

DechertOnPoint

Financial Transactions and Arbitration

A legal update from Dechert's International Arbitration Practice
and Global Commodities and Derivatives Team

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Introduction: Increasing Arbitration of Financial Disputes Reflects Globalization of Financial Markets

The growth and economic development of BRIC and other emerging and frontier economies in recent decades is well documented and a key driver in today's global economy. Accompanying these advances has been the expansion of international financial markets and the increasing use of complex international financial instruments in emerging economies, including by sovereign states. The same drivers behind the growth in the use of complex international financial instruments in emerging economies – globalization, rampant growth in emerging and frontier markets, and the rise in bargaining power of counterparties from those regions – have driven the rise of international arbitration as a now predominant means of resolving disputes arising out of international commerce.

This update explores a particular area of international commerce that has historically veered away from the use of arbitration – international finance – and explores the increasing intersection of the two fields. That intersection is best seen in the International Swaps and Derivatives Association's ("ISDA's") recent publication of optional arbitration agreements for use with ISDA's 2002 Master Agreement and 1992 Master Agreement (Multicurrency-Cross Border)(each a "**Master Agreement**").

This intersection is also reflected in the recent establishment of a new financial dispute resolution body, the Panel of Recognized International Market Experts in Finance ("**P.R.I.M.E Finance**"), whose aim is to provide a bespoke institution for the resolution of complex international financial disputes. Recognizing the needs of financial market participants, P.R.I.M.E Finance has published modified arbitration rules and appointed a panel of arbitrators recognized for their experience and expertise in international financial markets. These developments reflect both the increasing globalization of world financial markets and the relative advantages of arbitrating finance disputes in appropriate cases.

Importance of Planning for Disputes

Planning for dispute resolution is an essential part of any cross-border contract. Disputes should be avoided if at all possible, but giving certainty as to how future disputes will be resolved can avoid costly and time-consuming conflicts over that very issue. Thus, planning for disputes in a cross-border context should provide answers to the critical preliminary questions that will be asked in every international controversy: where, by whom, and by which legal rules will the dispute be decided?¹

¹ See e.g., the discussion in Born, *International Commercial Arbitration* 65 et seq (2009).

The answers to these questions can be vitally decisive to the outcome of the dispute, the availability and degree of monetary damages and other forms of relief (such as specific performance), the enforceability of the tribunal's award (as discussed below, critical in the context of cross-border transactions), the speed and efficiency of the proceedings (avoiding multiplicity in different jurisdictions), and the fairness of the process.

What is International Arbitration?

Arbitration, as with litigation, is an adversarial system of dispute resolution. Parties have their dispute determined by a tribunal in accordance with legal principles, applying adjudicatory procedures that ensure accepted standards of due process and procedural fairness are met. Lawyers advocate their clients' positions in written and oral submissions, and evidentiary hearings during which the cross-examination of witnesses and experts is conducted is the norm in international practice. Arbitration is not mediation or conciliation where a mediator or conciliator will seek to broker a negotiated settlement between the parties in dispute.

In contrast to litigation, however, arbitration is not public, disputes are not adjudicated by judges, and hearings are not conducted in a court. Arbitration is a private process, disputes are heard before and determined by independent arbitrators (often appointed by the parties, or pursuant to a mechanism agreed by them), and arbitration hearings are held in hearing rooms at arbitration institutions or board rooms at law firms or hotels. Procedural flexibility, informality, and efficiency are the hallmarks of arbitration practice, unlike the rigid, formal procedures of most court systems.

Critically, arbitration is a creature of contract. Parties must agree to arbitrate their existing or future disputes (or certain types of dispute) to the exclusion of domestic courts or other forums. Most commonly, commercial parties will include in their contract an express provision to submit future disputes to binding resolution by one or more arbitrators, applying agreed legal rules and adjudicatory procedures (*i.e.*, an "arbitration agreement"). Under all developed legal systems, an arbitration agreement (provided it meets minimum formal requirements) operates to exclude the jurisdiction of domestic courts to adjudicate the parties' dispute, and instead hands that jurisdiction to the arbitrators. The decision (award) of the arbitrators will be final and legally binding on the parties and, subject to limited grounds, may not be challenged before a court.

"International" arbitration arises by way of an arbitration agreement between parties from two or more different countries. Often, the law governing the contract will be that of a neutral legal system, the place of the arbitration will be a neutral third jurisdiction, and the arbitrators will be of nationalities other than any of the parties to the arbitration proceedings.

Why is International Arbitration Considered Good Practice for Resolving International Disputes?

Contractual rights are the lifeblood of international commerce and finance. In turn, the person or body with the authority to rule on what those contractual rights are has significant responsibility (and power) over the rights and obligations of the parties to that contract. Those rights may be wide-ranging and highly valuable, and the corresponding obligations onerous.

