

Israel's New International Arbitration Rules

By Eric S. Sherby

I. Introduction

Since its founding in the early 1990s, the Israeli Institute of Commercial Arbitration (IICA)¹ has established itself as the leading arbitral institution in Israel. Yet until recently, the IICA had maintained only one set of arbitration rules, which did not distinguish between domestic (Israeli) cases and international cases. Recognizing the increasing number of disputes in Israel involving non-Israeli parties, the IICA recently adopted a separate set of rules for international cases.²

This article discusses the major features of the IICA's International Rules (the "Israeli Rules" or the "Rules"), with an emphasis on those issues of particular importance to non-Israeli parties to arbitrations.

II. The Language of the Arbitration—English "Rules"

The rules of many national and regional arbitration institutions provide that the institution or arbitrator has the discretion to select the language for the conduct of the arbitration. Article 17 of the Arbitration Rules of the United Nations Commission on International Trade Law (the "UNCITRAL Rules") provides as follows: "Subject to an agreement by the parties, the arbitral tribunal shall, promptly after its appointment, determine the language or languages to be used in the proceedings." The substance of Article 17 of the UNCITRAL Rules has been adopted in the international rules of many arbitral institutions, such as the Swiss Chamber of Commerce,³ and the Japan Commercial Arbitration Association.⁴

The above-mentioned arbitral institutions (and the arbitrators appointed thereby), presumably, often decide that, when the arbitration agreement is in English, the language for the conduct of the arbitration should be English.

The IICA goes even further than the UNCITRAL Rules and the institutional rules that are modeled thereon. Rule 6.2(a) of the Israeli Rules provides that, when the language of the arbitration agreement is English, "the arbitration shall be conducted in English, unless the parties agree otherwise." In other words, when the arbitration agreement is in English, the issue of language is not an issue left to the discretion of the arbitrator or the IICA. There are only two, minor, exceptions, both of which would not apply if the arbitration agreement expressly states that the language of the arbitration is to be English:

- (a) If the arbitrator concludes that substantially all of the likely witnesses are Hebrew speakers, the arbitrator will usually have the discretion to order that oral examinations of those witnesses be

conducted in Hebrew (Such rule has no effect on the language of the pleadings, affidavits, etc.); and

- (b) The arbitrator has the discretion to conduct purely "administrative hearings"⁵ in Hebrew.⁵

In summary, Rule 6.2(a) gives certainty to non-Israeli parties to English-language arbitration agreements that any dispute governed by the Rules will be arbitrated in English.

Such a rule is a departure from the prevailing practice in Israel; the author has been involved in several arbitrations that were conducted predominantly in Hebrew, even though the arbitration agreement was in English and a significant number of witnesses were non-Israeli residents who did not speak Hebrew.

III. Number of Arbitrators

A. When the Agreement Calls for Multiple Arbitrators

The general rule of the IICA is that disputes are adjudicated by a *sole* arbitrator.

In drafting its international rules, the IICA recognized that most arbitral institutions provide the option of arbitrating before three arbitrators; at the same time, the IICA realized that a three-arbitrator case can be expensive and that not every transnational dispute merits the costs inherent in three-arbitrator adjudication. In the Israeli context in particular, there is a perception that a contractual requirement of multiple arbitrators can be abused by the party that has the greater ability to bear the higher costs associated with such a case.

Therefore, Rules 1.1(a)(iv) and 4.2(b) attempt to establish a balance between the general rule of honoring the parties' pre-dispute agreement to use multiple arbitrators and the cost/burden of a three-arbitrator case.⁶ Those rules provide that the parties' pre-dispute agreement to arbitrate before three arbitrators will be honored by the IICA, subject to one caveat: At least one party must, in its initial pleading with the IICA, make an express request for the appointment of three arbitrators. In other words, if the plaintiff fails to include a "multiple arbitrator statement" with its application to commence the arbitration, the plaintiff will be deemed to have *waived* any contractual right to request that the case be adjudicated by more than one arbitrator. Similarly, if the defendant fails to include a multiple arbitrator statement with its statement of defense, the defendant will be deemed to have waived any contractual right to request the appointment of multiple arbitrators.

(Any such waiver by the plaintiff does not affect any right of the defendant.)

The mechanism established by Rules 4.2(b) and 1.1(a) (iv) gives parties to an arbitration agreement the certainty that their pre-dispute selection of three arbitrators will be honored, subject simply to their paying sufficient attention to raise the issue at the first opportunity.

B. Three Arbitrators When Agreement Is Silent

Even when an arbitration agreement is silent as to the number of arbitrators, it might, nonetheless, be appropriate for three arbitrators to be appointed, so long as at least one party has timely requested such appointment. Rule 4.2(c) authorizes the IICA President to appoint more than one arbitrator when a timely request/notice has been filed. The rule gives substantial discretion to the President, who is to take into consideration various factors (in no particular order of importance) in deciding whether the dispute should be adjudicated by multiple arbitrators: (1) the costs inherent in a multiple-arbitrator case, (2) the subject matter of the dispute, (3) the complexities of the case; (4) the likely number of witnesses, and (5) "any other factors that justice and efficiency require."

