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£50m Trading Litigation Bill Underscores Potential Of ISDA Arbitration Clauses

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An 800-page English High Court judgment last week in a long-running and complex FX and derivatives litigation in London—described by the judge, following a four-month trial and a reported £51m indemnity costs order against the unsuccessful party, as "almost unmanageable"—is certain to ignite debate about the efficiency of English litigation.[1] Perhaps prophetically, at the same time that dispute was playing out growing demand from members of the International Swaps and Derivatives Association ("ISDA") led to ISDA's September 2013 publication of a suite of model international arbitration clauses (the "Model Arbitration Clauses") for use with swaps and derivatives contracts using ISDA's 2002 Master Agreement and 1992 Master Agreement (Multicurrency-Cross Border)(each a "Master Agreement").

Alongside high-profile jurisdictional battles such as that in the recent *Caryle* dispute, these developments all serve to highlight the importance of planning for disputes arising out of international financial transactions. But one size does not fit all. Commentators who suggest either litigation or arbitration is—by definition—superior for finance disputes, ignore the practical legal and enforcement aspects of particular transactions: where am I likely to be most successful? Can I successfully enforce my judgment or award in jurisdiction 'X'? Is confidentiality important? What are my options if I need to compromise on my preference? Are there issues of sovereign immunity? The most appropriate choice will need to be assessed case by case.

What is international arbitration?
Arbitration, as with litigation, is an adversarial system of dispute resolution. 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. The arbitrators then determine the dispute in accordance with legal principles, typically in a reasoned award. 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 (most often appointed by the parties) and arbitration hearings are held in hearing rooms at arbitration institutions or board rooms at law firms and, often, hotels. Procedural flexibility, informality and efficiency are the hallmarks of arbitration practice, unlike the rigid, formal procedures of most court systems.

Increasing use of international arbitration agreements in cross-border finance

While the (sometimes overstated) claims international arbitration has to efficiency advantages over litigation may be bolstered by the *Sebastian Holdings* litigation (the 84 page award in the recent $7.5b arbitration brought by the Abu Dhabi Investment Authority against Citibank provides a point of comparison[2]), ISDA's extensive consultation[3] and the recent 2013 survey of in-house counsel by Queen Mary University and PriceWaterhouseCoopers[4] have highlighted numerous other reasons why international arbitration is gaining popularity with parties to cross-border finance transactions.

■ *Arbitration clauses commonplace*. ISDA notes that there has been a surge in the frequency with which arbitration clauses are included in a range of financial contracts, and in the number of financial disputes referred to arbitration. Arbitration is being increasingly used in relation to privately negotiated or over-the-counter ("OTC") derivative transactions entered into under master netting agreements, such as the Master Agreements.

■ *Enforcement premium*. Arbitration benefits from a much more comprehensive regime for the cross-border enforcement of arbitral awards than exists for court judgments. As ISDA notes, "[s]ucceeding on the merits of a dispute may prove to be a pyrrhic victory if it is not possible to enforce the resulting judgment." The "enforcement premium" offered by arbitration is that over 140 countries have ratified the 1958 UN Convention on Recognition and Enforcement of Foreign Arbitral Awards (the "New York Convention"), which provides for the streamlined recognition and enforcement of arbitral awards in those jurisdictions (subject to limited exceptions). This is a particularly important consideration with emerging markets counterparties.

■ *Neutrality*. When neither contracting party is prepared to submit to the jurisdiction of its counterparty's local courts, arbitration in a neutral third country may be the only acceptable forum. Counterparties in emerging jurisdictions are increasingly reluctant for disputes to be resolved in the English or New York courts.

■ *Fairness*. Agreeing to arbitration allows a party to avoid having to litigate in a jurisdiction in whose courts it does not have confidence. That may arise because of a court's lack of expertise, delay, unfamiliar procedures, or a perception of bias or corruption on the part of a judicial authority. Indeed, PWC's 2013 survey noted that for some in-house counsel "fairness" – above all other considerations – is what companies look for in a dispute resolution mechanism: it is easier to explain to senior executives, or the Board of Directors, why the company had been unsuccessful if the Board felt that the process had been fair. Arbitration, because of its neutrality, gives a sense of fairness that litigation in foreign courts sometimes cannot.

