Jurisdiction of Sovereign States and International Commercial Arbitration: A Bound Relationship

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Historically, judgment has private roots, rather than public. Before States took over control of the entire judgment process, it was a private issue. Parties, which had a dispute, apply to a local authority for a "fair" solution. This authority could have been a chief of the clan (in early ages) or a senator (in Roman time) or an imam (or kadi) (in Islamic law) and so on. The picture was more or less the same all around the world; different communities (racial or religious) had different laws and different types of courts in the same country in order to resolve their own disputes. Until the 18th century, courts of the States were only one of these different types of authority for judgment (but on a nationwide and supreme basis compared with the others) and especially were used for disputes that arose between separate communities.

This view fell into disfavor after the appearance of the modern sovereign states in the 18th century. Modern sovereign states were extremely keen to unify and control their judicial system. That was considered to be an essential part of being a "country." After judgment began to be perceived as an entirely public interest, there was not enough room for alternative dispute resolutions (in any form rather than litigation) in the national law systems.

However, arbitration survived in the commercial field. Because of the needs of modern trade, the importance of arbitration increased dramatically in the 20th century. This trend created the UNCITRAL Arbitration Rules in 1976 (main arbitration institutions' rules based on that) and the Model Law on International Commercial Arbitration in 1985 (Model Law).

Some could say that arbitration means an exception to the jurisdiction of sovereign state courts, and it was created by sovereign states on their own. On the other hand, sovereign states have invented new solutions through their courts or by legislatures to keep that unwanted but necessary private method of dispute resolution. Sovereign states have developed a zone (with delimitations) for arbitration in their systems of law but also continue to supervise and support it within that zone.

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How far can sovereign states tolerate international commercial arbitration as exclusion to the jurisdiction of their courts?

There are three necessary elements to one of the most accepted definitions for sovereign states. These are territory (land), people (nation) and recognition by other sovereign states. It is a supreme authority over a geographic region and group of people. [1] Therefore, a sovereign state's interests in its own territory could be easily called its "vested interests." Otherwise discussing whether that is a vested interest or not, means discussing whether that state is sovereign or not. Like all other authorities, states are extremely interested in what occurs within their lands.

Being a supreme authority within a certain territory also means being the only legislator for this territory. However, without being a practitioner, this theoretical uniqueness would not be enough to fully cover the meaning of being a sovereign state. In this concept, exclusivity of jurisdiction is emphasized as a key element of sovereignty. Therefore it is very understandable why states cannot tolerate any attempt that brings an exception to the jurisdiction of their courts. "Parties cannot by contract agree to oust [except] the jurisdiction of the courts to deal with their rights under the contract…" [2]

Parties, in a dispute, may to opt for arbitration as a method to resolve their problem without applying to national courts. This is a flexible, cheaper and, most importantly, a confidential method.[3] That means arbitration is a way to escape from state authority.

Historically, and as a matter of strict legal theory, the court's jurisdiction cannot be excluded by private agreement. However, the law always follows real life needs and organizes them (through a very slow process), in light of the fact that there is no possibility to stick with that legal theory at the present. In commerce, people need fast, cheap and confidential methods to resolve their disputes. This need became a necessity especially after the industrial revolution. People start to build bigger ships, new railways and factories using mass production techniques. The amount of the capital involved was huge for this engineering madness, which was not possible to finance like good old-fashioned family businesses. That necessity created huge trans-national companies and they become the main actors in commercial life. These new actors start to cause far more complicated disputes for courts than ever. Tribunal processes become more complicated, long and expensive. Consequently, the need for alternative dispute resolution becomes vital in order for that new type of economy to continue. As the closest Western country to the East and the closest Eastern country to the West,[4] Turkey is in the very heart of that new commercial world.

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[1] Stanford Encyclopaedia of Philosophy.

[2] Scot v. Avery and others, HL, 10 July 1856.

[3] Sealy & Hooley, *Commercial Law, Text, Cases and Materials* (3rd edn, Oxford University Press, Oxford, 2003).

[4] Z. Akinci, *Milletlerarasi Tahkim* (2nd ed., Seckin, Ankara, 2007).