As a practical matter, the author's experience is that the IICA hesitates to appoint three arbitrators absent a contractual provision calling for multiple arbitrators.

IV. Raising the Issue of Applicable Law Early

When an international arbitration agreement does not contain a governing law clause, the determination of the law applicable to the dispute is often a time-consuming and costly part of the arbitration proceeding. Therefore, Rules 1.1(c) and 2.1(c) require the parties to raise the issue of applicable law as early in the case as possible. Specifically, each party is required to state, in its initial pleading, whether it is of the view that the substantive law of a country other than Israel applies to the arbitration agreement.

One of the reasons for requiring the issue to be addressed early is to assist the President of the IICA in determining whether to appoint an arbitrator who is versed in the law of such non-Israeli jurisdiction (even though the mere assertion by a party that foreign law applies would not necessarily mean that the IICA or the arbitrator will accept such contention).

V. Security for Costs—the Playing Field Has Been Evened

Under Israeli civil practice, the general rule is that the losing party pays at least some amount of the prevailing party's legal costs, even if the losing party's position was devoid of "frivolous" or "vexatious" conduct.⁷

Israel's approach to costs is often felt at the outset of a case. Under Israeli civil practice, a defendant that is sued in court by a foreign plaintiff has the right to request that

the court require the plaintiff to deposit security to ensure that, if the court awards costs against the plaintiff (at any stage of the case), the defendant will have available, in Israel, a source of funds for collecting on such an award. This procedure is designed to ensure that the defendant will not be forced to commence proceedings outside of Israel to collect on an award of costs. The practice of requiring a foreign plaintiff to deposit security has frequently been applied to arbitrations under Israeli law.

Rule 3.4 does away with such practice. It provides (in relevant part) that, in considering whether to order a party to deposit security for the arbitration expenses, "the arbitrator(s) shall not take into consideration that [a particular] party is based or domiciled outside of Israel or that such party does not have assets in Israel." Such provision recognizes that a non-Israeli party to an international transaction is not likely to consent to arbitrate before an Israeli arbitral institution if it knows that, by so consenting, it could be financially disadvantaged merely because it is a foreign entity.

VI. Evidence Gathering

Although Israeli courts have been inconsistent in permitting video-conferencing, the Rules recognize that advances in technology must be reflected in the conduct of international arbitration. Therefore, Rule 6.4 provides that "[n]othing herein shall be construed as restricting the discretion of the arbitrator(s), subject to an appropriate order regarding costs, to order video-conferencing or other forms of evidence-gathering." Presumably the party seeking to offer testimony via video-conferencing would be required to pay the costs associated with such procedure.

In addition, Rule 6.7 recognizes the importance in international arbitration of addressing special issues concerning witnesses from different countries. That rule provides that, when the arbitrator holds his/her (first) preliminary session with counsel for the parties, the arbitrator "shall, to the extent practical and subject to [the Rules,] determine the proceedings for . . . (as applicable) any special requirements with respect to foreign witnesses."

VII. Applicability of Substantive Law

A. Effect of Choice-of-Law Clause

To American lawyers, who are used to an arbitration regime in which an award can be vacated by a court if the arbitrator exhibited a "manifest disregard of the law," it is often surprising to learn that, under Israeli law, an arbitrator is not bound by substantive law unless the arbitration agreement provides otherwise (the "Default Rule"). The result of the Default Rule is that the failure by an Israeli arbitrator to apply substantive law is generally not a grounds for having a court vacate an award. (If the arbitration agreement does provide for the arbitrator to be bound by substantive law, his/her failure to apply substantive law usually will be a grounds for vacating the award.)

An ancillary issue is whether an agreement that contains both a choice-of-law (i.e., governing law) clause and an arbitration clause—but does not expressly state that the arbitrator is required to apply substantive law—trumps the Default Rule; in other words, is such an agreement considered one that requires the arbitrator to apply substantive law? Israeli case law does not provide a clear answer to that question.

The result of such lack of clarity is, for many non-Israeli lawyers (and their clients), a trap for the unwary. Many international practitioners are careful to ensure that their clients' international agreements do contain both an arbitration clause and a choice-of-law clause. However, because many such lawyers are unaware of the Default Rule, their contracts with Israeli parties usually do not state *expressly* that the arbitrator will be bound by substantive law.

In drafting its international rules, the IICA assumed that the inclusion of a choice-of-law clause usually indicates that the parties (at least those represented by counsel) expect the arbitrator to apply the substantive law chosen. Accordingly, Rule 8.2 provides, in relevant part: "Except when the context clearly indicates a contrary intention, (a) the inclusion in the Arbitration Agreement of a choice-of-law (governing law) clause shall constitute the parties' agreement that the arbitrator(s) will be bound by the substantive law so chosen." Such provision is intended to remove any ambiguity, in the construction of arbitration agreements, as to the intentions of the parties concerning the arbitrator being required to apply substantive law.

B. A Clear (Appealable) Award

As noted above, one of the grounds under Israeli law for requesting that a court vacate an arbitral award is that, despite the contractual requirement that the arbitrator render his award based upon substantive law, the arbitrator failed to do so.