■ *Industry standardization*. Regulatory pressure for the development of clearing mechanisms for OTC derivatives may also encourage the use of arbitration. ISDA notes that the clearing rules of most of the world's clearing houses (for securities and commodities trading, exchange-traded futures and options, and now many OTC derivatives) provide for disputes to be resolved by arbitration. Privacy and confidentiality, party autonomy and procedural flexibility, and the finality of arbitral awards, are also increasingly favoured advantages of international arbitration. Moreover, more U.S. and non-U.S. counterparties (such as public pension plans and state-owned or controlled enterprises) – perhaps with more bargaining power than ever – may simply reject English or New York litigation. Litigating cross-border finance disputes in London and New York will no doubt continue to be effective and remain commonplace (perhaps because of the 'lock-in' effects or stickiness of

boilerplate terms and their familiarity[5]), but as PWC's 2013 survey noted, over two thirds of in-house counsel in financial services companies now felt international arbitration is suited to resolving cross-border disputes in the industry.

ISDA's Model Arbitration Clauses

The increased interest in arbitration in cross-border finance is reflected in ISDA's recent publication of a range of optional arbitration clauses, which are intended to form part of the Schedule to a Master Agreement. The Model Arbitration Clauses can be found in the 2013 ISDA Arbitration Guide (the "Arbitration Guide") which supplements and amends the corresponding guidance in the ISDA User's Guides.[6] The Model Arbitration Clauses provide for use of the leading institutional arbitration rules, offering numerous combinations of arbitral rules, governing law, and seat (Arbitration Guide, Appendices A-G).

The institutional arbitration rules currently include the Rules of Arbitration of the International Chamber of Commerce ("**ICC**"), Arbitration Rules of the London Court of International Arbitration ("**LCIA**"), International Arbitration Rules of the American Arbitration Association—International Centre for Dispute Resolution ("**AAA-ICDR**"), Administered Arbitration Rules of the Hong Kong International Arbitration Centre ("**HKIAC**"), Arbitration Rules of the Singapore International Arbitration Centre ("**SIAC**"), Swiss Rules of International Arbitration ("**Swiss Arbitration**") and the Panel of Recognised International Market Experts in Finance Arbitration Rules ("**P.R.I.M.E. Finance**"). The Model Arbitration Clauses provide for English or New York governing law, historically the most popular among finance market participants, with London, New York, Paris, Hong Kong, Singapore, Zurich, Geneva and the Hague the arbitral seats offered.

ISDA is careful to note that the published options were a response to member feedback, and inclusion in the Arbitration Guide is not an endorsement of the clauses (or combinations of rules, governing law, and seats). Parties are free to modify the Model Arbitration Clauses as they devise and negotiate, and in all cases parties should seek appropriate legal advice to select the appropriate dispute resolution mechanisms for their circumstances.

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

The increasing use of, and anticipated future demand for, arbitration of international financial disputes has also led to the establishment in early 2012 of a new financial dispute resolution institution, the Panel of Recognised International Market Experts in Finance (P.R.I.M.E Finance). 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 disputes, customized arbitration rules, mediation and expert services. In the 2013 ISDA 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.

Recent *Sebastian*, *Carlyle* and *Sri Lanka* cases highlight the importance of planning for disputes and forum selection agreements

Planning for disputes is a critically important component of managing the risks associated with any contract or transaction. That is particularly so in contracts with an international dimension, which raise important questions as to where, by whom and by which legal rules any disputes arising out of

the contract(s) will be resolved. The answers to those questions will have a critical impact on the merits and enforceability of any judgment or award, the cost and speed of resolving any disputes and, ultimately, the risk that a contract will be performed according to its terms.

Some recent examples from cross-border finance disputes highlight the use and importance of forum selection agreements in trading, swaps and derivatives and other finance contracts.

Preceding the recent High Court judgment in *Sebastian Holdings* was a lengthy battle over where the litigation would be heard.[7] The dispute arose out of a suite of numerous interrelated contracts, including ISDA Master Agreements, Prime Brokerage Agreements, FX trading mandates and Master Netting Agreements, pursuant to which the Bank provided trading services to Sebastian, an SPV registered in the Turks and Caicos Islands. While on the one hand Sebastian brought proceedings against the Bank in New York in November 2008 to recover approximately $750m as damages for breach of one of the agreements, on the other the Bank wished to pursue its claims in England to recover approximately $250m which it contends Sebastian should have paid under two agreements each of which contained English jurisdiction clauses. Parallel actions were permitted: the suite of contracts did not provide for the consolidation of the disputes into a single proceeding or forum.

