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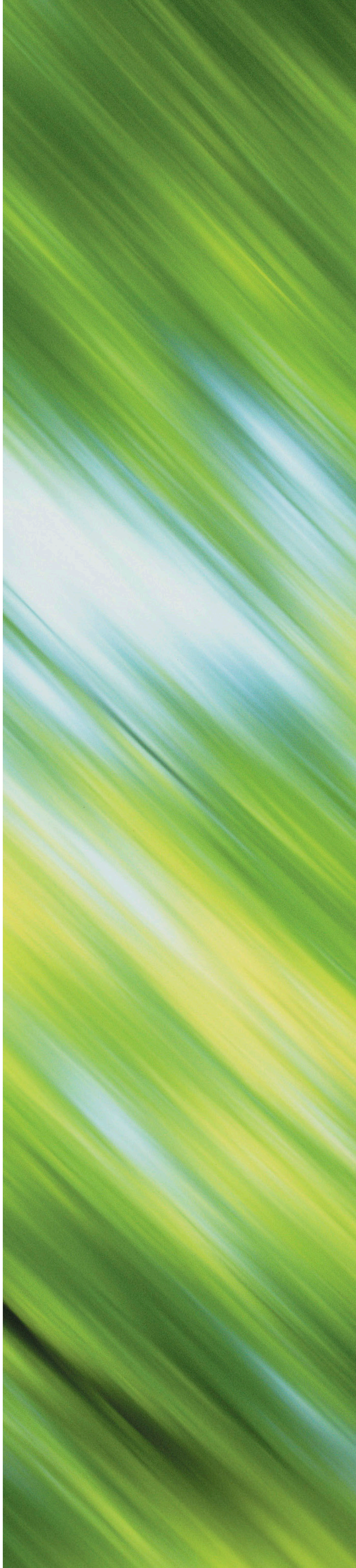

WELCOME TO THE 32ND EDITION OF K&L GATES' ARBITRATION WORLD

FROM THE EDITORS

Welcome to this 32nd edition of *Arbitration World.*

We are very pleased to include in this edition, as part of our series of guest contributions from expert witnesses, an article by Howard Rosen and Noel Matthews of **FTI Consulting**, regarding how "country risk" can affect the value of investments and the approach towards this issue in damages calculations in international arbitration.

We review recent developments in arbitration in Qatar, including court decisions regarding the validity of arbitration agreements and the enforcement of arbitration awards. As part of a series of articles related to so-called "Bermuda Form" liability insurance policies, we look at the process of formation of the arbitral tribunal in Bermuda Form policies and whether such insurance policies may conflict with certain U.S. state laws regulating insurance.

We report on a recent decision of the English Commercial Court regarding enforcement of a tribunal's order for a provisional payment, as well as a recent UK Privy Council decision on the meaning and effect of permissive arbitration clauses. We review the new mediation rules of the Vienna International Arbitration Centre (VIAC) and report on the work of an International Bar Association (IBA) Subcommittee in assessing how states have defined the public policy exception under the New York Convention.

We review some recent decisions of the Federal Supreme Court of Switzerland on arbitration award set-aside applications in the past year. We are also very pleased to include a guest contribution from Ben Beaumont, a barrister from Thomas More Chambers and Chairman of the Arbitration Club, regarding a recent decision of the Federal Supreme Court of Switzerland on the role of a Dispute Adjudication Board (DAB) under the FIDIC Red Book regime.

We also provide our usual update on developments from around the globe in international arbitration and investment treaty arbitration.

We hope you find this edition of *Arbitration World* of interest and we welcome any feedback (email **ian.meredith@klgates.com** or **peter.morton@klgates.com).**

EDITORS

Ian Meredith
ian.meredith@klgates.com
+44.(0)20.7360.8171

Peter R. Morton
peter.morton@klgates.com
+44.(0)20.7360.8199

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Arbitration News From Around the World

Sean Kelsey (London)

ASIA

India

One of the most high-profile arbitration-related cases in recent Indian judicial history has come to a close. By a judgment dated 28 January 2016 in the *Bharat Aluminium Co v Kaiser Aluminium Technical Service* (or "*BALCO*") dispute, the Supreme Court of India (the "Supreme Court") has held that, by prescribing that the law applicable to the relevant arbitration agreement was English law, the parties had agreed to exclude Part I of the Arbitration and Conciliation Act 1996 (the "Act") and hence such jurisdiction as that part of the Act confers on the Indian courts with respect to the decisions of arbitral tribunals. The dispute is best known for the landmark judgment of the Supreme Court dated 6 September 2012 in which it was held that, in relation to arbitration agreements executed after that date, Part I of the Act would not apply to international commercial arbitrations seated outside India (see **Indian Arbitration—Recent Trends**, *Arbitration World*, September 2012.) That decision meant that the substance of the dispute in *BALCO* would fall to be decided in accordance with prior caselaw, including the 2002 *Bhatia International* decision. In *Bhatia International*, the Supreme Court had held that Part I of the Act ("Part I") applies to international commercial arbitration held outside India, unless expressly excluded. Indian caselaw entered into an unwelcome state of uncertainty after the *Bhatia International* decision, with some judgments applying that decision, while in others certain Indian courts established the principle of implied exclusion of Part I. In the final chapter of the *BALCO* saga, the Supreme Court has now held that the law applicable to the relevant arbitration agreement was English law, and that therefore Part I of the Act had been impliedly excluded.

Myanmar

It has been reported that Myanmar adopted a new Arbitration Law (Union Law No. 5/2016) on 5 January 2016 (the "Law"). The Law passed by the Parliament of the Republic of the Union of Myanmar gives effect to Myanmar's ratification of the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards in April 2013. It is understood that the Law brings Myanmar's arbitration law in line with international practice and with the Model Law.

CARIBBEAN

British Virgin Islands

A judgment of the Judicial Committee of the United Kingdom Privy Council (the "Privy Council") has provided confirmation of the basic principle that parties intending to arbitrate their disputes should enter into a clear and unambiguous agreement to that effect. The case came before the Privy Council via the Eastern Caribbean High Court and the Eastern Caribbean Court of Appeal. The dispute related to the use of the word "may" in an arbitration clause, providing that the parties "may", rather than "shall", "will" or "must", resolve disputes through arbitration. As explained in the **full report** on this decision in this edition of Arbitration World, the decision arguably reduces the significance of the distinction between permissive and mandatory arbitration clauses, as parties are likely to be deterred from commencing litigation even though the applicable arbitration clause is permissive. The case also illustrates that unless they are clear and unambiguous as to the requirement that disputes be referred to arbitration, parties are on notice of the risk of expending time and money on litigation that is subsequently aborted—by which time it may be too late to preserve confidentiality.

EUROPE

England

Among a great many other things, courts in England have been giving consideration recently to issues relating to arbitrator conflicts of interest.

In the case of *Cofely Ltd v (1) Anthony Bingham (2) Knowles Ltd*, Mr Justice Hamblen has exercised the authority of the court on an application made pursuant to s.24(1)(a) of the Arbitration Act 1996 to order the removal of an arbitrator on the ground of apparent bias.

In his judgment dated 17 February 2016, Hamblen J held that the grounds of the application, viewed cumulatively, established apparent bias. The second defendant, Knowles, routinely influenced arbitrator appointments in favour of the first defendant, Mr Bingham, and Mr Bingham had failed to disclose his past involvement with Knowles, as required by the Chartered Institute of Arbitrator's (CIArb) Code of Professional and Ethical Conduct for Members (October 2000 edition, the "Code"). Information came to light in the course of the proceedings that over the preceding three years around 18 percent of Mr Bingham's appointments and 25 percent of his income as an arbitrator or adjudicator derived from cases involving Knowles. Rule 3 of the Code required its members to disclose "*all interests, relationships and matters likely to affect the member's independence or impartiality or which might reasonably be perceived as likely to do so*". The CIArb's "*acceptance of nomination*" form required disclosure by the arbitrator of "*any involvement, however remote*" with either party over the last five years. Hamblen J held that acting as arbitrator or adjudicator in previous cases involving one of the parties was "*involvement*" for the purposes of the Code.

It was immaterial that the appointments might have been made by an appointing body rather than by the party itself. The behaviour of Knowles and the evasive and aggressive manner in which Mr Bingham had responded to enquiries made by the claimant's lawyers had been inappropriate. The fact that his evidence betrayed a lack of awareness that his conduct was inappropriate demonstrated a lack of objectivity and an increased risk of unconscious bias. The challenge application was granted.

Separately, in a judgment of the High Court dated 2 March 2016 given in the case of *W Limited v M SDN BHD*, Mr Justice Knowles has 'cleared' Canadian arbitrator David Haigh QC of apparent bias and has identified what were stated to be a number of "*weaknesses*" in the IBA Guidelines on Conflicts of Interest in International Arbitration (the "IBA Guidelines"). Sitting as sole arbitrator, Mr Haigh made two awards, which were challenged on grounds of serious irregularity, under s.68 of the UK Arbitration Act 1996. It was alleged that Mr Haigh was subject to an apparent bias based on conflict of interest, because he is a partner of a law firm ("Burnet") that had extensively advised an entity, Q, which was the target of a well-publicised acquisition by the Claimant's parent company at around the time Mr Haigh made a statement of independence containing certain "*immaterial disclosures*".

Although Burnet continued to advise Q, its conflict check system had apparently not flagged any issue with Mr Haigh's acting as sole arbitrator, Mr Haigh was not aware of the transaction, and he gave evidence that he regretted not being aware of Burnet's continuing relationship with Q, as otherwise he would have disclosed it. Mr Haigh also gave evidence that he was no longer involved in the affairs of the Burnet partnership, and he was, in reality, a sole practitioner conducting an international practice with secretarial and administrative assistance from Burnet.

Knowles J found "*without hesitation*" that Mr Haigh had not been subject to an apparent conflict of interest. "*This was an arbitrator who did not know rather than […] whose credibility is to be doubted,*" he said. Knowles J went on to identify certain "*weaknesses*" in the IBA Guidelines, including the uncertainty as to whether the specific facts of a case might permit departure from a strict application of the Guidelines and their treatment as non-waivable any apparent conflict arising where "*the arbitrator or his or her firm regularly advises [a party to the case] or an affiliate of the party and […] derives significant financial income therefrom*". If such situations could not be assessed on a case-by-case basis, the effect would be that a non-waivable conflict would arise where a law firm advises an affiliate of a party to an arbitration, with no involvement of the arbitrator and without his or her knowledge. Knowles J stated that "*[i]t is hard to understand why this situation should warrant inclusion in the non-waivable red list. The situation is classically appropriate for a case-specific judgment.*" Knowles J further noted the contrast between the situation in the present case and some of the other potential conflict situations treated as waivable under the Guidelines—which include, for example, situations where an arbitrator has personally advised one of the parties on the dispute referred to arbitration.

Russia

The latest decision of a Russian court appears to confirm one of the current trends in that jurisdiction on the subject of asymmetric dispute resolution clauses. By a judgment dated 15 March 2016, the Commercial Court of Kemerovo region (the "Court") confirmed the validity of an arbitration agreement that purported to preserve a right of election between litigation and arbitration and gave order for enforcement of an arbitral award rendered pursuant thereto. The parties to the dispute were several oil companies (the "Companies") and a bank (the "Bank"). Their agreement appears to have provided that the claimant in any dispute was entitled to choose whether to commence proceedings before the Court or to refer the dispute to arbitration under the auspices of a local arbitration centre. In this instance, the Bank was the claimant, it chose arbitration, and secured an award. The Companies challenged the award before the Court, including on the grounds that the arbitral tribunal lacked jurisdiction. The Companies submitted that the dispute resolution clause was invalid and unenforceable, both for uncertainty and because it purported to give any claimant a unilateral choice of forum, giving rise to an imbalance in the parties' rights. The Court dismissed the challenge. Just as with the May 2015 judgment of the Supreme Court of the Russian Federation in *Primada LLC v Bot LLC*, the Court held that the dispute resolution provision was not in fact one-sided at all, as the right of election was available to any party, depending on whether they were the claimant in any given proceedings. The decision can thus be distinguished from the 2012 judgment in the *RTK v Sony Ericcson* case. In that case, the Russian Supreme Arbitrazh Court held that the parties' asymmetric dispute resolution clause violated the principle of equity of the parties because it expressly afforded only one of the contracting parties the right to choose between litigation and arbitration.

Russian, French and English perspectives on this topic were addressed recently as part of a series of K&L Gates international arbitration podcasts. A full recording, as well as a copy of the slide deck can be accessed **here**.

Switzerland

A Swiss court (the "Court") has upheld the award of a sole arbitrator seated in Lugano who found that he had jurisdiction to determine a steel products dispute between a Cypriot company and an Iranian

The Russian court confirmed the validity of an arbitration agreement that purported to preserve a right of election between litigation and arbitration.

company under the terms of an arbitration agreement in a contract which the parties had been unable to agree and into which they had never entered. Among other things, the Court affirmed the long-established principle in Swiss law that an arbitration agreement is separable from the main contract in which it is incorporated. This principle of separability or severability (equally familiar in English law) may be engaged, as a matter of Swiss law, even where the main contract does not take effect. The Court also confirmed that Article 178(1) of the Swiss Private International Law Act is mandatory in any arbitration seated in Switzerland. This provision provides that an arbitration agreement may be formed in simplified written form and does not require signature to take effect. Whereas parties are free to agree that an arbitration agreement will only be valid if signed, in this case, the parties did not so agree. On the facts, although the parties had not concluded a contract, they had exchanged numerous drafts containing an arbitration agreement, the terms of which had at no point been in issue between them. The judgment provides a fresh illustration of the by now well-known stance of Swiss law in supporting and upholding the autonomy of the arbitral process.

MIDDLE EAST

UAE

In a judgment given in August 2015 that appears not to have been publicised until January of this year, the Dubai Cassation Court has provided important guidance in relation to contractual obligations to seek amicable resolution of disputes before their referral to arbitration. The dispute related to the purchase by the claimant of 11 units in a property development plus 10 parking spaces. The sale and purchase agreement (the “SPA”) appears to have mandated efforts to use best endeavours to achieve amicable settlement of any dispute. One party (the “Claimant”) subsequently referred a dispute to arbitration under the auspices of the Dubai International Arbitration Court (“DIAC”). No jurisdictional challenge was raised. DIAC rendered an award in favour of the Claimant (the “Award”). The Claimant then brought proceedings in the Dubai Court of First Instance seeking ratification of the Award, which the Court of First Instance granted. The respondent in the arbitration sought to challenge ratification on grounds that the Claimant had failed to seek amicable settlement of the parties’ dispute before referring it to DIAC. The Dubai Court of Appeal upheld that challenge, quashing the Award. The Claimant appealed to the Cassation Court.