As a result, in those cases in which the arbitration agreement does provide that the arbitrator is bound by substantive law, one of the most frequently asserted grounds for requesting that a court vacate an award is that the arbitrator failed to apply substantive law. In cases involving such an agreement, Rule 8.5 attempts to give the parties their "money's worth." That rule provides as follows: "In those cases in which the arbitrator(s) is/are bound by substantive law, . . . the award shall separately set forth the arbitrator's conclusions of fact and his conclusions of law."

The requirement to separately set forth conclusions of law and conclusions of fact is intended to make it easier for a court to review an arbitrator's conclusions of law (in a manner similar to that established in Rule 52(a)(1) of the Federal Rules of Civil Procedure).

VIII. Facilitating a Settlement

One of the universal criticisms of arbitration is that arbitrators have an economic incentive to prolong the resolution of cases and that, as a result, issues in a case that might be resolved early—were the matter before a court—are deferred unnecessarily by arbitrators.

In drafting its international rules, the IICA recognized that, in many commercial disputes, the early resolution of one or a few legal or factual issues can frequently lead to a prompt resolution of the entire dispute. (Examples of such issues include whether a claim is time-barred, whether a party has a right to assign its contractual obligations, and the effect of a waiver.)

Therefore, Section 7.1 provides that, "[t]o the extent that it appears that the early resolution of one or more issues in dispute is likely to facilitate a settlement, the arbitrator(s) is/are authorized to conduct the arbitration with a view toward reaching resolution of such issues."

Rule 7.1 does not purport to define those disputes in which early resolution of one or more issues can lead to a prompt resolution of the entire controversy; rather, the rule leaves the issue to the discretion of the arbitrator, based upon the facts of the particular case.

IX. Maintaining the Attorney-Client and Other Privileges

Israeli law concerning the attorney-client privilege is similar to the law of most states of the United States. Nonetheless, in drafting the Rules, the IICA recognized that the law concerning attorney-client privilege is not universal and that, despite those differences, the issue of privilege is often taken for granted in the decision by a business person to agree to resolve an international dispute out of court.

Inherent in the decision to arbitrate in a foreign country is the possibility that the law applied in the arbitration will not be one that recognizes the privileged nature of communications that have already taken place or which are likely to take place. While cognizant of such a problem, the Rules do not purport to solve it—in part because the nature of the problem is such that there is no "one-size-fits-all" solution. Rather, Rule 10.2 attempts to minimize the risk by according the issue of privilege a special status:

Nothing herein shall be construed as derogating from the attorney-client privilege or any other privilege recognized by law. If a party is of the view that a privilege that is not recognized by Israeli law or which, under the circumstances, does not apply under Israeli law, should apply pursuant to the substantive law of some other country, the burden of proving the existence

and applicability of such privilege shall be upon such party. If that party makes a written application for the recognition and application of such privilege, to the extent that the arbitrator(s) denies(y) such application, such denial may be appealed within ten (10) Business Days to the President.

The denial of most motions by an arbitrator is (almost universally) not appealable. However, because the IICA recognizes the special importance of the issue of privileges in international disputes, Rule 10.2 allows the issue to be appealed to the President of the IICA. This section allows the arbitrators and the President to apply a choice-of-law analysis to determine whether it would be just to apply a privilege that would not otherwise exist under Israeli law.

Endnotes

1. See www.borerut.com, last visited on 7 April 2008. The IICA was founded by Israel's leading authority on arbitration, the late Professor Smadar Ottolenghi. Professor Ottolenghi served as President of the IICA until her untimely death in 2003.

For the past several years, Judge (Retired) Amnon Straschnov—formerly a Judge of the Tel Aviv District Court—has served as the President of the IICA. See <http://www.borerut.com/e-nasi.asp>, last visited on 7 April 2008.

2. See www.borerut.com/foto-in/Rules%20-%20institute%20of%20arbitration.doc, last visited on 7 April 2008.
3. <https://www.sccam.org.sa/en/rules.php> ("[t]he Swiss Rules of International Arbitration are based on the UNCITRAL Arbitration Rules"), last visited on 7 April 2008.
4. http://www.jcaa.or.jp/e/arbitration-e/kisoku-e/pdf/e_shouji.pdf, last visited on 7 April 2008; see Rule 11(1) ("Unless otherwise agreed by the parties, the arbitral tribunal shall determine, without delay, the language or languages to be used in arbitral proceedings. The arbitral tribunal shall, in so determining, take into consideration whether interpreting or translating will be required and how the cost thereof should be allocated").
5. An "administrative hearing" is defined as one that involves counsel, but not the parties themselves, and as to which it is expected that the only matters to be dealt with are administrative. Rule 6.2(a).
6. Under Rule 4.2(b), notwithstanding any provision in an arbitration agreement, the President of the IICA always has the discretion *not* to appoint an even number of arbitrators.
7. Israeli courts have substantial discretion in determining the amount of costs; they take into account (a) the amount of the claim, (b) the amount of the relief that was actually awarded, and (c) the manner in which the litigants conducted the case.

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