In another multi-jurisdictional cross-border derivatives saga, Sri Lanka's state-run oil company *Ceylon Petroleum Company* (Ceypetco) sought to avoid hedging agreements it entered into during 2008 with three international banks, Citibank, Standard Chartered and Deutsche Bank, to limit its exposure to oil price rises. Prices fell in the wake of the financial crisis, leaving the state entity owing the banks $460m. Sri Lanka's Supreme Court ordered the suspension of payments, and the banks each brought separate claims—an LCIA arbitration, a UK litigation and an ICSID arbitration, respectively. In addition to the different forums each action was brought under different governing laws—with consequently mixed results.[8]

In the hotly contested *Carlyle* litigation, a Kuwaiti investor (NIG) in a closed-end MBS investment fund sought to avoid an exclusive jurisdiction clause providing for litigation in Delaware. When the fund went into bankruptcy in 2009, NIG alleged that the subscription agreement—and the jurisdiction clause in it—were void *ab initio* because Carlyle did not have a licence to sell securities in Kuwait. NIG issued proceedings in Kuwait seeking to recover its investment, and argued in Delaware that the jurisdiction clause was void and of no effect. Rejecting those efforts, the Delaware Supreme Court upheld the forum selection clause, underlining the importance of unambiguous forum clauses.

Each of the above examples highlight the impact forum choices can have. The *Sebastian Holdings* battle continues in the New York courts, notwithstanding four years of "almost unmanageable" litigation in London culminating in a four-month trial—where written opening submissions reportedly ran to 930 and 845 pages, closing submissions 1530 and 1336 pages and the judgment 800 pages. In *Ceypetco* three banks litigated in three different forums with different outcomes, notwithstanding the similarity of the underlying transaction. In *Carlyle* the position was clear: NIG was required to litigate in Delaware.

One size does not fit all: drafting the right forum selection clause

When it comes to forum selection agreements, one size does not fit all. Commentators who suggest either litigation or arbitration is—by definition—superior, inevitably ignore the practical legal and enforcement aspects of particular transactions: neutrality is commendable, but where am I likely to be most successful? Can I successfully enforce my favorable judgment or award? Is confidentiality important? What are my options if I need to compromise on my preference? Is there sovereign immunity?

Whether arbitration or litigation is most appropriate for any given ISDA Master Agreement or other international financial contract will need to be assessed in 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, usually, negotiated. Parties should always seek legal and other advice necessary to elect the appropriate dispute resolution mechanisms for their circumstances.

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Useful Links:
http://www.dechert.com/ISDA_Adopts_Model_Arbitration_Clauses_for_Use_with_ISDA_Master_Agreements_10-23-2013/
http://www.dechert.com/international_arbitration/

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[1] *Deutsche Bank AG v Sebastian Holdings Inc.* [2013] All ER (D) 118 (Nov)
[2] *Abu Dhabi Investment Authority v Citibank*, Final Award dated 14 October 2011, ICDR Case No. 50 148 T 00650 09. The arbitration concluded two years sooner in 2011, with the merits hearing running 16 days as opposed to 45.
[3] *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 http://www.dechert.com/Financial_Transactions_and_Arbitration_10-23-2013
[4] *International Arbitration Survey 2013: Corporate choices in International Arbitration*, athttp://www.pwc.com/arbitrationstudy
[5] It has been suggested that litigation continues to be favoured by parties to cross-border finance transactions, even if arbitration appears more favorable, because of the "the inherent stickiness of boilerplate contract terms" or "'lock-in' effects of standardized contracts": Cross, *Arbitration as a means of resolving sovereign debt disputes*, American Review of International Arbitration, Vol. 17 p. 374 (2006)
[6] ISDA, *2013 ISDA Arbitration Guide*, Sept. 2013
athttp://www.dechert.com/Financial_Transactions_and_Arbitration_10-23-2013
[7] *Sebastian Holdings Inc.v Deutsche Bank AG* [2010] EWCA Civ 998 (Jurisdiction)
[8] *Standard Chartered Bank v Ceylon Petroleum Corporation* [2011] EWHC 1785 (Comm) (Standard Chartered successful; affirmed on appeal, [2012] EWCA Civ 1049); *Deutsche Bank AG v Democratic Socialist Republic of Sri Lanka*, ICSID Case No. ARB/09/02, (Deutsche Bank successful, however annulment proceeding is pending). Citibank's LCIA arbitration was held in private, however it has been reported Citi's attempt to recoup under the hedge was unsuccessful.