The Cassation Court found that the SPA “*provides no guidance as to what such amicable settlement entails and contains no material facts...to determine whether or not the settlement was pursued*”. In the circumstances, the requirement to try to achieve amicable settlement was unenforceable. The Cassation Court seems to have held, moreover, that the fact that a dispute proceeds to arbitration “*would indicate that the parties failed to amicably resolve their dispute*”, that the Court of Appeal should have taken that into account, and having failed to do so its judgment would not be upheld. Finally, the Court of Cassation held that any challenge based on a failure to fulfil requirements to achieve amicable settlement must be raised before the arbitral tribunal and may not be raised as a challenge to enforcement proceedings.

The case provides an illustration of the need to take care in the drafting of any agreement in relation to pre-arbitral dispute resolution procedures.

SOUTH AMERICA

Brazil

The Brazilian Superior Court of Justice ("STJ") has decided for the first time on the recognition of an arbitral award annulled in the country of its origin, refusing to enforce an ICC award set aside at the seat of arbitration.

The dispute concerned the price at which shares were acquired in two Argentine energy companies in 2001. Annulment of an award was sought by the respondents to the arbitration (the "Respondents"), and in December 2010, the Buenos Aires Commercial Court of Appeal set the award aside. In June 2011, the claimant (the "Claimant") filed a request before the STJ seeking recognition and enforcement of the arbitral award. The Respondents challenged the application, on the basis of the Argentine Court of Appeal's judgment, and by reference to Article V(1)(e) of the New York Convention, Article 38 VI of the Brazilian Arbitration Act and Article 51(e) of the Panama Convention (the "Instruments"). They also noted refusal of enforcement in certain courts of the United States, Spain and Chile.

The Claimant argued that the decision to set aside the award in Argentina was not binding on other states, and that use of the word "*may*" in the Instruments conferred only a discretion to refuse to enforce. By its judgment dated 2 December 2015 and published a short while later, the STJ rejected the Claimant's arguments and refused recognition and enforcement of the arbitral award, apparently on the basis of an application of the Instruments without regard to the discretionary nature of the relevant provisions.

This decision places Brazil in quite a different position from a number of other jurisdictions in which courts have enforced awards previously set aside at the seat. As such, it provides useful additional clarity with regard to attitudes of the country's courts on the subject of the enforcement of awards.

INSTITUTIONS

ACICA

Revised Arbitration Rules and Expedited Arbitration Rules of the Australian Centre for International Commercial Arbitration ("ACICA") came into force on 1 January 2016 (the "Revised Rules"). Among other things, the Revised Rules:

- introduce the concept of an "*overriding objective*";
- provide that the overriding objective is "*to provide arbitration that is quick, cost effective and fair, considering especially the amounts in dispute and complexity of issues or facts involved*";
- require that "[b]*y invoking these Rules the parties agree to accept the overriding objective and its application by the Arbitrator*";
- introduce new provisions in relation to consolidation of arbitrations and joinder of parties and governing the conduct of legal representatives; and
- provide for an expedited procedure to cover lower value or urgent matters.

According to ACICA, the Revised Rules "*provide enhanced processes for the efficient resolution of disputes*" and are intended to "*reflect current best practice*" in international arbitration.

AIA

Another arbitral institution that has brought into effect a new set of rules is the Italian Association for Arbitration (the "AIA"). Continuing the trend in recent years, Article 15 of the 2016 Rules

The new Rules of the Italian Association for Arbitration (AIA) came into effect on 1 January 2016.

contains new provisions in relation to consolidation of arbitrations, in order to cater for multi-party disputes. The new AIA Rules of Arbitration 2016 came into effect on 1 January 2016 and apply to all AIA arbitrations that are commenced on or after that date, unless the parties have agreed that the previous version of the rules (in force since 2012) should apply.

ICC

New guidance on the disclosure by arbitrators of potential conflicts of interest (the "Guidance") was adopted unanimously by the ICC Court International Court of Arbitration on 12 February 2016. The Guidance has been incorporated into the existing "Note to Parties and Arbitral Tribunals" on the conduct of ICC arbitrations. The Guidance requires arbitrators to make reasonable enquiries in consulting their own and their firm's records and other readily available materials, sets out certain specific situations potentially meriting disclosure, and underlines that the duty to disclose is ongoing, through the life of the arbitral proceedings. Each arbitrator is left to assess and decide whether a disclosure should be made. In the event of a challenge to an arbitrator's appointment, the mere fact of disclosure will not be taken by the ICC Court to imply the existence of a conflict. Finally, the Guidance reaffirms the increasingly clear message from the ICC that arbitrators have a duty to devote the necessary time to conduct the arbitration proceedings as diligently, efficiently and expeditiously as possible.

LCIA India

In January 2016, the London Court of International Arbitration (LCIA) announced that from 1 June 2016, arbitrations under the auspices of the LCIA India Rules will be administered by the LCIA in London and that it will be closing the doors of its offices in India. Going forward, LCIA India Rules-based arbitration and mediation will no longer be offered. Announcing the decision, the LCIA explained that Indian parties to arbitration continue to prefer to use the LCIA Rules rather than the LCIA India Rules.

SIAC

On 2 March 2016, the Singapore International Arbitration Centre ("SIAC") officially opened a representative office in the Shanghai Pilot Free Trade Zone ("Shanghai FTZ"). Announced at the end of January 2016, the opening makes SIAC the second institution to establish a presence in Shanghai after the opening of a representative office there in November 2015 by the Hong Kong International Arbitration Centre (HKIAC). SIAC's representative office in Shanghai FTZ is its third, having opened in Mumbai and Seoul in 2013. It is expected that, among other things, the Shanghai FTZ office will help to organise SIAC hearings in Shanghai. However, these are likely to have a seat in Singapore or elsewhere since the ability of foreign arbitral institutions to administer arbitrations seated in mainland China is questionable under Article 16 of China's arbitration law.

Separately, on 27 May 2016 the SIAC launched the 6th edition of the SIAC Rules of arbitration. The 5th edition of the SIAC Rules was adopted in 2013. The 6th edition contains new provisions relating to early dismissal of claims and defences, a first amongst the major commercial arbitration centres. The new SIAC Rules also include new provisions regarding multiple contracts and consolidation, joinder and intervention, as well as amendments to the emergency arbitrators and expedited procedure provisions, among others. The new SIAC Rules come into effect on 1 June 2016. The SIAC has also announced the launch of the SIAC Investment Arbitration Rules scheduled for September 2016.

SCC

Consultation by the Stockholm Chamber of Commerce ("SCC") on draft revised arbitration rules and rules for expedited arbitrations ended on 23 May 2016 (the "Draft SCC Rules"). In keeping with the same trends reflected in the new SIAC Rules, mentioned above, the Draft SCC Rules make provisions in relation to joinder and consolidation and expedition, for example, as well as enabling parties to request a single arbitration under multiple arbitration agreements, and authorising the SCC Board to override the objection of one party to such a single arbitration in certain circumstances. In addition, there are new provisions for security for costs and enabling treaty cases to be brought under SCC auspices. It is currently anticipated that the new SCC Rules will take effect on 1 January 2017.

AUTHOR
LONDON
Sean Kelsey
sean.kelsey@klgates.com

On 29 February 2016 a statement was released regarding the freshly introduced changes to the text of the Canada-EU Comprehensive Economic and Trade Agreement.

World Investment Treaty Arbitration Update

By Wojciech Sadowski and Patrycja Treder (Warsaw)

In each edition of Arbitration World, members of K&L Gates' Investment Treaty practice provide updates concerning recent, significant investment treaty arbitration news items. This edition features the re-opening of the discussions on the investor state dispute settlement mechanism in the Canada-Europe Trade Agreement and the decision of the ICSID annulment committee in *Micula v. Romania*.

CETA REOPENED

The negotiations between Canada and the EU on the Canada-EU Comprehensive Economic and Trade Agreement ("CETA") were finalised in 2014. However, on 29 February 2016, Cecilia Malmström, the EU Commissioner for Trade and Chrystia Freeland, the Minister of International Trade of Canada, released a joint statement regarding the freshly introduced changes to the text of CETA. The amendment encompassed the provisions on the promotion and protection of foreign investments and in the joint statement its scope was summarised in the following words:

> "*(…) Canada and the EU will strengthen the provisions on governments' right to regulate; move to a permanent, transparent, and institutionalised dispute settlement tribunal; revise the process for the selection of tribunal members, who will adjudicate investor claims; set out more detailed commitments on ethics for all tribunal members; and agree to an appeal system*".

Basically, the revisions implemented to the CETA text correspond to the Concept Paper entitled Investment in TTIP and beyond– the path for reform published by the European Commission on 5 May 2015. Canada and the EU now state that once the process of translation of the amended CETA text into French and 21 other EU official languages is completed, they will focus on the swift ratification. Below is a summary of the relevant changes.

First, the amendment introduced a provision ensuring that the host state's right to regulate to achieve legitimate policy objectives is fully preserved. Beforehand, such a guarantee was only present in the CETA preamble. The article also clarifies that the measures introduced by the host state that may negatively affect an investment or interfere with an investor's expectations, including the expectations of profit, would not amount to a breach of the CETA investment chapter. The mentioned measures refer in particular to the enforcement of state aid regulations. Beside the fact that investment arbitral tribunals already widely recognise the host state's right to regulate for the public benefit, these changes may be criticised for two main reasons. First, the blanket exemption of a host state from any liability for the implemented measures as long as they are adopted to achieve legitimate policy objectives is too far-reaching. A foreign investor may be deprived of any protection from the legislative measures undertaken by the host state from the very start. Not only is it the host state deciding what measures are necessary from the public purpose perspective, but also it is rather difficult for a foreign investor to prove the contrary, namely that the measures did not fulfil their public purpose functions. Second, the exclusion of the measures relating to the enforcement of state aid regulations is solely implemented to satisfy the European Commission priorities. Apart form this, an approach purporting to distinguish state aid measures from other policy measures is not supported by any other rational reason.

Second, the amendment of the CETA text replaced the traditional investor-state dispute settlement mechanism ("ISDS") with an investment court system ("ICS"). The ICS would be based on the establishment of a permanent tribunal consisting of 15 members appointed by Canada and the EU along with the member states. Such an approach was recently adopted in the EU-Vietnam Free Trade Agreement and presented in the aforementioned May 2015 Concept Paper. These changes are introduced with a long-term perspective to establish a multilateral ICS. Here, the main drawback is the procedural imbalance of the parties to any future CETA dispute. As in any other investment dispute, one of the parties is a host state. In a CETA dispute, it will be either Canada or the EU and/or a member state. In a traditional ISDS, the equality of the parties to an investment dispute was ensured in two ways. First, each of the parties appointed one arbitrator and a presiding arbitrator was appointed either by the mutual consent of the disputing parties or by a third party. Second, all members of the tribunal were impartial and independent from the disputing parties. With the replacement of the ISDS with the ICS in the CETA, the impartiality and independence of tribunal members will be rather doubtful as they will be appointed, with a possibility of a reappointment, and employed by Canada and the EU along with the member states, who may be future parties to investment disputes. Consequently, the parties' equality principle may not be preserved.

Third, the amendment of the CETA text introduces the appeal mechanism based on the Appellate Tribunal. The Appellate Tribunal will become fully operational upon the adoption of a decision by the CETA Joint Committee, including all the necessary technical details. It is another point that may be criticised. Apart from the fact that the aforementioned principles (the impartiality and independence of tribunal members, as well as the parties' equality principle) may be undermined as in the case of the ICS, there are at least two other shortcomings of the proposed appeal mechanism. First, the introduction of the appeal mechanism would be faced with difficulties concerning the establishment of a permanent arbitral body with a defined roster and presumably an institutional apparatus. Second, it will considerably prolong the dispute resolution process and make it significantly more costly.

Finally, the amendment specified that the tribunal may only decide a dispute on the basis of the CETA provisions and in accordance with the principles of public international law. The tribunal is not competent to decide on matters of Canadian national law or EU law or the member state law and it is obliged to treat them as a matter of fact. The latter in fact only reiterates what was already established by the investment arbitral tribunals. Hence, there is a question as to whether it was actually necessary from the international investment law perspective to introduce such a provision.

Annulment application in Micula dismissed

On 26 February 2016, the ICSID annulment committee composed of Dr Claus von Wobeser, Dr Bernardo M. Cremades and Judge Abdulqawi A. Yusuf rendered a decision dismissing Romania's application for the annulment of the award rendered on 11 December 2013 in the case (ICSID No. ARB/05/20) between Mr Ioan Micula, Mr Viorel Micula, S.C. European Food S.A., S.C. Starmill S.R.L. and S.C. Multipack S.R.L. and Romania (the "Micula" case). By way of that award, which was the first defeat ever of Romania before an investment treaty tribunal, the state was obliged to compensate claimants for what was considered by the Tribunal as an unlawful revocation of an incentive scheme granted to the claimants' investments pursuant to a regulatory framework enacted in or around 1998.

The relevance and notoriety of the *Micula* award is mostly due to the fact that the incentive scheme granted to claimants was cancelled by Romania on the eve of its accession to the EU because of its likely incompatibility of the EU rules on state aid. Since the rules on state aid on the common market of the EU have been traditionally in the centre of focus of the European Commission, the EU institution took a very proactive approach towards the case arguing that a damages award would be in violation of these rules.

Following the issuance of the *Micula* award by the ICSID Tribunal on 11 December 2013, the European Commission, which intervened in the course of the arbitral proceedings, took a number of steps to oppose the enforcement of that award in the EU, including a decision enjoining Romania from complying with the award. The *Micula* case has also been featured as an emblem of the alleged clash between EU law and the existing system of the intra-European international investment agreements. It has had an undeniable impact on the shaping of the current EU policy towards the international investment agreements, including the aforementioned Concept Paper entitled *Investment in TTIP and beyond—the path for reform* published by the European Commission on 5 May 2015.