Under these circumstances, modern sovereign states may permit arbitration as an exception to the jurisdiction of their courts, but only with some very functional "safeguards" that they can be justified as necessary public interest.[5]

3- State safeguards in arbitration

Like living creatures, states also develop some defense systems against those who attack their existence and this existence certainly concerned with the jurisdiction of their courts. From that point of view, sovereign states have placed "limitations" and "restrictions" on the arbitral process as a defensive system in order to protect the jurisdiction of their courts. There are the limits to the powers of an arbitral tribunal, arbitrability and public policy; State courts intervene in the arbitral process to protect these interests. [6]

The Limits to the Powers of the Arbitral Tribunal;

The arbitration process is not independent of national jurisdiction. States give an existence to arbitration, but this existence unbreakably depends on the law system. States create this dependence through legislation (with separate clauses in different statues, but mostly and recently with an independent Arbitration Act) and control with their courts. National courts have a supreme position over an arbitral tribunal.[7]

When it comes to having or changing an arbitration act, the UNCITRAL Model Law on International Commercial Arbitration is the main source for that scope. Most states have adapted the Model Law in one way or another. The Turkish International Arbitration Law (TIAL), which was enacted on 21 June 2001 and came into force on 5 July 2001, has a hybrid structure on that respect by combining the Model Law and the Swiss International Arbitration Law.[8]

Through legislation, sovereign states create a framework for arbitration in order to keep it under control. In Article 5 of the Model Law , "In matters governed by this Law, no court shall intervene except were so provided in

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[5] English Arbitration Act 1996, Art. 1-(b).

[6] "An arbitral tribunal, unlike a national court, drives its power, authority and jurisdiction from an arbitration agreement (or an arbitration clause in a contract) between parties to a contract. However, arbitral proceedings, subject to the relevant national law, are subjected to judicial supervision and control. A national court also plays a supportive role in making the arbitral adjudication more effective. It, generally, directs back to the arbitration a party to a valid arbitration agreement who is not willing to arbitrate. It also gives effect to the arbitration agreement by staying local judicial proceedings. Finally, when the award is made a court converts the arbitral award into a judgment to enable the winning party to obtain its recognition and enforcement" Richard B. Lillich, and Charles N. Brower (eds). *International Arbitration in the 21st Century: Towards 'Judicialisation' and Uniformity?* (Transnational Publishers, New York, 1994).

[7] "The state prescribes the boundaries of arbitration and enforces these boundaries through its courts". A. Redfern & M. Hunter *Law and Practice of International Commercial Arbitration* (4th edn, Sweet & Maxwell, London, 2004).

[8] Z. Akinci, supra note 4.

this Law," [9] seems to create a limitation on national courts in matters of International Commercial Arbitration rather than other way around. This article has a strong "pro-arbitration" sense. However, another side of the coin is when the Model Law creates a free area for international commercial arbitration to function, it also draws limits too.

The powers of an arbitral tribunal are those conferred upon it by the parties themselves within the limits allowed by the applicable law (law governing the arbitration agreement and the law of the seat of the arbitration), together with any additional powers that may be conferred by operation of law. If legislatures keep those limits too tight, arbitral tribunals may have less power to operate effectively.

The powers that parties confer upon the arbitral tribunal, whether directly or indirectly, are limited by the relevant national law systems. These powers may be exercised by a national court. The reason for that is that an arbitral tribunal does not actual power (to order and enforce) over property and persons. Because the arbitral procedure is entirely private, it is not possible to extend it powers to third parties without court decisions.

This fact has its clear reflection in Article 6/II of the TIAL that states that "Arbitrators or arbitral tribunals have no authority to grant any preliminary injunction or sequestration which need to be conducted by an execution office or any other public authority; neither these cautions can have any affect on the third parties."

In recognition of this fact, many systems of law supplement the powers of arbitral tribunals. This may be done by;

- giving powers directly to arbitral tribunals;
- authorizing national court to exercise powers on behalf of arbitral tribunals or the parties themselves; or
- a combination of these two methods.