In the context of an international dispute, it is possible that a contract might be subject to interpretation at multiple points. Arbitral tribunals, domestic and appeal courts (in different jurisdictions), and if formal enforcement of the arbitral award or court judgment is required, courts at the place of enforcement, may each seek to interpret a contract in their own way. Incompetent or arbitrary decisions (or at worst parochial or corrupt ones) at any stage may not only incorrectly rewrite a contract, but have wide-ranging consequences for the outcome of a dispute.²

If parties to an international contract are exposed to the risks of such uncertainty, not only might it be difficult to predict the outcome of any dispute between them and, critically, whether they can enforce the result (and how long these processes might take), but the contract itself may be unstable. That is, the terms of the contract may be uncertain and therefore difficult or impossible for the parties to perform.

International arbitration seeks to aid in the legal predictability and stability of international contracts by providing for the impartial, centralized, and final resolution of disputes arising out of international contracts. Broadly speaking, it does so in five ways:

- *Neutrality.* To avoid actual or perceived impartiality of domestic courts and “home court advantage”, arbitration provides a neutral forum, neutral arbitrators, neutral governing law, and neutral procedures.
- *Centralized forum.* By agreeing to exclusively arbitrate disputes arising out of their contractual relationship, those disputes are centralized in one forum. This minimizes the risk of litigating the same dispute in multiple different courts and jurisdictions.
- *Final and binding adjudication.* Arbitral awards are final and binding on the parties, and they are only permitted to be appealed or challenged on very limited grounds.
- *Worldwide enforcement regime.* The UN 1958 Convention on Recognition and Enforcement of Foreign Arbitral Awards (the “**New York Convention**”) obliges Convention States (of which there are now over 140) to provide that foreign arbitral awards are recognized and generally capable of enforcement in their jurisdiction in the same way as domestic awards. The New York Convention ensures foreign and non-domestic arbitral awards will not be discriminated against, and aims to provide for straight-forward enforcement where necessary. There is no such system for the global enforcement of litigation judgments, such that international arbitration is seen as offering an “enforcement premium”. This "enforcement premium" is one of the primary reasons why parties to international contracts arbitrate disputes arising out of those agreements.
- *Party autonomy and procedural flexibility.* While domestic court procedures are often prescriptive and onerous and courts slow to deal with disputes, parties to arbitration enjoy very wide autonomy to agree on appropriate procedures, and arbitrators have flexibility to adopt them. If parties seek efficiency and speed, then they can readily agree to procedures and appoint an appropriate tribunal to achieve those objectives. In turn, party autonomy and procedural flexibility enhances the neutrality of the arbitration process.

In an increasingly globalized economy, with more and more international contracts, the demand for an impartial, centralized, and final dispute resolution system – whose outcomes can be enforced swiftly around the globe – has increased exponentially. While international arbitration does not achieve these

² *Ibid.*

aspirations perfectly (multiplicity of proceedings still arises, enforcement courts are not always perfect, and demands for better efficiency rightly remain), it is most often seen as offering the best solution – or at least the only one the parties can agree on.³

The key point for parties negotiating finance contracts is that one size does not fit all. Any analysis that seeks to suggest that either litigation or arbitration is – by definition – superior, but which ignores the practical and enforcement aspects of a particular transaction, fails to address key issues, such as: where am I likely to be most successful and can I successfully enforce my favorable award? Institutions and counterparties need to be able to collect their debts: pyrrhic victories are valued little by shareholders and investors, if at all.

Is International Arbitration Suitable for Resolving Disputes Arising out of International Financial Transactions?

Historically, parties to international financial transactions have agreed to refer their disputes to the jurisdiction of the English and New York courts. That certainly made sense in a world where international finance was dominated, and largely only conducted, in those cities (or their colonial offspring). Financiers from London and New York also had significant bargaining power, particularly over foreign parties, to insist on dispute forums of their choice. The English and New York courts and the judgments they delivered were also relatively fit for the purpose.

But the dimensions of the world economic order have changed dramatically in the past two decades, and the demands of users of the international legal system have necessarily evolved to reflect those seismic changes. Not only is more business being done with and in emerging and frontier markets⁴, but participants in those markets have more bargaining power to negotiate alternatives to the London and New York courts. Critically, the assets against which awards may need to be enforced can be located in jurisdictions where an arbitral award will be quicker and more certain to enforce than a domestic court judgment from England, New York, or elsewhere.

As a result, the use of international arbitration as a dispute resolution mechanism in international financial transactions has increased markedly. Why?

- *Arbitration is the only option?* Practitioners and scholars may debate the merits of arbitration versus litigation. In reality, arbitration can often be the only compromise possible. This applies to international financial transactions in the same manner as with other commercial agreements.
- *Enforcement.* A debt is only as valuable as the ability to recover it. The New York Convention provides that arbitral awards are enforceable as domestic court judgments in over 140 jurisdictions. The “enforcement premium” offered by an arbitral award may mean arbitration is the only commercially sensible choice.