The decision of the ICSID annulment committee is an important development in this saga, since the annulment application was the only available legal remedy in which the award of 11 December 2013 could have been undone. Following the ICSID annulment committee's decision to dismiss Romania's application for annulment, the award as such can no longer be quashed in any legal proceedings. At most, Romania—with the presumed continued support from the European Commission—will continue to oppose the enforcement of that award based *inter alia* on its alleged non-compliance with the international public order provisions, of which the EU rules on state aid are alleged to be a part. That line of reasoning, of course, has much better chances of being followed by state courts within the EU than outside it, and a continuous refusal by Romania to comply with the award is likely to produce adverse effects on its international reputation and credibility.

The analysis of the annulment committee's decision shows that Romania attempted to challenge the award on three distinct grounds, which can be summarised as: the alleged failure to apply the applicable law (which Romania alleged included EU law and the Romania-EU association agreement), the alleged failure to decide on the issue of the enforceability of the award and the alleged failure to establish with respect to each claimant individually, and the amount of corresponding losses and damages. The ICSID annulment committee rejected all three contentions, based on Article 52 of the ICSID Convention that mandates to construe narrowly the possible grounds of annulment.

The committee disagreed with each of Romania's detailed contentions. It accepted that the Arbitral Tribunal did not fail to apply the applicable law and noted that before Romania's accession to the EU, EU law did not apply on its territory. The Tribunal was also considered by the committee to have dealt with the contention of the alleged non-enforceability of the award, even if this led the tribunal to the conclusion that this was not an issue before the Tribunal because it was not its duty to address the potential non-enforceability of the award after it had been rendered. Finally, the committee dismissed the argument concerning the alleged lack of detailed specification of the loss incurred and damages awarded to each claimant. The committee considered that the Tribunal's way of dealing with the allocation of damages was consistent with what the claimants were asking for, while some apparent inconsistencies in the reasoning could be clarified by reference to other portions of the award.

As a separate part of its decision, the committee dealt with the submission of the European Commission on matters related to the alleged EU law implications of the award. In that respect, the committee did not provide any detailed assessment of the arguments raised by the European Commission and limited itself to a short position that it confirmed its conclusion not to annul the award.

AUTHOR
WARSAW
Wojciech Sadowski
wojciech.sadowski@klgates.com

Patrycja Treder
patrycja.treder@klgates.com

A continuous refusal by Romania to comply with the *Micula* award is likely to produce adverse effects on its international reputation and credibility.

Treaty Arbitration: Unpacking the Discount Rate—Part II

Howard Rosen and Noel Matthews **(FTI Consulting)**

INTRODUCTION

This is the second of two articles that discuss the use of discount rates in assessing losses in international arbitration. In this article, we explore how "country risk" can affect the value of investments and the approaches taken to incorporate this risk in damages calculations in international arbitration.

DEFINING "COUNTRY RISK"

We explained in Part I of this article that the discount rate applied in a discounted cash flow valuation depends, in part, on the risk attaching to the asset being valued. We also explained that risk has a precise meaning in the context of valuation theory: the variability of future cash flows around anticipated returns. An implication of this definition is that risk includes variability relating to both 'out performance' as well as 'under performance'. This can be contrasted with the use of risk in everyday language, which tends only to be associated with adverse outcomes.

When valuing assets in less developed economic markets, valuers must have regard to both adverse outcomes that are less prevalent in developed economic markets (such as the chance of labour disruption) and increased variability of future cash flows around anticipated returns (for example, more macro-economic volatility). Both types of risk are sometimes referred to, in aggregate, as "country risk".

This can include **political risk** (higher taxes on profits, expropriation, inability to repatriate profits, etc.), **macroeconomic risk** (inflation, currency instability, high or unstable interest rates, etc.) and environmental risk (war, labour disruption, natural disaster, etc.).

A potential source of confusion when discussing country risk is that some valuers adjust the discount rate to try to take account of all of these “country risks”, whereas other valuers adjust the discount rate only to take account of risk as commonly understood in valuation theory (variability of future cash flows around anticipated returns). If taking the latter approach, valuers may consider whether it is also necessary to modify cash flow projections to take account of adverse outcomes associated with investments in the relevant country.

COUNTRY RISK IN INTERNATIONAL ARBITRATION

The characteristics of an investment may affect its exposure to country risk, and should be taken into account when valuing a business interest in a country. Consider the differences in the risk profiles of two companies investing in different businesses in the same country on the same date. One investment is made in a company that extracts a natural resource that is sold on world export markets in hard currency. The other is a manufacturing business that relies on domestic inputs and sells its products on domestic markets in local currency. Clearly these two investments made on the same date, in the same country, face different exposure to the country risks of the host state.

Of particular relevance in a number of recent arbitral awards is the extent to which tribunals should take account of a state’s propensity to expropriate when valuing expropriated assets. Since market conditions, timing of investment, and the nature of investment are unique to each dispute, there is no one approach that can fit all cases. Investments tend to "price in” the chance of expropriation, so that if an investment is made in a favourable or unfavourable investment climate (in terms of the chance of expropriation), it should lead to different outcomes.

Suppose an investment is made when a state is acting favourably towards foreign investors. The chance of expropriation is relatively low. Suppose also that a new government is then formed that is more hostile towards investors. The chance of expropriation rises, and the value of the asset falls accordingly. If the state eventually expropriates the investment, then at the date of the expropriation the value of the investment was already adversely affected by the prior actions of the state. The question for the tribunal is how that perceived chance of expropriation should be taken into account in compensating the investor. The options available to the tribunal include:

- Option 1: Compensation on the basis of no perceived chance of expropriation.
- Option 2: Compensation on the basis of the relatively low-perceived chance of expropriation that existed at the date of the investment.
- Option 3: Compensation on the basis of the value immediately before expropriation, taking into account the higher perceived chance of expropriation that existed at that time.

Figure 1 illustrates the available choices, assuming a 20 percent probability of expropriation on the date of investment. The blue dotted line is the value of the asset before taking account of the perceived chance of expropriation, and this is assumed not to change. In theory, this is the value of the asset to the government or to an investor that will be fully compensated in the event of expropriation (Option 1).The value of the asset after taking account of the chance of expropriation—the solid orange line—falls as the perceived probability of expropriation rises.

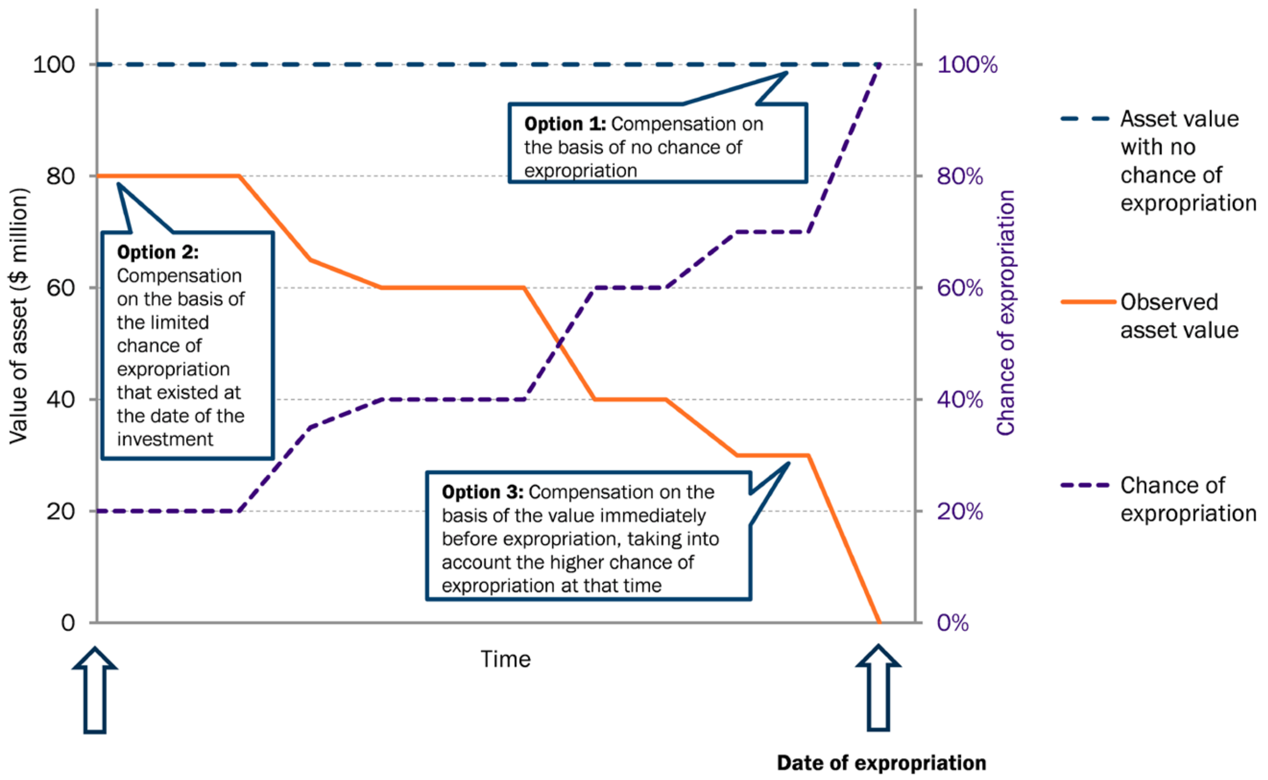


Figure 1

Each of the options described has different results. If compensation is on the basis of no perceived chance of expropriation (i.e. $100 million in Figure 1), then there is a chance that the investor is over-compensated. In Figure 1, the value of the asset, even at the date of the initial investment, was only $80 million. Therefore, **Option 1** puts the investor into a better position than they would have been absent the expropriation.

Applying **Option 2**, two investors might invest in similar assets, with the same expected cash flows absent any perceived chance of expropriation, but at different dates. If one invested at a time when the state's propensity to expropriate was low, and another when the propensity to expropriate was high, then the compensation would differ for the two investors.

Option 3 potentially creates incentives for states to act in ways that drive down the value of an asset prior to an expropriation. Further, the value of the asset in the state's hands ($100 million in Figure 1) is much greater than compensation to the investor ($30 million), potentially creating incentives to expropriate.

A number of recent awards involving Venezuela have considered this issue, with contrasting conclusions. The table below summarises the tribunals' views on how to take account of the state's propensity to expropriate in four of these awards. In each case, the "country risk premium" or "CRP" (the adjustment made to the discount rate to reflect country risk) depended in part on the tribunal's views regarding how to take account of the chance of expropriation.

A feature of some of the Venezuelan awards is the attempts by experts and tribunals to make adjustments to the discount rate to take account of country risk and to isolate the chance of expropriation in those adjustments. There is very little consensus between valuation practitioners (and experts) on how country risk should be measured or to what extent different types of country risk can be 'diversified away' by holding a portfolio of investments.

There is also limited consensus as to how different types of country risk should be incorporated into a valuation. In principle, many types of country risk (including a state's propensity to expropriate) should be taken into account in a probability weighted estimate of cash flows (since they cause adverse outcomes, rather than increasing the variability around the projected return); however, this can be difficult to do in practice and a common solution is to attempt to incorporate an adjustment for these factors within the country risk premium. Even among those who favour making adjustments to the discount rate to include a country risk premium, there is no consensus about

Award	Tribunal's view
Gold Reserve Inc. v Venezuela	• Adopted a CRP of **4 percent** • "It is not appropriate to increase the country risk premium to reflect the market's perception that a State might have a propensity to expropriate investments in breach of BIT obligations" (paragraph 841) • Appears to be consistent with Option 1 in the list above
Flughafen v Venezuela	• Adopted a CRP of **7.9 percent** • "*A Government that through the adoption of new political attitudes, adopted after the investment was materialized, which increases the country risk, cannot benefit from a wrongful act attributable to it, that reduces the compensation payable." But also concluded that: "When in 2004 the Claimants decided to invest … the country risk already existed, and investors were well aware of the existence of political and legal uncertainties… The political and regulatory risk existed before the investment, and in the short time in which investors maintained it, its quantification could not be significantly altered.*" (paragraphs 905 and 907) • This appears to be broadly consistent with Option 2
Mobil v Venezuela	• Did not quantify the CRP, but applied an overall discount rate of **18 percent** • Stated that "*the compensation must correspond to the amount that a willing buyer would have been ready to pay to a willing seller in order to acquire his interests but for the expropriation, that is, at a time before the expropriation had occurred or before it had become public that it would occur... The Tribunal considers that the confiscation risk remains part of the country risk and must be taken into account in the determination of the discount rate.*" (paragraph 365) • Appears to be consistent with Option 3
Tidewater v Venezuela	• Adopted a CRP of **14.75 percent** • Considered that this "*quantifies the general risks, including political risks, of doing business in the particular country, as they applied on that date*" (paragraph 186) • Potentially consistent with Option 3
Sources: ICSID Case No. ARB(AF)/09/1; ICSID Case No. ARB/10/19; ICSID Case No. ARB/07/27; ICSID Case No. ARB/10/5.	

how that premium should be calculated. Methods we see applied in practice include:

1. **Sovereign yield spreads:** the spread of the yield on a government's traded USD debt over comparable bonds issued by the US government. This is calculated using market yields, where available, or using an implied premium based on the government's credit rating for countries without traded USD denominated debt.
2. **Scaled sovereign yield spread:** the sovereign yield spread is sometimes scaled upwards to reflect the fact that equity is riskier (more volatile) than debt, for example, scaling the country default spread by the ratio of the standard deviations of equity and government bond prices.
3. **CDS (Credit default swap) spreads:** this method is similar to a sovereign yield spread approach. A sovereign CDS spread represents the premium (in basis points) paid on insurance against the default of a particular company or sovereign entity, above the premium paid in insurance against the default of the base country's debt (usually the United States).
4. **Volatility of local stock market:** this method derives a country risk premium by comparing the volatility of the local market (in hard currency terms) to the volatility of developed stock markets.
5. **Credit rating regression analysis:** this method uses statistical analysis to derive a relationship between credit ratings and expected (or required) returns to equity investors.