It would not incorrect to say that Turkish law has a dual system in this matter. For instance in Article 9 of the TIAL, an arbitrator or tribunal has the direct power to decide the place of arbitration, if parties have not agreed on that point previously. According to the exigencies of the situation, the arbitrator or tribunal has full authority to decide to hold a hearing in a different place than where the parties have agreed on already. In Article 12-B "…An arbitrator or arbitral tribunal can require assistance from a civil court of first instance to determine evidence.".

Similarly, the English Arbitration Act sets out the powers of the national courts in relation to arbitral proceedings in Articles 42-45. This relationship, like the one in the TIAL, can be in two forms. First, English courts may issue

[9] Same rule, with exact words, has been placed in Article 3/II of the Turkish International Arbitration Law.

an order to support orders of the tribunal. [10] Secondly, courts may issue its own orders to assist the arbitral tribunal.[11]

Court intervention promotes arbitration by supplying it with a much needed "control system" when enforcing arbitral agreements, appointing arbitrators, reviewing awards, and so forth.[12]

In addition, the law governing the arbitration itself, *lex arbitri*, should be considered to see whether it supplements or restricts powers the parties have conferred, or purported to have conferred, on the arbitral tribunal. The 1996 English Arbitration Act provides a good example, in theory at least, of how arbitral tribunals and national courts can work together to make an arbitration regime effective.[13]

Arbitrability and Public Policy;

This is the most common and most effective limitation on arbitration. In general, arbitration is limited to only commercial concerns. Present politics and economic positions see commercial activities, almost purely, as the subject matter of the private individuals. There is very small room for public and public interests in arbitration. Obviously this trend also affects national law systems too and they have broadly allowed arbitration in that field.[14] In Turkey, the scope of public interest, as a limitation on international arbitration,[15] has been reduced by legislation that changed two articles (Articles 128 and 155) in the Turkish Constitution on 13 September 1999. Before this amendment, investments in the forms of Built-Operate and Built-Operate-Transfer[16] (nearly all in energy sector) had been considered to be "public service concession agreements" by Turkish courts.[17]

Dealing with "commercial" disputes is the main limitation on arbitration. The meaning of commercial is defined by States.[18] This gives a huge power to States to limit, through their wishes, the matter that arbitrable. There is no common definition of exactly the term "commercial" means; every State

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[10] "Unless otherwise agreed by the parties, the court may make an order requiring a party to comply with a peremptory order made by the tribunal." Art. 42-(1).

[11] "Unless otherwise agreed by the parties, the court has for the purposes of and in relation to arbitral proceedings the same power of making orders about the matters listed below as it has for the purposes of and in relation to legal proceedings." Art. 44.

[12] Richard B. Lillich and Charles N. Brower, supra note 6.

[13] A. Redfern & M. Hunter, supra note 7.

[14] M. Sornarajah, *The international Law on Foreign Investment*, (2nd edn, Cambridge University Press, Cambridge, 2004).

[15] A. Ulusoy, *Hukuk-Ekonomi Perspektifinden Uluslararası Tahkim ve Kamu Hizmeti*, (Liberte Yayınları, Ankara, 2001).

[16] Z. Aslan and N. Arat, "Kamu Hizmeti Imtiyaz Sozlesmelerinden Kaynaklanan Uyusmazliklarda Tahkim Usulu" (2005) İstanbul Üniversitesi Sosyal Bilimler Dergisi Vol. 8.

[17] Turkish Constitutional Court, 28.06.1995 date and 71/23 Decision No.

[18] "…it will apply the Convention only to differences arising out of legal relationships, whether contacyual or not, which are considered as commercial under the national law of the State making such declarition." New York Convention, Art.1.3.

creates their own definition compatible with their interests. Also there is a definition in an explanatory to Article 1(1) of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards [hereinafter the "New York Convention"]. "The term "commercial" refers to matters arising from all relationships of a commercial nature, whether contractual or not." However this is not binding even for states which sign that convention.

