

R.I.Z.

Rechtszentrum für europäische und
internationale Zusammenarbeit



Law Centre for European and
International Cooperation

NON-JUDICIAL DISPUTE SETTLEMENT IN INTERNATIONAL FINANCIAL TRANSACTIONS

March 22 and 23, 1999

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Program

MONDAY, MARCH 22, 1999

I. Non-Judicial v. Judicial Dispute Settlement in International Financial Transactions

Session Chair: Joe Norton, Dallas / London/ Hong Kong

1. 9:30 - 9:45 Norbert Horn, Cologne:
Introductory Remarks to Non-Judicial Dispute Settlement in International Financial Transactions
2. 9:45 - 10:15 Ambassador Roberto McLean, Dallas:
Growing Importance of Arbitration in International Finance
- 10:15 - 10:45 Coffee
3. 10:45 - 11:15 George Walker, London:
Counterpoint: The Importance of Judicial Dispute Resolution in Financial Transactions
4. 11:15 - 11:45 Jeswald Salacuse, Boston:
Mediation and Direct Negotiations in International Financial Conflicts
5. 11:45 - 12:15 Michael Gordon, Florida:
NAFTA and Financial Dispute Resolution
- 12:15 - 12:45 Discussion
- 12:45 - 14:15 Lunch

II. Regional Trends Regarding Non-Judicial Dispute Resolution in International Financial Transactions

Session Chair: Jens Bredow, Bonn

1. 14:15 - 14:45 Claus von Wobeser, Santa Fe:
Non-Judicial Settlement of Financial Disputes in Latin America
2. 14:45 - 15:15 Katherine Lynch, Hong Kong:
Non-Judicial Settlement of Financial Disputes in Greater China

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|----|---------------|---|
| | 15:15 - 15:45 | Coffee |
| 3. | 15:45 - 16:15 | Timothy Kautz, Frankfurt a.M.:
Non-Judicial Settlement of Financial Disputes in
Russia |
| 4. | 16:15 - 16:45 | Hani Sarie-Eldin, Cairo:
Non-Judicial Settlement of Financial Disputes in
the Middle East |
| 5. | 16:45 - 17:15 | Joe Norton, Dallas / London/ Hong Kong:
The Evolving U.S. Experience With ADR
Respecting Financial Institution Disputes |
| | 17:15 - 17:45 | Discussion |
| | 20:00 | Dinner |

TUESDAY, MARCH 23, 1999

- | | | |
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| 6. | 9:00 - 9:30 | Horacio Grigera Naón, Paris:
The ICC Arbitration System and the Resolution of
International Financial Transaction Disputes |
|----|-------------|--|

III. Rescheduling Public and Private International Debt

Session Chair: Horacio Grigera Naón, Paris

- | | | |
|----|---------------|--|
| 1. | 9:30 - 10:00 | William M. Berenson, Washington, D.C.:
ADR in Financial Disputes in the Americas - The
OAS perspective |
| | 10:00 - 10:30 | Coffee |
| 2. | 10:30 - 11:00 | Gerry N. Olson, London
Renegotiating Debt in a Bankruptcy Context |
| 3. | 11:00 - 11:30 | Michael Gruson, New York/ Frankfurt a.M.:
Renegotiating Syndicated Loans |

4. 11:30 - 12:00 Mads Andenas, London:
Arbitration and Dispute Settlement Clauses Used
by Development Banks and Other International
Financial Agencies
- 12:00 - 12:30 Discussion
- 12:30 - 14:30 Lunch

IV. Dispute Resolution in Structured Finance

Session Chair: Norbert Horn, Cologne

1. 14:30 - 15:00 Julian Lew, London
Arbitration and Other Dispute Settlement in Project
Financing
 - 15:00 - 15:30 Coffee
 2. 15:30 - 16:00 Marc Steinberg, Dallas
Non-Judicial Dispute Settlement in Capital
Market Transactions
 - 16:00 - 16:30 Discussion
 3. 16:30 - 17:00 Concluding Remarks:
Joe Norton, Dallas / Norbert Horn, Cologne
- End of Conference:** 17:00

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NON-JUDICIAL V. JUDICIAL DISPUTE SETTLEMENT
IN INTERNATIONAL FINANCIAL TRANSACTIONS

**Introductory Remarks to Non-Judicial Dispute Settlement in
International Financial Transactions**

Norbert Horn
Cologne

Conference
Non-Judicial Dispute Settlement in International Financial Transactions

Law Centre for European and International Cooperation (R.I.Z.)