One observation on the different methods we have described is that they can lead to very different estimations of the country risk premium. Further, in arbitration, the perceived chance of expropriation is often considered as a particularly important component of country risk. However, the statistics resulting from the methods described may or may not be correlated with a state's propensity to expropriate. As a consequence, not only is it difficult to arrive at any consensus on the calculation of an appropriate country risk premium, it is even more challenging to attempt to isolate one aspect of country risk (such as the chance of expropriation).

CONCLUSION

The choice of discount rate can have significant effects on valuations and, consequently, on the awards rendered by tribunals. Differing opinions regarding to what extent, and how, discount rates should be adjusted for country risk can lead to particularly large differences in value. The divergent views of experts on this topic is not surprising: it reflects a lack of consensus in academic analysis and also the difficulties in drawing conclusions from data observed in emerging markets.

At the same time, tribunals must consider whether they should include or exclude the effect of a state's perceived propensity to expropriate in their assessments of value. Whatever the right answer in principle, in practice it is very difficult to isolate the chance of expropriation in any measure of country risk. In the circumstances, it seems likely that country risk will continue to be a topic of debate for the foreseeable future.

AUTHORS

FTI CONSULTING

Howard Rosen

Noel Matthews

The jurisprudence relating to arbitration has been marked by uncertain progress within the member states of the Gulf Co-operation Council.

Qatar—The Shifting Sands of Arbitration

By Matthew Walker and Joseph Lee (Doha)

The jurisprudence relating to arbitration has been marked by uncertain progress within the member states of the Gulf Co-operation Council ("**GCC**"), formed of six members: Saudi Arabia, the United Arab Emirates, Oman, Bahrain, Kuwait and Qatar. In this article, we examine recent developments with the progress of arbitration in Qatar.

THE CURRENT LAW

The current law on arbitration is split across two pieces of legislation. Largely, one governs international arbitration, and the other covers domestic arbitration. The former is addressed largely by Emiri Decree Number 29 of 2003. This decree ratified into Qatar Law the signature by Qatar of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958) (the "**New York Convention**"), and the decree is short and uncomplicated. The New York Convention applies, unedited, as part of the canon of Qatar Law.

Both international and domestic arbitration are, however, also addressed within the Civil and Commercial Procedural Code ("***CCPC***"), Law 13 of 1990. The main chapter of the CCPC that addresses arbitration is Chapter 13, Articles 190–210. Other provisions of the CCPC have also been considered relevant in certain judgments of the Qatar courts, notably Article 69 and Articles 379–383, which relate respectively to judgments and foreign judgments.

In recent decisions, it has been apparent that the Qatari courts have encountered difficulties with certain inconsistencies between these laws. In particular, it should be noted that in the Arabic language, which is the only version of the CCPC with force in law in Qatar, the same word (*hukum*) has been used to describe "judgment" and "award". Understandably, this has caused the Qatari courts something of a challenge, since the courts are bound to enforce the law, even where the law itself may be inconsistent, particularly as to the application of Emiri Decree Number 29 of 2003 within the context of the CCPC.

"IN THE NAME OF HIS HIGHNESS THE EMIR"

On 7 December 2013, the Qatar Court of First Instance published a redacted copy of a judgment (Decision 2216/2013), in which it refused enforcement of an ICC award on the grounds that the award had not been issued in the name of His Highness the Emir. Following an appeal against the original judgment of the Qatar Court of First Instance and that of the Qatar Court of Appeal, the Qatar Court of Cassation considered the issue in Appeal No. 164/2014. The Qatar Court of Cassation accepted the appellant's position that the New York Convention does not require as a condition for recognition and enforcement that the award be issued in the form of judgment required by the state in which recognition and enforcement is sought. In particular, the Qatar Court of Cassation considered the relevant law applying to foreign-seated arbitrations and noted that awards did not need to be issued in the name of His Highness the Emir:

"*Article One and Article Two of the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards which was ratified by the State of Qatar by Emiri Decree No. (29) of 2003 which came into effect as of 15/3/2003 provide that a State shall recognize and enforce foreign awards in accordance with the procedures [sic] rules applicable in the State specified by its domestic laws. The said Articles do not provide for the form of details of the award…*".

"*The Appealed Judgment is contrary to this view, ruling that the arbitration award issued in Paris pursuant to the ICC Rules is null and* *void on the grounds that it was not issued in the name of His Highness the Emir of Qatar… [However, since] the award is not governed by the Qatari Procedures Law in any aspect other than its enforcement in the State of Qatar, the Appealed Judgment [is therefore] defective and must be vacated for this reason alone without the need to discuss the other reasons of cassation*".

NOT ANNULLED, BUT NOT ENFORCED YET

After the annulment action had closed, the case moved to the execution division of the Qatar Court of First Instance, so that the award could finally be enforced (Case No. 704/2/2015). Unfortunately, that court refused to issue an order for recognition and enforcement of the award on procedural grounds. Despite the judgement of the Qatar Court of Cassation requiring the dismissal of the annulment action, the Qatar Court of First Instance refused to enforce the ICC award holding that the award submitted by the claimant had (1) not been authenticated and certified by the competent authorities, and (2) no certificate was attached proving that such award was final.

The Qatar Court of First Instance applied Articles 379 and 380 of the CCPC in its analysis of whether the requirements under Article 4 of the New York Convention had been satisfied. This judgment, however, appears to be difficult to reconcile with the previous judgment of the Qatar Court of Cassation. Further, this judgment raised uncertainties as to the enforceability of a foreign award, since it requires a claimant seeking enforcement of an arbitration award to get the award authenticated and certified by the competent authorities, but without the court specifying what the authentication steps were or who the competent authorities might be. Regrettably, the Court of Appeal upheld this decision at the end of April 2016, although we understand the Claimant intends to appeal this decision to the Court of Cassation.

DIFFICULTIES BEFORE THE ARBITRATION HAS STARTED

In addition to difficulties with enforcement, in a recent decision from the Qatar Court of First Instance issued in January 2016, the court voided an arbitration agreement between the parties and seized jurisdiction, while observing that arbitration is an "*exceptional method for dispute settlement*". In the case in question, Case No. 918/2015, the contract contained an arbitration clause stating that disputes would be "*finally settled by arbitration to take place in Singapore in accordance with the Singapore International Chamber of Commerce and laws of Singapore*".

The Qatar Court of First Instance held that the Singapore International Chamber of Commerce is not an arbitral forum. Rather than give effect to the parties' clear intent to arbitrate, the court held that it should void the arbitration clause in its entirety. In particular, the court held as follows:

"*It is judicially established in the legal precedence of the Court of Cassation that the arbitration is an exceptional method for disputes settlement. Arbitration is based on avoiding the ordinary judicial methods, and its scope is limited to the desire of litigants to refer the dispute to an arbitration tribunal (Objection No. 9/2010)*".

In practical terms, this is a ruling that cannot be challenged under local procedure on any interlocutory basis and would only be capable of being appealed once the court has ruled on the substantive dispute. This may, in practice, render futile any potential questioning of the court's judgment on the arbitration clause itself.

NEW DRAFT ARBITRATION LAW

If there is a cause for guarded optimism, it is that a new, draft arbitration law, based on the UNCITRAL Model Law, is currently the subject of discussion and review within the Council of Ministers and

Shura Council within the Qatari government. Depending on the final draft of this new law—and depending on whether the law is to be published simultaneously in English and Arabic, or just in Arabic—it is to be hoped that careful consideration will be given to ensure that the law formally recognizes arbitration awards as a distinct legal instrument separate from the judgment of a court. It is also hoped that the new law will recognise that the authority of the arbitrator, and the arbitration award, is derived from the parties' agreement, rather than emanating from the state and its courts, since this essential element of arbitration appears to be an issue with which the judiciary has struggled in recent judgments.

This remains an interesting time to be practising and commentating on arbitration in the GCC—not least because of the great variety of speeds of evolution within different jurisdictions across the region. At one end of the spectrum, the Dubai International Financial Centre (DIFC) court continues to push the outer edges of the boundary between judicial and arbitral jurisprudence—for instance, developing a scheme to turn its own court judgments into awards; while, at the other end of the spectrum, long-promised new laws on arbitration remain parked in legislative committees. It is hoped that the passing of new laws will see further development in GCC arbitration jurisprudence in the short to medium term.

AUTHORS

DOHA
Matthew Walker
matthew.walker@klgates.com

Joseph Lee
joseph.lee@klgates.com

As with arbitrations generally, the make-up of the three-arbitrator tribunal is a very important factor in determining who will win a Bermuda Form arbitration.

Bermuda Form Arbitrations from the Policyholder's Point of View: Tribunal Formation and "Frequent Flyers"

by John M. Sylvester (Pittsburgh)

INTRODUCTION

One of the common features of so-called "Bermuda Form" liability insurance policies is the inclusion of an arbitration clause calling for a non-administered arbitration of policyholder-insurer coverage disputes by a three-arbitrator tribunal, with the arbitration conducted under the English Arbitration Act but applying New York substantive law. Counsel who have participated in multiple Bermuda Form arbitrations over the years have come to recognize that there are a number of recurring issues generating significant discussion and debate between policyholders and insurers. This is one of a series of Arbitration World articles that will address some these issues. The focus of this article is the process of formation of the arbitral tribunal in Bermuda Form policies and the risk of the process being tilted in favor of insurers. **Elsewhere in this edition**, we cover the topic of whether such Bermuda Form policies may conflict with applicable U.S. state laws regulating insurance.

As with arbitrations generally, the make-up of the three-arbitrator tribunal is a very important factor in determining who will win a Bermuda Form arbitration. One can expect that each of the arbitrators will endeavor to be fair and open-minded in the case but will nevertheless be guided by his or her own background, past experiences, and past positions. It is critical to a just resolution of the arbitration proceeding that the tribunal members do not pre-judge the case based on any preconceived notions, but rather judge the case on its merits and on the evidence presented at the hearing. In this regard, from the perspective of many policyholders, the arbitrator selection process set forth in the Bermuda Form policy is tilted in favor of the insurer—and therefore should be modified to create a more level playing field.

A typical arbitration provision in a Bermuda Form policy provides that a tribunal of three arbitrators shall be chosen, with one appointed by the policyholder, one appointed by the insurer, and then a third arbitrator, the tribunal chair, chosen by the two party-appointed arbitrators. If the two party-appointed arbitrators cannot agree on a tribunal chair within a 30-day period, then either party can apply to the High Court of Justice in England and Wales for appointment of the chair. From the policyholder's perspective, there are concerns about the party-appointment process employed by Bermuda insurers and, in particular, about the propensity of the insurers to appoint arbitrators from the same small group of candidates over and over again (sometimes colloquially referred to as "frequent flyer" arbitrators).

It is the case that, for many commercial policyholders, participating in a Bermuda Form arbitration proceeding will be a once-in-a-generation event. Commercial policyholders may have only one catastrophic liability situation that exceeds the large self-insured retentions typically underlying a Bermuda Form excess liability policy. If that catastrophic liability situation leads to a coverage dispute, the policyholder may well be delving into the Bermuda Form arbitration process for a first time. By contrast, for a Bermuda insurer, these coverage-dispute arbitrations are a regular-course-of-business activity, and thus, the insurer may be involved in a number of new arbitrations each year. Consequently, policyholders sense that the Bermuda insurers maintain a limited list of "go to" arbitrators that they select, time after time, for multiple arbitrations. This repeated appointment by insurers of the same arbitrators can give rise to concerns about impartiality. If such “frequent flyer” arbitrators are being given a steady stream of appointments by a particular insurer or group of insurers, concerns may arise that they feel they owe a debt of gratitude to those insurers for the frequent appointments, and such feelings may creep into their thought process when deciding the outcome of an arbitration.

Moreover, even if the party-appointed arbitrators are not so influenced, Bermuda insurers are able to build a dossier on each of these arbitrators, based on how he or she has ruled on particular issues in prior arbitrations. Thus, when the next arbitration comes along that raises a similar issue as one that has been previously adjudicated, an insurer may know which arbitrators are inclined toward the insurer’s point of view on the issue. This strategic information is not available to the policyholder because of the confidentiality of Bermuda Form arbitrations and awards.

One way to begin to address this concern is to have full disclosure by each proposed party-appointed arbitrator regarding any actual or potential conflicts, including the number, scope, and nature of prior appointments by either party to the arbitration or even by the insurance industry as a whole. The Bermuda Form arbitration process—which is a non-administered process—does not have any established rules for conflict disclosures by arbitrators, and thus, party-appointed arbitrators may consider themselves free to disclose as much or as little information about potential conflicts as they deem relevant. This can leave policyholders wondering if they have received all relevant information on which to determine whether an objection and (if need be) disqualification challenge is appropriate. To address this concern, the Bermuda Form arbitration provision should specify the application of robust disclosure rules by all arbitrators on a tribunal.

This might be done through the adoption of institutional rules of arbitration, such as the LCIA Rules, which place an obligation on arbitrators to disclose any circumstances that are likely to give rise to any justifiable doubts as to his or her impartiality or independence in the mind of any party (Articles 5.4 and 5.5 of the LCIA Rules). Similarly, the ICC Rules require prospective arbitrators to complete a declaration of impartiality and independence, with details of any potential qualifications thereto (Article 11(2) of the ICC Rules).

If it is not possible to agree that the arbitration should be institutionally administered, then a potential further alternative lies in the International Bar Association ("IBA") Guidelines on Conflicts of Interest in International Arbitration. These guidelines have a colored-list system for disclosing an arbitrator's associations with the parties and their counsel. For example, under the IBA Guidelines, one of the required "Orange List" disclosures is whether: "The arbitrator has within the past three years been appointed as an arbitrator on two or more occasions by one of the parties or an affiliate of one of the parties" (§ 3.1.3). Such a disclosure scheme allows for an informed decision regarding the grounds for potential objection/challenge to an arbitrator's appointment. An even stronger rule would enforce a strict numerical limit on the number of appointments of the same arbitrator that one party may make (such as the disqualification of any arbitrator who has received two appointments from a party within a six-year span). At a minimum, however, by one means or another, there should be full disclosure of the details of such prior appointments, so that any potential grounds for objection/challenge will be transparent to all parties involved. Such disclosure rules should be built into the Bermuda Form policy's arbitration provision and not left to chance as is the case now under the standard Bermuda Form language.