According to Swiss law, any alleged non-arbitrability of a controversy may be raised either as "lack of jurisdiction" or as "public policy."[19] The authority or competence of the arbitral tribunal comes from the arbitration agreement (or an arbitration clause in a contract) between the parties. Therefore lack of a valid arbitration agreement means lack of jurisdiction.[20] The arbitral tribunal would not be possible without a valid arbitration agreement. The TIAL, in Article 4, requires a written form for this agreement, either as a separate arbitration agreement or an arbitration clause in a commercial contract.

The brief definition for arbitrability would be that the subject matter of the dispute is capable of settlement by arbitration.[21] Similarly in the English Arbitration Act "(b) the parties should be free to agree how their disputes are resolved, subject only to such safeguards as are necessary in the public interest."[22] In that article, public policy looks much wider a term than arbitrability, which is entirely true. Public policy (*ordre public*) is a concept of law where every country has its own view on the meaning.

Arbitrability creates a zone for arbitration and that zone is controlled by sovereign States through public policy. Like the TIAL (Article 1 para. IV; "This law has no jurisdiction over disputes on Turkish real property rights and subject matters that are beyond the power of the parties"). Some other arbitration acts[23] do not separate arbitrability from public policy.[24] This may understandable, because, at the end, arbitrability mainly is a reflection of the public interests in the arbitration (in the grounds of the dispute). "Arbitrability refers to the public policy limitations upon arbitration as a method of settling disputes."[25] "Arbitrability, in essence, is a matter of national public policy."[26]

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[19] P.M. Baron & S. Liniger, "A Second Look at Arbitrability; Approaches to Arbitration in the United States, Switzerland and Germany" (2003) *Arbitration International*.

[20] Model Law, Art. 16.

[21] New York Convention, Art. II.1.

[22] 1996 English Arbitration Act, Art.1(b)

[23] "Any dispute which the parties have agreed to submit to arbitration under an arbitration agreement may be determined by arbitration unless the arbitration agreement is contrary to public policy…" New Zealand Arbitration Act of 1996.

[24] "In many jurisdictions, a challenge to an award based on grounds of arbitrability will often be linked to the concept of public policy." A. Redfern & M. Hunter, supra note 7.

[25] L. Cohen & M. Staff, "Trade, Industry and Industrial Relations" (1999) *Journal of International Trust and Corporate Planning*. Footnote; A. Redfern and M. Hunter, supra, note 10, at p 137.

[26] P.M. Baron & S. Liniger, supra note 19.

However these two terms are separated in Article V(2) of the New York Convention: "(a) The subject matter of the differences not capable of settlement by arbitration under the law of that country; or (b) The recognition or enforcement of the award would be contrary to the public policy of that country." This article gives a different basis for those two terms. Arbitrability is based on matter of the dispute while public policy is based on recognition and enforcement of the arbitration agreement or award. The reason for that is in an international convention (the New York Convention) and in that field, things are not as clear as they are on a national basis. The importance of this distinction becomes clearer and more necessary when an arbitration award crosses the border of the country for recognition and enforcement in another country. As already mentioned above, public policy is different in each country, similar to how they have different legal systems, and can also change from time to time within the same legal system.[27] Therefore arbitrability and public policy cannot always necessarily have the same meaning. For example; a perfectly arbitrable and, or enforceable, subject of a dispute in one country, possibly cannot be arbitrable and, or enforceable, in another country.

To consider arbitrability and public policy separately could bring more separation to international commercial arbitration from national legal systems in the order to deal with these to issue separately. In that context more separation would mean more autonomy for arbitration.

National courts may take a "second look" at the arbitrability of a particular matter. US Supreme Court explains this statement in the Mitsubishi case, which reserved the right to have a potential judicial review in the award enforcement stage.[28] This safeguard has been implemented differently by different countries. For example, the Swiss legal system has a very pro-arbitration perspective on that issue.

Through the definitions of arbitrability, states keep the jurisdiction of their courts in certain areas where there are strong public interests. This concept of non-arbitrability can be certain for that entire area. For example, criminal law is entirely and internationally accepted to be a non-arbitrable area because of its non-commercial nature. However this may not be so clear in some other areas of law. Antitrust and competition law would be a very good example. In this areas, some disputes may concern an arbitrable subject matter, where as some others may not.[29] On the contrary, the entire field of maritime law is perfectly arbitrable, because of its totally commercial nature.