Cologne, March 22-23, 1999

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Selected Bibliography of Publications in English: Legal Problems of Codes of Conduct for Multinational Enterprises, (editor and co-author) 1980; The Transnational Law of International Commercial Transactions, (co-editor and co-author with Clive M. Schmitthoff) 1982; German Private and Commercial Law. An Introduction, (co-author with H. Kötz and G. Leser) 1982; The Restructuring of International Loans, *Int'l Bus. Lawyer*, pp. 400-409, Oct. 1984; Adaptation and Renegotiation of Contracts in International Trade and Finance, (editor and co-author) 1985; The Lawful German Revolution: Privatization and Market Economy in a Re-Unified Germany, 39 *Am. J. of Comp. Law*, pp. 725-746, 1991; The Law of International Trade Finance, (editor and co-author) 1989; Bank Guarantees, Standby Letters of Credit, and Performance Bonds in International Trade, (co-author with E. Wymeersch) 1990; Institutional Aspects of Banking Supervision in Germany: Banking Supervision in the EC, (*Études Europeennes*) Brussels, (co-authored with Balzer) 1995; The UN Convention on Independent Guarantees and the Lex Mercatoria, 1997; Banks' Duties to Inform and to Give Advice Under German Law, 9 *Eur. Bus. L. Rev.*, pp. 367-380, 1998; European Monetary Union: Legal and Institutional Aspects in their Economic and Political Setting, 13 *J. of Int'l Banking L.*, pp. 71-79, Feb. 1998.

CONFLICT MANAGEMENT AND DISPUTE SETTLEMENT IN INTERNATIONAL FINANCIAL TRANSACTIONS: GENERAL INTRODUCTION

Norbert Horn, Cologne

(R.I.Z. Conference March 1999)

ABSTRACT

I. Introduction

Parties to international financial or commercial transactions often prefer to resolve their disputes through non-judicial conflict resolution mechanisms rather than by invoking the jurisdiction of State courts. The term "non-judicial dispute settlement" encompasses two very different approaches: (1) arbitration as a substitute for a legal action before a State court, and (2) mediation, conciliation, or any other procedural technique of conflict management that aims for an agreed settlement, i.e. a conflict solution based on the mutual consent of the parties. Regarding international financial transactions, there are some areas where such concepts are used, and others where they are still not found.

II. Judicial versus Non-Judicial Dispute Settlement

1. Court Procedures

It has sometimes been said that bankers prefer judges over arbitrators. Many contracts for international credits and bond issues contain jurisdiction clauses. One advantage of State court decisions is their binding effect backed by the authority of a State's jurisdiction. Among the disadvantages of jurisdiction is that, with respect to many countries, parties cannot have confidence in the impartiality and quality of their administration of justice. More importantly, the enforcement of a State Court's judgment is often not assured by treaties.

2. Arbitration

Arbitration has a long tradition in settling international commercial disputes. It leads to a binding decision comparable to that of a judgment by a State court. In contrast to court decisions, arbitral awards are enforceable world-wide on the basis of the New York Convention and a network of bilateral and multilateral treaties.

3. Other Alternative Dispute Resolution (ADR)

In various types of international economic transactions, alternative dispute resolution mechanisms other than arbitration, such as mediation, conciliation, the use of experts, or other ADR forms have become increasingly important. They are designed for situations where the parties have a strong interest in continuing with a given contract and completing it. Such a situation is typical for long-term and complex contracts on construction and infrastructure projects, turn-key delivery of plants, BOT contracts, and the like. The suitability of ADRs (other than arbitration) for financial transactions is an open question to be discussed *infra* (IV).

4. Differing and Complementary Functions of the Various Settlement Mechanisms

Judicial and non-judicial dispute settlement mechanisms are alternative strategies that serve different purposes of conflict management with respect to a given contract. Both courts and arbitral tribunals offer a litigious procedure that leads to a binding decision but might be detrimental to the future cooperation of the parties. On the other hand, non-binding ADR mechanisms that preserve the possibility of future cooperation are more successful if they are backed by the option to invoke a court or arbitral tribunal.