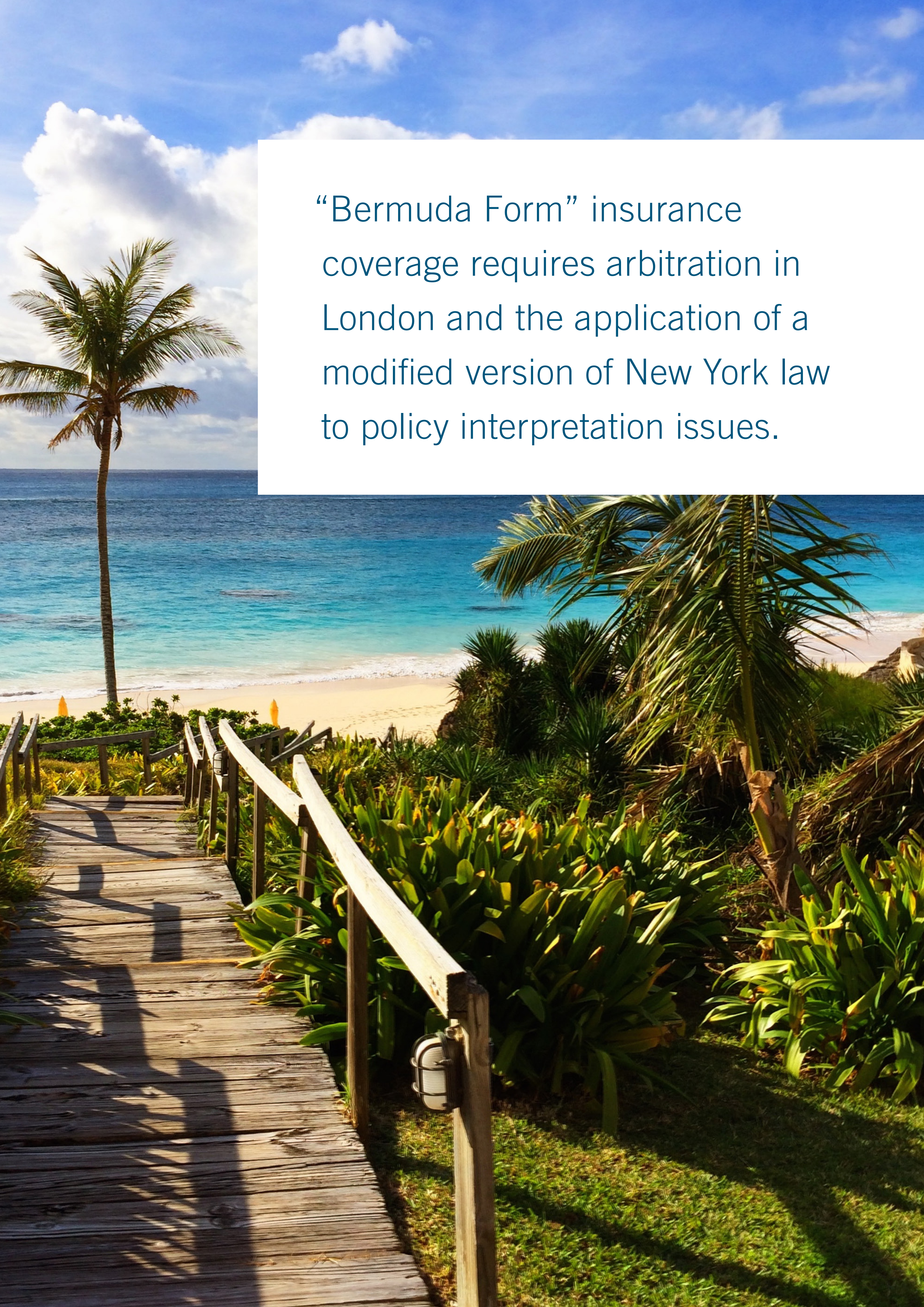
CONCLUSION

This is one of a series of Arbitration World articles that will discuss potential means of improving the Bermuda Form arbitration process from the policyholder's perspective. Additionally, this topic was covered in our **October 2015 webinar** "*Can the Arbitration Process under Bermuda Form Policies be Enhanced for Policyholders?*", available on the K&L Gates Hub. Adoption of rules that promote full disclosure by appointed arbitrators and that limit the practice of "frequent flyer" appointments by Bermuda insurers would help give policyholders confidence that, if arbitration of a coverage dispute is necessary, they will be operating on a level playing field.

AUTHOR

PITTSBURGH
John M. Sylvester
john.sylvester@klgates.com

"Bermuda Form" insurance coverage requires arbitration in London and the application of a modified version of New York law to policy interpretation issues.



Tilting the Balance: the Expanding Use of Pro-Insurer Arbitration Clauses in International Insurance Policies

By Thomas E. Birsic and Max Louik (Pittsburgh)

INTRODUCTION

For the past several decades, insurance companies have inserted binding-arbitration provisions into their policies with increasing frequency. When a dispute arises over whether a claim is covered under the insurance policy, the type of arbitration mandated by these policies can stack the deck in the insurer's favor—at least as compared to how the same dispute would play out in U.S. courts, for example. While it is certainly best to address any such "pro-insurer" arbitration provisions prior to placement, another avenue may be to consider whether, in certain jurisdictions, such provisions conflict with the applicable state laws regulating insurance.

THE RISE OF BINDING ARBITRATION PROVISIONS IN INSURANCE POLICIES

After the collapse of the U.S. excess-liability-insurance market in the mid-1980s, several excess-liability insurers set up shop in Bermuda to continue provide access to excess coverage, albeit on different terms than in the past. This so-called "Bermuda Form" coverage requires arbitration in London under English procedural law and the application of a modified version of New York law to policy interpretation issues. Notably, the Bermuda Form purports to set aside rules of construction that traditionally favor the policyholder, such as the reasonable expectations doctrine and *contra proferentem*, which calls for construing ambiguities against the drafter of the policy (typically the insurer).

Specifically, the Bermuda Form provides that "the provisions, stipulations, exclusions and conditions of this Policy are to be **construed in an evenhanded fashion** as between the Insured and the Insurer; without limitation, where the language of this Policy is deemed to be ambiguous or otherwise unclear, the issues shall be resolved in the manner most consistent with the relevant provisions, stipulations, exclusions and conditions (**without regard to the authorship of the language, without any presumption or arbitrary interpretation or construction in favour of either the Insured or the Insurer or references to the 'reasonable expectations' of either thereof or to *contra proferentem*** and without reference to parol or other extrinsic evidence)." (Emphasis added).

With increasing frequency, we have also seen mandatory arbitration clauses—often slanted in one way or another in the insurer's favor—inserted into employment practices liability insurance policies, professional services policies, representation and warranty policies, and first-party property policies, among others. In addition to setting aside traditional rules of construction, which often provide the greatest leverage to the policyholder, some of these policies require the selection of arbitrators who are members, or former members, of the insurance industry or who belong to pro-insurer arbitration groups, such as the AIDA Reinsurance and Insurance Arbitration Society ("ARIAS").

THE U.S. LAW CONFLICT

Perhaps in anticipation of the type of arbitration provisions identified above, many states have enacted statutes that prohibit enforcement of arbitration clauses in insurance policies (or other contracts of adhesion). However, these state laws can give rise to conflicts implicating the McCarran Ferguson Act, the Federal Arbitration Act, and the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the "New York Convention").

The McCarran Ferguson Act permits state laws to reverse preempt federal laws under certain conditions. The act provides that "[N]o Act of Congress shall be construed to invalidate, impair or supersede any law enacted by any State for the purpose of regulating the business of insurance . . . unless such Act specifically relates to the business of insurance." 15 U.S.C. § 1012(b). Several courts have held that the McCarran-Ferguson Act reverse preempts Chapter One of the Federal Arbitration Act, such that it is within a state's authority to deny enforcement of arbitration clauses in U.S. domestic insurance policies. *See, e.g., Am. Bankers Ins. Co. v. Inman,* 436 F.3d 190, 494 (11th Cir. 2004).

The United States is also a signatory to the New York Convention, which obligates the United States to recognize and enforce "commercial" arbitration agreements that do not "aris[e] out of such a relationship which is entirely between citizens of the United States . . . ." 9 U.S.C. § 202. Chapter Two of the Federal Arbitration Act provides that the New York Convention "shall be enforced in United States courts in accordance with this Chapter." 9 U.S.C. § 201. Thus, the question becomes whether state laws prohibiting arbitration of international insurance disputes can reverse preempt the New York Convention and apply the prohibition to international policies.

The Circuit Courts of Appeals are split. In *Stephens v. American International Insurance Co.*, 66 F.3d 41, 45–46 (2d Cir. 1995), the Second Circuit held that the anti-arbitration provision of a Kentucky rehabilitation and liquidation law applied to foreign corporations because the New York Convention was not self-executing and only carried the force of law through Chapter Two of the Federal Arbitration Act—i.e., an "Act of Congress" that invalidates, impairs or otherwise supersedes Kentucky's insurance law. Conversely, the Fourth Circuit has rejected reverse preemption, noting that the McCarron Ferguson Act "is limited to domestic affairs," and that

Chapter Two of the Federal Arbitration Act “falls outside of its scope.” ESAB Group, Inc. v. Zurich Ins. PLC, 685 F.3d 376, 382 (4th Cir. 2012); *see also Safety Nat’l Cas. Cop. v. Certain Underwriters at Lloyd’s, London*, 587 F.3d 714, 275 (5th Cir. 2009) (rejecting reverse preemption because the New York Convention itself supersedes state law, while Chapter Two of the Federal Arbitration Act merely implements the New York Convention).

CONCLUSION

Regardless of when and how the U.S. Supreme Court decides to resolve the conflict, policyholders should proceed with caution before procuring coverage under an international insurance policy that requires arbitration of disputes. Although arbitration can sometimes be an effective means of dispute resolution in international insurance disputes, policyholders should carefully consider the features of the proposed dispute resolution process, as well as any wider terms of the policy that might be skewed in the insurer’s favor. A more detailed analysis of relevant considerations for policyholders regarding Bermuda Form policies was undertaken in our October 2015 webinar “*Can the Arbitration Process under Bermuda Form Policies be Enhanced for Policyholders?*”, available on the K&L Gates Hub.

AUTHORS

NEW YORK

Thomas E. Birsic
thomas.birsic@klgates.com

Max Louik
max.louik@klgates.com

Although arbitration can sometimes be an effective means of dispute resolution in international insurance disputes, policyholders should carefully consider the features of the proposed dispute resolution process.

English High Court Enforces Tribunal's Provisional Order to Pay US$100 million

by John Gilbert (London)

INTRODUCTION

Critics of arbitration sometimes point to arbitrators' inability and/or reluctance to take steps on a provisional basis to protect parties. In the recent Commercial Court decision of *Pearl Petroleum Company Limited, Dana Gas PJSC and Crescent Petroleum Company International Limited v The Kurdistan Regional Government of Iraq* [2015] EWHC 3361 (Comm), the arbitral tribunal ordered the Respondent to make a provisional payment of US$100 million and the Commercial Court enforced that order under the Arbitration Act 1996 (the "**Act**"). The judgment is also interesting because of the issues of state immunity in connection with arbitration that are discussed.

BACKGROUND

The Claimants were companies involved in the exploitation of gas fields in the Kurdistan Region of Iraq (together referred to as "**Pearl**"). The Respondent was the Kurdistan Regional Government ("**KRG**"). A dispute arose over the scope of the agreement by which Pearl had been granted the right by KRG to exploit the fields. In particular, Pearl alleged that it had been underpaid by KRG to a total of US$1.12 billion. The dispute was referred to LCIA arbitration with its seat in London and an arbitral tribunal comprising Lord Hoffmann, Lord Collins and Mr John Beechey (the "**Tribunal**").

Pearl had been required to sell the condensate and liquefied petroleum gas ("**LPG**") produced to KRG. KRG had been making regular payments for that condensate and LPG, but it was alleged that the payments were only at around 70 per cent of the value of what should have been paid. Once the dispute was underway, KRG stopped making any payments. This put one of the Claimants, Dana, in the position of facing insolvency, with the result that it would be unable to take the benefit of a favourable result in the arbitration, and it was feared that KRG might use Dana's potential insolvency to terminate the agreement.

To maintain the status quo while the proceedings continued, Pearl applied for an order pursuant to Article 25 of the 1998 LCIA Rules that KRG resume making payments. In July 2014, the Tribunal granted the order, but it became immediately apparent that KRG would not make the required payments. Consequently, Pearl made an application to the Tribunal for a peremptory order under section 41 of the Act, which was opposed by KRG.

In October 2014, the Tribunal made an order that KRG should make a payment to Pearl of US$100 million within 30 days. If the sum remained unpaid after 30 days, the Tribunal would make a peremptory order to the same effect. In making its ruling, the Tribunal noted that KRG's counsel had indicated that the reason for refusing to make the payments required by its previous order was the "*bitter disputes*" with Pearl.

KRG did not make payment, so the peremptory order took effect. Subsequently, Pearl obtained the Tribunal's permission under section 42(2)(b) of the Act to apply to the court to enforce the peremptory order.

ISSUES BEFORE THE COURT

Pearl applied for an order under section 42 of the Act, which allows the English High Court to make an order requiring a party to comply with a peremptory order made by a tribunal in an arbitration seated in England and Wales or Northern Ireland.

KRG opposed the order on the following three grounds:

1. The court did not have jurisdiction to make the order under section 42 because the Tribunal's peremptory order was not properly made within its jurisdiction under section 41 of the Act and Article 25 of the LCIA Rules.
2. The Respondent had immunity under the State Immunity Act 1978 ("**SIA**").
3. The court should not exercise its discretion to make the order.

COURT'S DECISION

Mr Justice Burton decided to enforce the Tribunal's order. He found that the court had jurisdiction to enforce the Tribunal's order, KRG did not have state immunity and he should exercise the court's discretion to enforce the order.

