims do not normally arise, at least directly, out of a contract). Finally, the issue may also be confused by the fact that not every arbitration involves counsel and arbitrators from the two principal legal traditions; indeed, much of international commercial arbitration is 'intra-tradition' rather than 'inter-tradition', and in such more homogeneous contexts, 'philosophical' issues relating to the function of the exercise are unlikely to arise.

Nonetheless, there seems to be a shared sense among many legal practitioners that common lawyers tend to focus in their argument and reasoning more strictly on technical issues of law and evidence, whereas civil lawyers tend to focus more on the interests and concerns of international commerce. As a result, common

²⁴ See Heiskanen, *supra* n. 1 at pp. 205–208. See also Dicey and Morris, *supra* note 23, pp. 47–48 (noting that '[c]onflicts of characterisation ... are more likely to arise between a common law country and a civil country, because the legal categories and the habits of legal thoughts in civil law countries are sometimes unfamiliar to common lawyers.')

lawyers tend to view civil lawyers as more ‘political’ (and technically less sophisticated), whereas civil lawyers tend to view their common law colleagues as more ‘formalistic’ (and more removed from business needs).²⁵

The above is certainly an oversimplification in the sense that many international arbitration practitioners straddle the common law/civil law divide, either by education or experience, or both. Nor is it to say that there is necessarily, in practice, a philosophical division between lawyers educated in the common law and civil law traditions – that they always tend to argue against the background of their own traditions. Indeed, it appears that the most convincing – and successful – lawyers are those who understand both traditions and are able to draw on both in developing their arbitration strategy and legal argument. In other words, what matters, often, is not the tradition from which the lawyer comes, but his or her ability to draw on the intellectual resources available in the sources of international commercial arbitration.

Nonetheless, the fact remains, arguably, that there is no shared or common ‘philosophical’ understanding as to whether the function of international commercial arbitration should be the adjudication of claims or the settlement of commercial disputes. This fundamental issue remains open at the source, and thus also as a source of legal argument and – why not? – legal creativity in the context of concrete claims and disputes. This is not necessarily a bad thing. Indeed, the ‘open source’ of international commercial arbitration may well be one of the sources of its strength as a method and technique of dispute settlement. Being both principled and sensitive to the context is not an easy balancing act but it is not impossible either. International commercial arbitration, as a practice, seems at least capable of striking such a balance. The better it succeeds in this task, the more successful it will be as a method of commercial dispute resolution.

IV. CONCLUSION

While the issue of ‘arbitral philosophy’, as defined above, is perhaps not always in the fore of the minds of the parties when selecting arbitrators, it probably should be. Similarly, the members of arbitral tribunals, when adjudicating claims submitted to them, or when settling disputes submitted to them, should perhaps be more aware of the delicacy of the function they are exercising. Characterisation of the case, in substantive terms, should be based on reflection rather than a reflex.

²⁵ As explained *infra*, this is an oversimplification and the labels can in fact be easily reversed: if the ‘civil law’ approach is taken too seriously and the parties are always required to have engaged in negotiations before their arbitration claims are considered admissible, this would appear an excessively formalistic requirement. Similarly, if the ‘common law’ philosophy is taken too literally, to allow claims based not only on breach of contract but also on tort, the difference between (private) arbitration and (public) court adjudication effectively disappears, and arbitration becomes simply one of the many tools employed by the state to intervene in private commercial relationships.

It is another matter whether an arbitral tribunal should make an attempt to take a specific view on the issue of its function; this may not be advisable and not even possible. Indeed, it seems that there is no objective basis for preferring one arbitral philosophy over the other; but at the same time, whenever the respondent chooses to challenge the claimant's claims, or at least some of them, on the basis that they are essentially fictitious and unrelated to the real business dispute between the parties, the tribunal can hardly avoid taking a view on what is essentially a 'philosophical' issue.

Once the Pandora's case is open, it is always already too late to close it; one can only try to deal with the consequences ...

In any event, whether or not the arbitral tribunal should explicitly pronounce on the issue of its function, it would seem that at least the parties should keep the two competing approaches in mind when developing their arbitration strategy. For the claimant, the arbitration case tends to be about the merits of its claims, *i.e.* whether or not they are adequately grounded in fact and law. For the respondent, the subject matter of the dispute between the parties may well lie elsewhere – usually there where it decides to draw its principal line of defence. On the respondent's side, in particular, it is a critical strategic decision as to whether the defence should focus on directly attacking the claimant's case, on its merits, or whether the tribunal should be made aware that the subject matter of the dispute between the parties lies elsewhere, if it indeed does, at least arguably. The end result may be a head-on collision of the claim and its disputation by the respondent – a classic arbitral 'duel' – or the process may turn into a complex dispute settlement process where the arbitral tribunal is forced to enter deeper into the business relationship between the parties and look for the root cause of the difference between them. In other words, the tribunal may have to determine whether it is the claimant's claim or the respondent's defence that appears to have more 'merit' and thus deserves to be considered as a matter of priority, at least provisionally.

Either way, the more effective the counsel in exploiting the merits of the distinction between the merits of the claim and the subject matter of the dispute, the more effective he or she will be in pursuing the client's interests. Similarly, the more perceptive the arbitrator in characterising the case, the more certainly he or she will be able to assess the merits of the claim and to pronounce a fair and just resolution of the dispute.



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