³ Statistics from two leading international arbitration institutions demonstrate the increased popularity of international arbitration. In 1995 (the first year International Chamber of Commerce (the “ICC”) statistics were publicly available), the ICC received 417 requests for arbitration; this had increased to 796 in 2011 (an increase of 91%). The London Court of International Arbitration (the “LCIA”), based in London, received around 50 requests for arbitration in 1995. In 2011 the LCIA received 224 (a 448% increase).

⁴ Intra-emerging market transactions, moreover, play an increasingly major role in the world economy.

- *Privacy and confidentiality.* Arbitration proceedings are private, and parties can also agree that their arbitration proceedings and any award will be confidential.
- *Expert tribunals.* Parties can agree on the appointment of arbitrators who are experts in international financial transactions (such as the P.R.I.M.E Finance panel of arbitrators).
- *Injunctive relief.* Creditors can obtain injunctive relief from arbitral tribunals and courts as necessary.
- *Emergency arbitrator appointment.* In emergency situations, the leading arbitral institutions provide for the rapid appointment of tribunals.
- *Efficiency.* Parties have wide autonomy and can design efficient procedures. Under the major rules, arbitral tribunals have a corresponding obligation to conduct proceedings efficiently.
- *“Strike out” and preliminary issue determination.* Parties can agree to (or arbitral tribunals can order) the early determination of issues in dispute – similar to “strike-out” procedures in some domestic commercial courts.

There is no doubt that international arbitration is fit for the purpose for resolving complex international financial disputes. This is reflected, for example, in the number of financial disputes being referred to the leading international arbitral institutions,⁵ ISDA’s wide-ranging consultation with its members concerning the use of international arbitration to determine disputes arising out of its Master Agreements⁶, and its recent publication of the [2013 ISDA Arbitration Guide](#) (the “**Arbitration Guide**”) as well as the recent establishment of the P.R.I.M.E Finance arbitration rules and panel of expert arbitrators.

2013 ISDA Arbitration Guide and ISDA Model Arbitration Clauses

From 2011 to 2013 ISDA undertook a wide-ranging consultation of its members regarding the use of arbitration for disputes arising out of its Master Agreements. Reflecting the demand seen from its members, ISDA recently published a wide range of optional international arbitration clauses for use with the Master Agreements. For further information on ISDA’s model arbitration agreements and the use of arbitration for Master Agreements more generally, please refer to Dechert *OnPoint* “[ISDA Adopts Model Clauses for Use With ISDA Master Agreements](#)”.

P.R.I.M.E. Finance Arbitration

The increasing use of, and anticipated future demand for, arbitration of international financial disputes led to the establishment in early 2012 of a new financial dispute resolution institution. P.R.I.M.E Finance’s aim is to provide a bespoke forum for the resolution of complex international financial disputes. Its offering includes a panel of specialist senior arbitrators who are experts in complex international financial

⁵ For example, the LCIA reported that 27% of its caseload in 2012 was comprised of financial and commodities disputes (30.5% in 2011): Registrar’s Report 2012.

⁶ See ISDA, *Memorandum on arbitration in derivatives*, Jan. 2011, at <http://www2.isda.org/functional-areas/public-policy/financial-law-reform/page/2>; ISDA, *The use of arbitration under an ISDA Master Agreement: feedback and policy options*, Nov. 2011, at <http://www2.isda.org/functional-areas/public-policy/financial-law-reform/page/1>; ISDA, *2013 ISDA Arbitration Guide*, Sept. 2013 at 2013 ISDA Arbitration Guide.

disputes, customized arbitration rules, mediation, and expert services. In the Arbitration Guide, ISDA has included in its model arbitration clauses an arbitration clause that provides for arbitration under the P.R.I.M.E Finance arbitration rules (as well as six other international arbitration institutions).

Drafting Arbitration Clauses for International Finance Contracts

It is essential that parties to international transactions plan for termination (all contracts end) and dispute resolution. That planning can be vitally decisive to the merits of the dispute, the availability and degree of monetary damages and other forms of relief (such as specific performance), the enforceability of the tribunal's award, the speed and efficiency of the proceedings (avoiding multiplicity), and the procedural fairness of the process.

Whether arbitration is appropriate for an entity's Master Agreement or other international financial contract will need to be determined in the circumstances of each case. If arbitration is the most appropriate dispute resolution mechanism, then the best combination of governing law, arbitral institution, seat, and other necessary provisions will need to be considered and negotiated. Parties should always seek legal and other advice necessary to elect the appropriate dispute resolution mechanisms for their circumstances.