Jurisdiction

On the question of whether the court had jurisdiction to enforce the Tribunal's peremptory order, KRG argued that a tribunal has power under section 41 of the Act to make a peremptory order only where it was an order to do something "*necessary for the proper and expeditious conduct of the arbitration*". KRG argued that the order to pay the sum did not fall within this category and, moreover, it was not expressly identified by the Tribunal as doing so. This argument was rejected by the judge. On the facts, the order was necessary for the proper and expeditious conduct of the arbitration and was recognized by the Tribunal as being so because it was intended to protect the status quo while the proceedings progressed. KRG also argued that the peremptory order had not been properly made because it had not been given the chance to show "*sufficient cause*" to explain its non-compliance with the previous order. This was also rejected on the facts.

State immunity

KRG argued that the court should not make an order against it because it was entitled to state immunity as a "*separate entity*" of Iraq pursuant to section 14 of the SIA. This led to a number of questions, including: (i) whether entering into the agreement with Pearl was an exercise of sovereign authority, and (ii) if so, whether it was an exercise of sovereign authority by a state. The judge concluded that entering into the agreement had been an exercise of sovereign authority because it included the granting of rights to exploit the gas fields. However, it was an exercise of sovereign authority by KRG, not Iraq, because Iraq denied KRG's ability to award such rights itself. Consequently, it was not an exercise of sovereign authority by a state and KRG was not entitled to state immunity.

Arguments were made as to whether, if KRG were entitled to immunity, the order could be made by the court against it. Although the judge's decision on whether KRG was entitled to state immunity meant that he did not need to decide the issues, he addressed them. First, the judge concluded that KRG had agreed to arbitration and that the court proceedings related to the arbitration (with the Tribunal's consent), so KRG did not have immunity from the court proceedings under section 9 of the SIA. Second, the judge concluded that an application for an order under section 42 of the Act is not an application for an injunction, so section 13(2)(a) of the SIA (which prevents an injunction being made against a state) does not apply. Finally, the judge concluded that the waiver of state immunity in the agreement between KRG and Pearl was sufficient to cover an application to enforce the Tribunal's peremptory order. It had been argued that there should be a "*trifurcation*" of the question of immunity (into adjudication, section 13(2)(a) relief and execution) and that, to be effective, a waiver would have to address all three expressly. The judge did not agree with this conclusion. Although not part of the ratio of the judgment, this is likely to come as a relief to those involved in drafting such provisions where only a "*bifurcation*" between adjudication and execution is normally recognized.

Discretion

KRG argued that, even if the court had the jurisdiction to enforce the Tribunal's order, doing so was discretionary and it should not exercise its discretion in the circumstances. Counsel for both parties accepted that enforcing an order under section 42 of the Act, which required the payment of money should not be frequent. However, in the circumstances, the judge was persuaded that he should exercise his discretion to make the order.

Application for permission to appeal

For completeness, it should be noted that an application for permission to appeal the judgment was heard in May 2016 and was dismissed.

CONCLUSION

In argument, counsel for KRG argued that enforcing the Tribunal's peremptory order would represent an intervention by a court into an arbitration that would be out of keeping with the intention behind the Act. In contrast, counsel for Pearl argued that, by enforcing the award, the court would be supportive of the Tribunal. Opinion on the case is likely to be similarly split. However, even though it was acknowledged in the case that the circumstances where a court would be asked to enforce a tribunal's order for a provisional payment will be rare, this is a case worth noting because it demonstrates that it is possible to find "*teeth*" for interim measures in arbitration, not just final awards. It also highlights the steps that are open to parties for use in appropriate circumstances that can sometimes be overlooked.

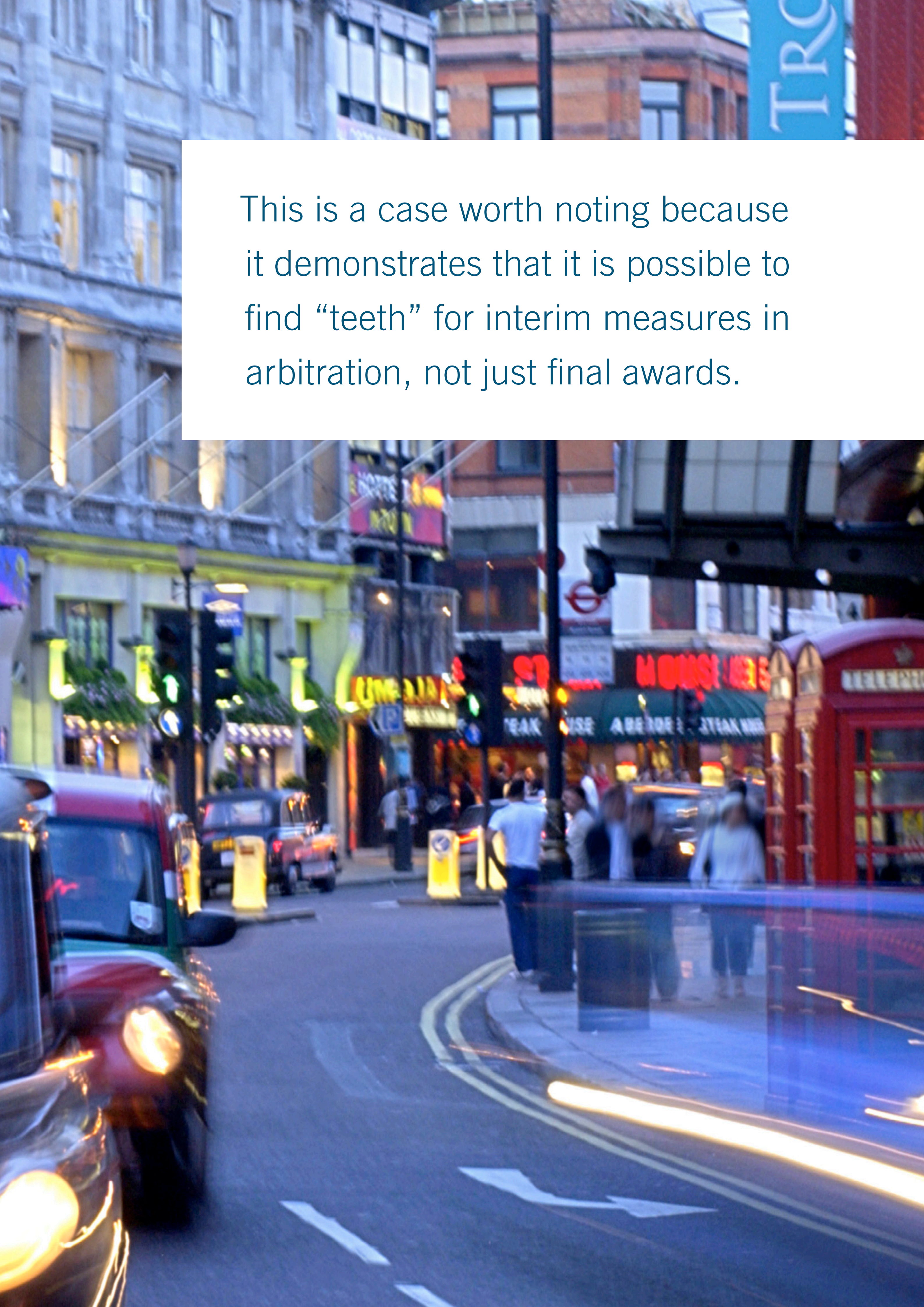
AUTHOR

LONDON

John Gilbert

john.gilbert@klgates.com

This is a case worth noting because it demonstrates that it is possible to find “teeth” for interim measures in arbitration, not just final awards.



I'll Arbitrate if I Want to: The Privy Council's Recent Decision on the Meaning and Effect of Permissive Arbitration Clauses

by Zaib Malik (London)

This article reports on the recent decision of the UK Privy Council ("**PC**") in the case of *Anzen Limited and others (Appellants) v Hermes One Limited (Respondent) (British Virgin Islands)*, which concerned the meaning and effect of a permissive arbitration clause, i.e. a clause that appears to give the parties concerned an option to resolve disputes through arbitration rather than requiring that they do so. The PC is the highest court of appeal for several independent commonwealth countries, and its decisions are held as a source of legal authority by the courts of a number of other Commonwealth countries, including the courts of the United Kingdom and India. The potential impact of this significant decision is therefore likely to span a number of jurisdictions.

BACKGROUND

The Appellants and Respondent were shareholders in a British Virgin Islands ("**BVI**") company known as Everbread Holdings Ltd ("**Everbread**"). The parties entered into a shareholders' agreement dated July 2012 ("**SHA**"). The arbitration clause was at Clause 19.5 of the SHA and stated, "any party may submit the dispute to binding arbitration."

The Respondent commenced court proceedings in the BVI against the Appellants and Everbread on 10 February 2014. On 18 February 2014, the Appellants applied to stay the court proceedings pursuant to section 6(2) of the BVI Arbitration Ordinance 1976 (the "**Ordinance**") on the ground that Clause 19.5 of the SHA was a valid and binding arbitration provision. Section 6(2) of the Ordinance states that where the parties have entered a binding arbitration agreement, if one party commences legal proceedings, upon the application of a party, the court can stay those proceedings.

The core point in issue was whether the Appellant was entitled to a stay of proceedings under section 6(2) of the Ordinance.

DECISION

The PC first considered whether Clause 19.5 was permissive (i.e. providing an option to solve disputes through arbitration) or mandatory (i.e. prescribing that disputes must be resolved through arbitration), given use of the term "may", rather than "shall", "will" or "must" in the text regarding resolving disputes through arbitration. Section 6(2) had traditionally been concerned with mandatory arbitration clauses. It concluded that the clause was permissive only for the following reasons:

i. The language and context of Clause 19.5 clearly suggested the clause was permissive rather than mandatory and that clauses intended to deprive a party of a right to litigate needed to be clearly worded.

ii. This interpretation was backed by a number of English authorities (in particular Lobb Partnership Ltd v Aintree Racecourse Co Ltd [2000] CLC 431) and Commonwealth authorities, which had interpreted similarly worded arbitration clauses the same way. The PC conceded that there was more of a mixed record on this point in the United States.

iii. The fact that the word "may" was frequently used by the commercial community in arbitration clauses when arbitration is intended as an express alternative to litigation (i.e. when there is a choice between the two).

The PC then decided the core question of what a party was required to do, given the permissive wording of Clause 19.5, in order to exercise the right to have a dispute resolved by arbitration. The PC postulated two alternative conclusions: (i) a party seeking a stay was required first to refer the identical subject matter to arbitration; or alternatively (ii) all a party had to do was to make an unequivocal request to the other party to submit the dispute to arbitration or apply for a corresponding stay (as the appellants had done), even without any intent to arbitrate.

The PC preferred conclusion (ii), for the following reasons:

i. Conclusion (i) was impractical and not consistent with business common sense. In circumstances where a party had commenced litigation, in order to obtain a stay, the other party would be forced to commence arbitration even if it did not seek any positive relief, potentially at considerable cost, and possibly in circumstances where the party that had commenced litigation may actually have no interest in or ability to settle the dispute through arbitration, thus preventing the parties from simply letting the matter lie.
ii. Under Section 6(2), it was already an established principle that the courts have the power to order a stay pending arbitration, even though neither party has actually submitted, or will necessarily ever submit, the dispute to arbitration.
iii. Conclusion (ii) was consistent with the general principle of consent, which is the "hallmark" of arbitration. The PC stated that Clause 19.5 clearly contemplated a consensual approach, and an analysis whereby notice will trigger the mutual agreement to arbitrate a dispute fitted better into a consensual scheme than one that requires the artificial construction, and commencement of arbitration in respect of a cross-claim.

COMMENT

The PC's decision is binding in the BVI as it concerned BVI legislation. However, the decision is also likely to be highly influential in a number of other jurisdictions, which have similarly worded legislation and in which the PC's decisions are held as a source of legal authority. For instance, the decision will be relevant in jurisdictions such as England and Wales, and India. Section 9(1) of the Arbitration Act 1996 in England and Wales, and section 8(1) of the Arbitration and Conciliation Act 1996 in India are very similar to section 6(2) of the Ordinance.

This decision suggests that in circumstances where the parties are bound by a similarly worded permissive arbitration clause, either party is entitled to commence litigation in the absence of either electing arbitration as the forum to resolve the dispute. The PC's preferred interpretation of Clause 19.5 has the effect that a party wishing to arbitrate can obtain a stay of the litigation proceedings through an unequivocal request or application for a stay, thus producing the same practical result as if the clause were mandatory.

The PC based its decision in part on what would make most commercial sense. Yet the PC did not appear to consider the negative effect on the party that commences litigation at potentially considerable cost only then to be put to the expense and trouble of commencing an arbitration to pursue its case. In practice, the decision arguably reduces the significance of the distinction between permissive and mandatory arbitration clauses, as parties are likely to be deterred from commencing litigation even though the applicable arbitration clause is permissive.

In this case, the Appellants' appeal was upheld, and it appears to have benefited from the PC's pro-arbitration inclinations. However, the outcome may have been different in some other courts/jurisdictions. It therefore remains crucial for parties to word arbitration clauses clearly and carefully in order to reduce the risk of disputes over the correct forum for the dispute even before any consideration of the substantive merits.

AUTHORS

LONDON

Zaib Malik

zaib.malik@klgates.com

The new VIAC mediation rules replace the VIAC rules of conciliation and are an entirely new set of rules rather than a modification of existing ones.

A Look at the New Vienna Mediation Rules

by Ian Meredith (London) and Hendrik Puschmann (London/Frankfurt)

INTRODUCTION

The new mediation rules of the Vienna International Arbitration Centre ("VIAC") took effect on 1 January 2016. VIAC is the international arbitration court of the Austrian chamber of commerce and is a leading arbitral institution in Central Europe.

The new VIAC mediation rules replace the VIAC rules of conciliation and are an entirely new set of rules rather than a modification of existing ones. There is a transitional provision for conciliation agreements under the old VIAC conciliation rules: unless parties to such agreements expressly opt out, disputes to which such an agreement applies will now be automatically covered by the new mediation rules instead (art. 14(2)).

The new mediation rules follow a comprehensive revision of VIAC's arbitration rules, which came into force on 1 January 2013 and were discussed in Arbitration World in **March 2014**.

THE MAIN PROVISIONS OF THE RULES

The rules adopt a broad definition of mediation: they apply to any "*alternative dispute resolution method chosen by the parties*" where "*one or more neutral persons […] support the parties in the resolution of their dispute*" (art. 2).