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[27] A changing view on antitrust issue in USA. Mitsubishi Motors Corp v Soler Chrysler-Plymouth Inc 473 US 614, 628 (1985).

[28] "Having a permitted the arbitration to go forward, the national courts of the United States will have the opportunity at the award enforcement stage to ensure that the legitimate interest in the enforcement of the laws has been addressed" Mitsubishi Motors Corp v Soler Chrysler-Plymouth Inc, 473 US 614, 628 (1985).

[29] An example for this: "Unlike patents or trade marks, copyright is an intellectual property right which exists independently of any national or international registration, and may be freely disposed of by parties. There is, therefore, generally no doubt that disputes relating to such

So what is public policy? Referring to Redfern & Hunter, most developed arbitral jurisdictions have similar conceptions of public policy. In Switzerland, public policy is considered to be the fundamental legal principles of the Swiss legal and economic system.[30] Also in Germany, public policy means fundamental notions of justice, and there is a very similar definition in the US. All these criteria are very subjective and easily filled up through the wishes of sovereign States. Apparently there are two different systems that fill that very wide concept -- civil law and common law. In effect, "public policy" is a product of the common law, "discovered" case by case, while "*ordre public*" is an abstract notion which expresses the fundamental principles of a legal system[31] and a society that is applied by interpretation (i.e. under the standard civil law process). Obviously, this means that the difference is primarily one of the structure and method of creation of the content of public policy.[32] It is worth mentioning that Turkish Constitutional Court, in a decision (see footnote 17), has recognized the legislators' sole right to define public policy through legislation by stating that the legislature has an absolute power to say what goes into that definition.

The common law process may bring flexibility to the subject of public policy, but may also uncertainty too. Common law courts, in comparison, could have more influence on arbitration than their civil law counterparts; they can use that advantage to protect or regain their jurisdiction. Civil law practice on that subject may look old-fashioned, but when its sets out what is public policy and what is not, that certainly will help create a more arbitration-friendly atmosphere. Therefore it is important to have a clear view of public policy.

Also there is a specific and unwritten restriction on arbitration arising out of state immunity (when one of the party is a state or its agencies). When a is State acting as a commercial individual, obviously their disputes, which arise out of commercial transactions with private individuals, can be settled by arbitration.[33] However, it would not be wrong to say, in general, that states are not to keen to arbitrate on that commercial transaction instead of going to their national courts. In the national courts, the State can be "more equal" than private individuals by using (at least) their legislative power. States are using some instruments to exempt arbitration on that particular base. Every country has different practices on that issue; some countries have special

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private rights may be referred to international arbitration." A. Redfern & M. Hunter, supra note 7.

[30] "Public policy is only violated if an award violates fundamental legal principles and is therefore incompatible with Swiss legal understanding." P.M. Baron & S. Liniger, supra note 19.

[31] New French Code of Civil Procedure.

[32] Haris P. Meidanis, "Public Policy and Ordre Public in the Private International Law of the EU: Traditional Positions and Modern Trends" (2005) *European Law Review*.

[33] TIAL, Article 1 para. V (related to the public service concession agreement).

requirements (e.g. permission for an arbitration agreement) and limitations[34] but also there are some other perspectives – for example Swiss law has a very pro-arbitration provision on that issue.[35]

At this stage, the solution looks quite clear: if states or their entities act in a commercial nature as a counterpart to private individuals, arbitration should be permitted without any specific restrictions or limitations. However, in practice, the issue is more difficult than this. Because even if states agree to arbitrate, the arbitration is going to go through their law system at the end and their courts will be supreme for all process (see footnote 33). For this reason, national court intervention in the arbitration process becomes more important to the concepts of "fair hearing" and "independence of the arbitral tribunal."

Intervention in the Arbitral Process by National Courts;

Any decision given by an arbitral tribunal as to its jurisdiction is subject to control by the courts of law, which in this respect have the final word. According to Redfen & Hunter, in practice that involvement is likely to take place at one of three stages: in the beginning, during (interim awards) the arbitral process, or following the award. There is an exception to this for ICSID arbitration where all applications are awaiting a decision by national courts to become final. Whether as an interim or final, any arbitral award may be set aside by a "competent" court and it may be refused recognition or enforcement by under Article 16(3) of the Model.

As briefly mentioned above, the relationship between national courts and the arbitral process is not a garden of heaven, and certainly not a relationship of equal partnership. This relationship is (ideally) described as one of supervision and assistance, from the court to the arbitral process.

But what are the limits of this position? The answer is changing country by country and it depends on their legal systems' perspectives on arbitration. In modern, arbitration-friendly legal systems, this involvement is very limited and formed by the Model Law (with some national differences). However these limitations can be very strict in some countries.

According to Redfern & Hunter, Article V of the Model Law may seem to be "a striking declaration of independence," but actually the Model Law cannot exclude, and does not seek to exclude, national courts as the competent court. In Article VI, the Model Law refers to another authority beside courts "…courts or, where referred to therein, other authority competent to perform these functions;" this other authority could possibly be an arbitral institution

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[34] For details see; A. Ulusoy, supra note 15, and also K.I. Vibhute, "Waiver of State Immunity by an Agreement to Arbitrate and International Commercial Arbitration", (1998) *Journal of Business Law*.

[35] "If a party to the arbitration agreement is a state or enterprise or organization controlled by it, it cannot rely on its own law in order to contest its capacity to be a party to an arbitration or arbitrability of a dispute covered by the arbitration agreement." Swiss Private International Law Act 1987, Art.177(2)

or chamber of commerce. That limitation for competent court assistance and supervision can be considered in two main groups.

The first group has been listed in Article VI. These are Articles 11, 13, 14, 16 and 34 that have been issued regarding, for example, the appointment of an arbitrator (Art. 11), jurisdiction of the arbitral tribunal (Art. 16) and setting aside of the arbitral award (Art. 34).

The second group are Articles 8, 9, 27, 35 and 36. Articles 8 and 9 are about recognition of the arbitration agreement. Article 27 says: "The court may execute the request within its competence and according to its rules on taking evidence." Articles 35 and 36 are organized for the recognition and enforcement of arbitral awards.

Article V clearly excludes any form of intervention in international commercial arbitration, instead of these two groups.

Nonetheless, the involvement of national courts in the international arbitration process remains essential to its effectiveness.

CONCLUSION

International commercial arbitration is dependent on, and based on, relevant laws.[36] National courts have a supreme position over the entire arbitral process.[37] Safeguards are, at the very beginning, set out by states in order to protect the jurisdiction of their courts where it is necessary.

Growing international recognition of the commercial importance of arbitration has helped to modernize many different national laws that govern the process of international commercial arbitration in different parts of the world. This liberal approach has tended to minimize court interference. However this intervention is not necessarily disruptive of the arbitration process; it may equally be supportive.[38] Finally we should bear in mind that arbitration is a private proceeding with public consequences.

From that point of view, on the path to more effective and more widely-used arbitration, limited intervention and power of national courts should not be the only way to take. But also, a court's power to be used to support and cover the weaknesses of arbitration, should considered as another way to shape modern international commercial arbitration. To give national courts the opportunity to practice in that way, will allow national legislatures the opportunity to appropriately determine the content of proper safeguards.

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[36] There is four possible relevant laws: first, governing law; second, *lex arbitri*; third, substantive law (law for commercial dispute) and finally law that governs recognition and enforcement of the arbitral award.

[37] "The relationship between national courts and arbitral tribunals swings between forced cohabitation and true partnership… it is not a partnership of equals… National courts could exist without arbitration, but arbitration could not exist without national courts". A Redfern & M. Hunter, supra n 7.

[38] From Redfern & Hunter, footnote, Claude Reymond, "The Tunnel Case and the Law of International Arbitration" (1993) 109 L.Q.R., p.337 at p.341.

In conclusion, more public influence on international commercial arbitration does not necessarily bring harm to its spirit as a private method of dispute resolution, but may bring more strength to its functionality in terms of effectiveness.