The provisions for the procedure of the mediation conform to international standards and are uncontroversial:

- Proceedings are commenced by filing a request for mediation (art. 3), which is required to set out the parties' contact details, a short description of the matter, and any agreements or proposals as to the format (number of mediators, language etc.) of the proceedings.

- VIAC will assist the parties with identifying and appointing a mediator (art. 7) or, if the parties fail to reach an agreement, will appoint the mediator for them.
- Once a mediator is in place, he or she takes over the conduct of the proceedings, though "guided by the wishes of the parties" (art. 9).
- The proceedings can be terminated by any party at any time, and the mediator can terminate them as well if, in his or her opinion, they will not resolve the dispute (art. 11).

The mediator has a number of duties to the parties, including:

- Full disclosure of any potential conflicts prior to his or her appointment (art. 7(3)).
- The duty to start his or her work promptly on being appointed (art. 9(2)).
- The duty to assist the parties in resolving their dispute (art. 9(2)).
- The duty to keep confidential any information received from one party vis-à-vis the other party or parties (art. 9(6)). The rules moreover safeguard the confidential and privileged nature of the proceedings as a whole and any documents and information exchanged in their course (arts. 9(5) and (12)).

In terms of fees and costs, VIAC charges a registration fee of EUR 1,500 (art. 4). VIAC will then also handle the advance on the mediation costs and administer the costs aspects of the mediation throughout (art. 8). In so doing, VIAC charges an administrative fee by reference to the value in dispute amounting to half of the fee that would be payable for a VIAC arbitration. VIAC will waive its registration fee for any ensuing VIAC arbitration, if commenced before, during or immediately after the mediation, and will also deduct any administrative fees charged for the mediation from its arbitration handling fees.

The mediator's fees are set by the VIAC secretariat in consultation with the mediator and parties (art. 8(8)). A recent article by the deputy secretary-general of VIAC and a member of the working group charged with drawing up the mediation rules indicates that the secretariat will consider hourly fees between EUR 300 and EUR 500 as adequate.

COMMENTS

With its old conciliation rules, in place since its foundation in 1975, VIAC was one of the first institutions to offer a "one-stop shop" for both arbitration and alternative dispute resolution (ADR) proceedings. Since then, this has become a global trend. ADR—and mediation in particular—is an increasingly common step in the dispute resolution process. Parties to an arbitration agreement often prefer to attempt a conciliatory resolution of their dispute under the auspices of the same institution they have already chosen to administer any arbitration proceedings. Most of the major institutions—such as the ICC, LCIA, HKIAC or ICDR—now have a set of mediation rules. This trend looks set to continue.

So VIAC's overhaul of its ADR framework is timely. The old conciliation rules had only changed minimally since coming into force. The new mediation rules are fully in line with current global best practices regarding mediation. They are fairly brief and light on detail, especially regarding procedure. They do not, for instance, set time limits or outline the required contents of any mediation statements or make any statements about settlement agreements, unlike some other sets of rules. Nor do they contain any provisions for challenging mediators. In light of the consensual nature of mediation proceedings (which any party can end at any time), this restraint is to be welcomed.

VIAC's mediation fees, moreover, are relatively modest. The fact that they can to some degree be set off against the fees in any subsequent VIAC arbitration is an innovative step. VIAC will also work towards keeping the mediator's fees at a reasonable level.

In line with its approach to arbitration, VIAC is likely to allow for maximum party autonomy in its administration of the rules. It is, however, capable of refusing to administer proceedings that are "incompatible" with the mediation rules (see art. 1(2)). It remains to be seen what exactly this means. VIAC has already indicated, however, that parties should be particularly careful when agreeing derogations from "core administrative provisions" such as the scope of the rules (arts. 1 and 14), the commencement and termination of proceedings (arts. 3 and 11) and costs (arts. 4 and 8). VIAC maintains facilities in Vienna where proceedings can take place. It is not, however, limited to administering mediations taking place there (or indeed within Austria). The secretariat has made it known that it is available to assist the parties beyond the mere administration of proceedings. In particular, the secretariat can provide assistance with drafting mediation agreements.

VIAC plans to publish a practitioners' handbook on the mediation rules, modelled along the line of its existing handbook of the VIAC arbitration rules, i.e. offering a detailed section-by-section commentary. Such commentaries are invariably a useful resource for both party representatives and arbitrators or mediators and are rarer when it comes to mediation rules, so this initiative is to be welcomed.

AUTHORS

LONDON
Ian Meredith
ian.meredith@klgates.com

LONDON/FRANKFURT
Hendrik Puschmann
hendrik.puschmann@klgates.com

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The concept of "public policy" is not defined under the NY Convention, and this task is left to each adopting state.

Understanding the Public Policy Exception Under the New York Convention

by John Kelly and William KQ Ho (Melbourne)

THE NEW YORK CONVENTION

It is difficult to overstate the importance of the New York Convention (*otherwise known as the Convention on the Recognition and Enforcement of Foreign Arbitral Awards*) ("**NY Convention**") to international arbitration. The NY Convention mandates all adopting states to recognise and enforce international arbitral awards unless one of the exceptions applies. One such exception is where the recognition or enforcement of an award would be contrary to the public policy of the country where recognition and enforcement is sought.

It is widely accepted by courts that the exceptions listed under Article V of the NY Convention should be narrowly and strictly interpreted, the emphasis being that arbitral awards should be recognised and enforced unless there are exceptional circumstances. Nevertheless, many unsuccessful parties have sought to resist the enforcement of an unfavourable award by arguing that it would be contrary to the public policy of the country where enforcement is sought (Art V(2)(b) of the NY Convention).

The concept of "public policy" is not defined under the NY Convention, and this task is left to each adopting state. Not surprisingly then, this has resulted in the notion of public policy being manifested in various forms.

IBA SUBCOMMITTEE REPORT ON THE PUBLIC POLICY EXCEPTION

Given the absence of a concrete definition, the International Bar Association Subcommittee on Recognition and Enforcement of Arbitral Awards (the "Subcommittee") conducted an ambitious project in 2014 and 2015 to better understand how various states have defined public policy. While the project is ongoing, the Subcommittee published a general report of its current findings in October 2015 (see **Recognition and Enforcement of Arbitral Awards—study on public policy**). The report covers more than 40 jurisdictions, including Australia, England, France, Germany, Italy, Japan, Poland, Singapore, the UAE and the United States.

Statutory definition

Interestingly, the Subcommittee found that the majority of jurisdictions had no statutory definition of public policy. One of the very few jurisdictions to do so is Australia. Section 8(7A) of the International Arbitration Act 1974 (Cth) provides:

> *"To avoid doubt and without limiting paragraph (7)(b), the enforcement of a foreign award would be contrary to public policy if: (a) the making of the award was induced or affected by fraud or corruption; or (b) a breach of the rules of natural justice occurred in connection with the making of the award."*

The courts' definition

The absence of a statutory definition in most jurisdictions leaves responsibility with the state courts to define the concept. The Subcommittee noted the inconsistency between definitions of public policy as a ground for refusing enforcement as opposed to that for setting aside an award.

The Subcommittee also identified separate trends adopted by civil and common law jurisdictions in defining public policy. Generally speaking, civil law nations seek to define the concept by reference to the principles and values that form the foundation of society. For example:

- Austria – "*Fundamental values of the Austrian legal system.*"
- China – "*The principle of the law, fundamental interests of the society, safety of the country, sovereignty and good social customs.*"
- Germany – "*The very fundamentals of public and economic life.*"
- Japan – "*The basic principles or basic ideas of the legal system of our country.*"
- Mexico – "*The legal institutions, principles, norms that conform the State. … The essential principles of the State that transcends to the community given the offensiveness of the mistake made in the decision.*"

On the other hand, common law countries tend to identify more explicit fundamental values such as justice, fairness and morality. For example:

- Australia – "*Fundamental norms of justice and fairness.*"
- Singapore – "*[T]he most basic notions of morality and justice.*"
- United States – "*Most basic notions of morality and justice" and "[f]undamental notions of what is just in the United States.*"

Only very few countries defined the concept by reference to "transnational" public policy; the majority of states apply the local principles.

Narrow interpretation of public policy

While the Subcommittee noted that domestic courts have found it difficult to precisely define the meaning and scope of public policy, the Subcommittee noted that there is a tendency of the courts to narrowly construe the public policy ground for denying enforcement. Less evident is the precise level or nature of a violation of public policy required in order for the court to deny enforcement. The myriad of terms used to describe the level of violation required are emphasised by the Subcommittee. Clearly demonstrated is the inconsistency between jurisdictions. Further, although the level of required violation of public policy varies, it has been found that such violation must be "*clear*" (Portugal), "*concrete*" (Nigeria), "*evident*" or "*patent*" (Mexico), “*blatant*” (Lebanon), “*manifest*” (China), “*obvious and manifest*” (Poland), “*flagrant*” (Turkey), “*particularly offensive*” (Sweden), “*severe*” (Germany), “*intolerable*” (Austria), “*unbearable*” (Switzerland), “*repugnant to the legal order*” (Italy), etc.

Despite the inconsistency in defining public policy, the Subcommittee noted that there is, in general, consistency in the purpose of defining the scope: namely, to narrow the scope of the intervention to be made by the court. This is done with a view to prevent (or limit) the court from reviewing awards on their merits at the enforcement stage.

It should also be noted that there is some discrepancy between states as to whether the public policy assessment should be made of the entire award (including its reasons) or only the result or the operative part of the award. As examples only, it appears that Poland favours the latter approach and Germany the former.

In assessing public policy, most courts recognise that the concept has two aspects: a procedural one and a substantive one.

Procedural public policy

The procedural aspect is primarily comprised of basic and fundamental procedural rules. The Subcommittee highlights Art V(1)(b) (i.e., no proper notice of the appointment of arbitrator or arbitration proceedings) and (d) (i.e., the composition of the panel or the procedure adopted was not in accordance with the agreement) of the NY Convention as separate grounds for refusing enforcement on the basis of procedural irregularity. Given this, it is queried whether violation can be sanctioned under both Art V(1)(b) and the public policy exception in Art V(2)(b). The majority of jurisdictions answer affirmatively.

Refusal of enforcement is marginally more likely through violation of procedural public policy as opposed to substantial public policy. This can be attributed to a collection of procedural irregularities that are nearly universally accepted as impacting public policy. These include:

- violation of right to be heard or of due process;
- violation of equal opportunity to present one's case;
- award obtained by fraud or based on falsified documents; and
- award obtained following bribery of or threats to an arbitrator.

Further, violation of *res judicata* and lack of independence and impartiality of the arbitrators are generally (not universally) deemed contrary to public policy. On the other hand, the complete lack of reasons supporting an award and *lis pendens* (where a pending proceeding before the domestic courts in the country where enforcement is sought could result in incompatible decisions) are generally considered not to affect public policy.

Substantive public policy

The Subcommittee noted the difficulty in identifying trends common across jurisdictions regarding substantive public policy. One key commonality is awards that give effect to illegal activities. While universally accepted violations are scarce, general categories that trend across jurisdictions do exist:

- antitrust and competition law (EU countries);
- pacta sunt servanda ("*agreements must be kept*");
- equality of creditors in insolvency situations;
- state immunity;
- prohibition of punitive damages;
- prohibition of excessive interest; and
- the inarbitrability of a dispute.

CONCLUSION

Ultimately, the Subcommittee confirms the difficulty of precisely defining the concept of public policy across more than 40 jurisdictions. What is clear is that Art V(2)(b) of the NY Convention provides very limited grounds and is comprised of a very limited number of rules and values. These limited rules and values are generally narrowly interpreted by the courts, with varied levels of intensity required, across the jurisdictions. Inconsistencies of approach are rife, and with uniformity largely lacking between countries, public policy as a grounds for refusing the recognition or enforcement of a foreign award remains largely undefined. It is, of course, important to recognise that there remain jurisdictions (including and excluding the 40 jurisdictions studied) where the concept of public policy is more broadly defined than others. Having said that though, the Subcommittee found that, in the vast majority of the studied jurisdictions, "*courts narrowly interpret or apply these rules and values by requiring a certain level of intensity for a given circumstance to be held contrary to public policy.*" The predominant trend, so the Subcommittee says, is "*to limit the review to a conformity-check of the arbitral decision itself, not its reasons, with public policy as assessed in the country where enforcement is sought.*"

AUTHOR

MELBOURNE

John Kelly
john.kelly@klgates.com

William KQ Ho
william.ho@klgates.com

Switzerland is not a Model Law jurisdiction, but the relevant provisions of the Act are similar to the Model Law.

A Roundup of Recent Arbitration Decisions of the Swiss Supreme Court

by John Magnin (London) and Hendrik Puschmann (London/Frankfurt)

INTRODUCTION

Swiss arbitration law is contained in the Private International Law Act (the "Act"). Switzerland is not a Model Law jurisdiction, but the relevant provisions of the Act are similar to the Model Law. Swiss case law can hence be salient to the interpretation of Model Law provisions in other countries.

The Act envisages "appeals" against arbitral awards made in Switzerland. These are not really appeals; the Act merely provides, at s. 190(2), narrow procedural grounds for setting aside awards:

a. the tribunal was not properly constituted;
b. the tribunal wrongly accepted or declined jurisdiction;
c. the decision went beyond the claim submitted or failed to decide one of the claims;
d. the principle of equal treatment or the parties' right to be heard was not respected; or
e. the award is incompatible with public policy (substantive or procedural public policy).

These grounds are similar to, but even more restrictive than, those at art. 34(2) of the Model Law.

Set-aside applications are heard by the Federal Supreme Court (the "Court"). The Court anonymises arbitration judgments prior to publication, but it is nevertheless often clear who the parties are.

Judgments are available in French, German or Italian (Switzerland's national languages). A private initiative of Swiss lawyers compiles unofficial English translations of arbitration-related judgments, which are available **here**. Quotations in this article are taken from these translations.

The Court has made several noteworthy rulings on set-aside applications in the past year, three of which we summarise below. The theme running through them, and other judgments, is that the Court takes a restrained approach—minimalist, even—to interfering with arbitral decisions.

EDF V HUNGARY (CASE NO. 4A_34/2015), 6 OCTOBER 2015—CONTRACTUAL CLAIMS V TREATY CLAIMS

Background

The EDF group acquired a majority stake in Budapest's main electricity company, BERt, in 2000. BERt benefited from a number of agreements with the state which, on Hungary's accession to the EU, were found by the European Court of Justice (ECJ) to amount to state aid. Hungary terminated the agreements, which gave rise to a dispute with EDF over the amount of compensation due to BERt. EDF initiated UNCITRAL investment arbitration proceedings under the Energy Charter Treaty ("ECT") for violation of the fair-and-equal-treatment provision at art. 10(1), and was successful.

Hungary applied to the Court for the arbitration award to be set aside. Among other grounds, it pleaded that the tribunal had wrongly accepted jurisdiction in contravention of section 190(2)(b) of the Act. Art. 10(1) ECT contains an 'umbrella clause' whereby each contracting state undertakes to "*observe any obligations it has entered into with an Investor or an Investment*". Hungary had opted out of this provision. It now argued that, given that the dispute was about BERt's contracts with Hungary, the claim fell under this umbrella clause and the tribunal had accordingly lacked jurisdiction.

Ruling

Dismissing the application, the Court held that the fair-and-equal-treatment obligation at art. 10(1) ECT and the umbrella clause for contractual obligations contained in the last sentence of that article "*are not interchangeable*". They are, in other words, two separate obligations. The umbrella clause "*puts the contract by the investor with the host state directly under the protection of the [investment] treaty*", so that the investor can sue under the treaty for any breach of its contract. This does not mean, however, that every claim under art. 10(1) is automatically captured by the umbrella clause. This "*would be tantamount to depriving Art. 10(1) [...] of any meaning*".

CASE NO. 4A_486/2014, 25 FEBRUARY 2015—CONTRACTUAL INTERPRETATION, EVIDENCE AND PUBLIC POLICY

Background

The case involved a share purchase agreement governed by Swiss law and containing an ICC arbitration clause. The purchaser sued the seller—the facts of the underlying arbitration are of little significance—and prevailed. The seller applied for the award to be set aside. It alleged that the tribunal had failed properly to research and apply Swiss contract law. This, it submitted, amounted to a violation of its right to be heard under s. 190(2)(c) of the Act. One of the seller's arguments was that the tribunal had failed to consider an expert report on contractual interpretation.

Ruling

The Court dismissed the application. It held that as long as the tribunal considered the relevant law on contractual interpretation at all—even if this was not mentioned in the award—its construction of the contract could not amount to a lack of due process even if that construction "*were to prove wrong, or even untenable*". The only way in which a tribunal's faulty interpretation of a contract could give rise to grounds for setting aside an award would be if the result was to amount to a violation of Swiss public policy, which was not the case. The threshold for a public-policy violation under Swiss law is very high in any event, as the Court emphasised at several points of the judgment.

The same principle applied to the tribunal's alleged failure to consider the expert report. The Court held that an arbitral tribunal may refuse to allow evidence without violating the right to be heard for a number of reasons. Hence the Court "*cannot review an anticipated assessment of the evidence except from the <u>extremely restrictive</u> point of view of public policy*" (emphasis added).

CASES NO. 4A_532/2014, 4A_532/2014, 29 JANUARY 2015—BRIBERY

Background

A series of disputes arose under two contracts between a firm of consultants on the one hand and two entities belonging to the same group of construction companies on the other hand. In each case, the consultants passed on monies received to an individual who was subsequently investigated in the UK under the Bribery Act and indicted in the United States under the Foreign Corrupt Practices Act. Based on this fact, the construction companies refused to pay the balance outstanding under the consultancy agreements. The consultants commenced arbitration proceedings, the contracts both providing for ICC arbitration in Geneva. The construction companies applied for a stay pending clarification of the consultants' involvement in the ongoing corruption investigations. The arbitrators rejected this application and issued awards in the consultants' favour.

The construction companies applied to the Court for the awards to be set aside on grounds of public policy; in doing so, they produced fresh evidence of corruption that post-dated the arbitral awards.

Ruling

The Court held that, in principle, bribery is contrary to Swiss public policy. Bribery would, therefore, provide grounds for annulling an award under s. 190(2)(e) of the Act, <u>provided that</u> bribery was established—rather than merely alleged—at the time of the arbitration proceedings <u>and</u> that the tribunal failed to take this fact into account in reaching its decisions. A tribunal refusing to stay proceedings because of ongoing corruption investigations, or even indictments, does not amount to a violation of public policy.

As in its ruling in case 4A_486/2014, summarised above, the Court made it clear that it would not re-examine a tribunal's findings on the evidence before it, however erroneous those findings might be.

AUTHOR

LONDON

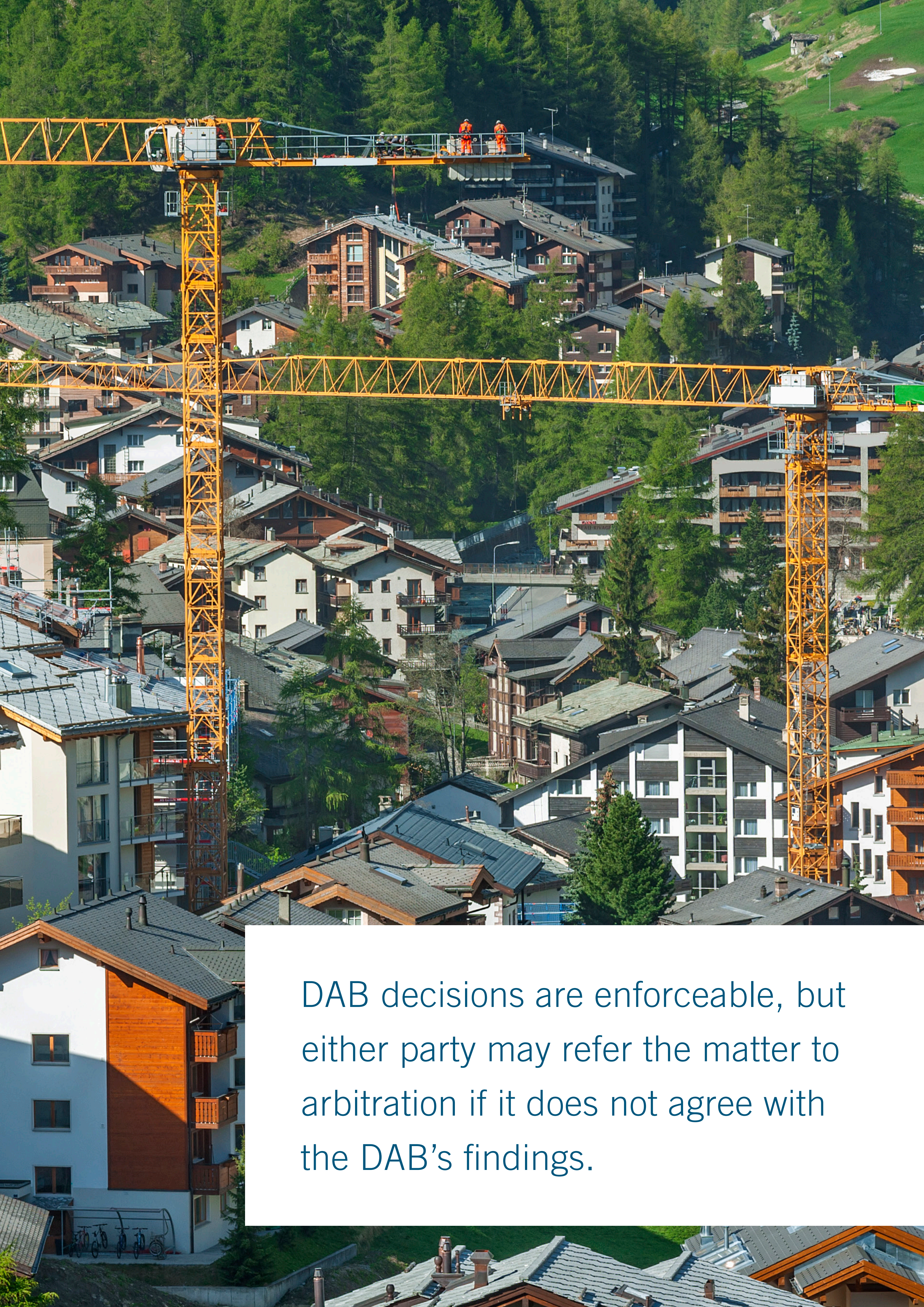
John Magnin

john.magnin@klgates.com

LONDON/FRANKFURT

Hendrik Puschmann

hendrik.puschmann@klgates.com



DAB decisions are enforceable, but either party may refer the matter to arbitration if it does not agree with the DAB's findings.

FIDIC Dispute Adjudication Board Referrals: Lessons from a Landmark Swiss Court Judgment

by Ben Beaumont **(Thomas More Chambers)**

INTRODUCTION

The Swiss Federal Supreme Court (the "**Court**"), in its important judgment No. 4 A_124 of 2014 on the role of a Dispute Adjudication Board ("**DAB**") under the FIDIC Red Book regime, considered when parties need not formally commence DAB proceedings before referring a dispute to arbitration.

The application before the Court was for setting aside an arbitral award. The powers of the Court in this regard are outlined in the round-up of **Swiss arbitration decisions** published in this edition of *Arbitration World*. The judgment, originally delivered in French, has been **informally translated into English**. Quotations in this article are taken from that translation.

THE FIDIC DAB MECHANISM

FIDIC, the International Federation of Consulting Engineers, is a pre-eminent global construction association. Its 1999 general conditions for construction contracts (the "Conditions"), commonly known as the Red Book, are widely used for complex construction projects. They envisage DABs as the principal dispute resolution mechanism. A DAB is a construction-specific adjudication tribunal that renders its ruling on an expedited timescale and without a hearing. DAB decisions are enforceable, but either party may refer the matter to arbitration if it does not agree with the DAB's findings. Parties appoint the DAB in a consensual process. If one party (usually the respondent employer) does not cooperate, this can lead to significant delays in the DAB being appointed.

The relevant provisions of the Conditions are as follows:

- Clause 20(2) of the Conditions states that "*disputes shall be adjudicated by a DAB.*" This, on its own, would appear to make the DAB process mandatory.
- Clause 20(4)—in what may seem to contradict Clause 20(2)—was a key point of the proceedings: "*[i]f a dispute (of any kind whatsoever) arises [...] either Party may refer the dispute in writing to the DAB*", unless the DAB procedure has been initiated first, except where (i) the dispute involves a party's non-compliance with an existing DAB decision or (ii) no DAB is in place when the arbitration is commenced.
- Clause 20(6) sets out the jurisdiction of the arbitral tribunal over "*any dispute in respect of which the DAB's decision (if any) has not become final and binding.*"

THE UNDERLYING ARBITRATION

A dispute arose between the parties to two interlocking contracts for road works. The contracts incorporated the Conditions and contained an ICC arbitration clause with Geneva as the seat (the judgment omitted the substantive governing law).

The claimant contractor requested that the respondent employer agree to set up a DAB. The Conditions set no timetable for the party-driven appointment process. In this particular case, it took the parties almost 15 months to agree on who should be their representatives on the DAB. However, the board has to have agreed among its members on its own terms and conditions before a board can review a dispute. It is generally agreed by distinguished authors that a DAB will not have any authority to consider a dispute until these internal agreements are signed. Delays continued, no longer the fault of the employer, but arising from the very slow nature of the adjudication board membership signing their own agreements.

The contractor eventually applied to the ICC for the appointment of an arbitral tribunal. The employer objected to the tribunal's jurisdiction. It argued that DAB referral is mandatory. The parties' agreement to the mandate of the board required that all disputes must be referred to it. The delaying factor was irrelevant. Therefore, in the employer's submission, the second exception in Clause 20(2) of the Conditions—explained above—was not available.

The tribunal, in a partial award that is not publically available, rejected the employer's objection. To quote the Court's summary of the award, it held that the DAB procedure "*is not mandatory in that it would be a pre-condition to the right of a party to initiate arbitration […] Indeed, the word shall used at [Clause 20(2) of the Conditions] must not be read in isolation but in the broader context of the dispute resolution mechanism,*" particularly the fact that Clause 20(4) states that parties may refer a dispute to adjudication

THE COURT JUDGMENT

The Employer applied to the Court to set aside the jurisdictional award. The Court refused.

The Court held that the tribunal's finding that the DAB mechanism is not mandatory for the FIDIC regime is incorrect, because the permissive wording at Clause 20(4) "*simply means that when a dispute arises between the parties, each may seize the DAB; it says nothing else and certainly not that seizing the DAB is optional*".

At the same time, the Court held that it was incumbent upon the parties to proceed with good faith in appointing the DAB. The exceptions to mandatory DAB referral in Clause 20(4) would need to be broadly interpreted: the doctrine of good faith may mean a party cannot rely on the absence of a DAB decision to object to arbitration. "*[S]aying in advance once and for all when it may be applied is impossible because the answer to the question depends upon the facts germane to the case at hand*".

In the present case, the Court held that delaying the DAB appointment for so long was contrary to good faith. Hence it confirmed the tribunal's ruling on jurisdiction even if it did not agree with "all its underlying reasons".

DISCUSSION

This is an unusual and salutary decision. It is salutary both (i) because the Court rightly disagreed with the ICC tribunal on whether DAB referral is mandatory under FIDIC contracts, reaffirming that it is mandatory, and (ii) because it paved the way for an exception to this rule where a party unreasonably delays the appointment of the DAB.

Until now it has been thought that parties can delay agreeing to the setting up of a DAB interminably. Some employers have for a long time abused the process by refusing to act in good faith in setting up the DAB, thereby rendering any such dispute management process unworkable.

The Swiss decision has now, at least under the terms of the contract before it, brought that assumption to an end. The Swiss decision will, of course, only be binding in Switzerland. However, it can be expected to be seen as persuasive in other jurisdictions as well.

The concept of good faith is not readily recognised in some common law jurisdictions. However, in such jurisdictions the doctrine of estoppel, for example, may provide an alternative path to the same result. In any event, this decision may assist parties in seeking to bring some effective implementation to the concept of the DAB.

AUTHOR

THOMAS MORE CHAMBERS

Ben Beaumont

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