III. Arbitration in International Financial Transactions

1. Fields of Application

a. General Observations: Loans and Bonds: Although bankers are said to dislike arbitration, we find arbitration clauses in many areas of international financial transactions. Private borrowers and lenders of international credit still prefer forum clauses over arbitration clauses. This is true also with respect to syndicated loans. In the terms of the loan that determine the rights of bondholders of internationally issued bonds, we sometimes find arbitration clauses.

b. International Banks: The General Conditions Applicable to Loan and Guarantee Agreements of the World Bank provide for arbitration under an *ad hoc* procedure. The European Bank for Reconstruction and Development adopts the UNCITRAL Arbitration Rules.

c. Sovereign Borrowers: Sovereign States as borrowers cannot invoke their sovereign immunity in case they fail to fulfill their obligations and are sued either in court or before arbitral tribunals. Traditionally, they dislike forum clauses subjecting them to a foreign jurisdiction, although such forum clauses are found today in international lending. Arbitration clauses are used as a compromise. Such clauses are also found in agreements on the rescheduling of international sovereign debts.

d. Bank Guarantees: Bank guarantees and stand-by letters of credit are today a widely used means for securing international commercial and financial transactions. Typically, neither forum clauses nor arbitration clauses are found in the short documentation of such guarantees. Arbitration clauses are, however, increasingly used in bank guarantees.

2. Arbitration and Investor Protection

Arbitration clauses have been increasingly used in contracts on financial services including securities brokerage and the like. Such clauses determining arbitration in another country often constitute an unsurmountable legal obstacle to the protection of a small investor. Courts in both the United States and in Germany, as well as in other countries, are reluctant to recognize such clauses.

3. Drafting Arbitration Clauses

Arbitration clauses must be drafted as clear as possible. Optional clauses that give a party the right to either elect arbitration or to seek the jurisdiction of a court, are not advisable. In arbitration clauses with a sovereign party, a waiver of sovereign immunity should be included.

IV. Other ADRs in International Financial Transactions

1. Fields of Application in General

Direct negotiations between borrower and lender are the typical conflict settlement procedure in situations of imminent or existing default in international credits. As a rule, however, banks dislike the intervention of third parties as mediators or conciliators. A more structured procedure of mediation and the like is increasingly used in other international commercial transactions such as infrastructure projects, turn-key delivery of plants, and BOT contracts.

2. Various Types of ADRs and their Application to International Financial Transactions

a. Mediation and Conciliation: Mediation and conciliation are classical tools to bring about a negotiated settlement through the aid of a third party intervener. There are internationally recognized Conciliation Rules issued by UNCTRAL, ICSID, and the ICC. They are used in credit or other financial contracts only if those contracts are connected to the afore-mentioned long-term construction and project contracts.

b. Experts: ICC DOCDEX Rules: In cases where the dispute concerns mainly a question of fact, experts may come into play. This again is important in construction and similar contracts, but has more recently also been found in banking transactions. The ICC developed "Rules for Documentary Credit Dispute Resolution Expertise" (DOCDEX), effective since October 1997.

c. Conflict Management of Long-Term Contracts and Development Banks: Development banks financing long-term and complex construction and infrastructure projects, in order to monitor the execution of the contract and its financing, make use of dispute settlement mechanisms developed for those contracts. Often, dispute resolution boards (DRBs) are used.

d. Mini-Trials: Mini-trials describe a technique of carrying out a non-binding legal procedure in order to clarify the legal situation as the basis for an agreed settlement. Banks are not keen on submitting their case to outside persons in such mini-trials, but a legal discussion between their lawyers is the normal starting point for renegotiating a contract.

3. Restructuring of Debts in an International Debt Crisis

a. The International Debt Crisis of Countries: The International Debt crisis of countries has become a common phenomenon since the late seventies and early eighties. The imminent international insolvency of States or whole groups of States is a problem of such large political and economic weight as to go beyond the possibilities of a single forum or arbitral tribunal. The law, nevertheless, remains the basis for crisis management and the rescheduling of debt.

b. The Restructuring Process: The restructuring process encompasses techniques of coordinating the various groups of creditors under the leadership of the IMF and the World Bank. The sovereign creditors are organized in the Paris Club and the private creditors organize themselves in groups normally managed by the lead managers of syndicated loans.

c. Debts Not Suitable for Rescheduling: Short-term inter-bank money lines; World Bank credits; many bond issues.

d. Clauses With a View to Restructuring: Pari-Passu clauses; arbitration clauses; and, in syndication agreements, some clauses on majority votes.

V. Concluding Remarks

International financial transactions are not the main area where alternative dispute resolutions are used. The case of the international debt crisis demonstrates, however, how important it is to find procedural and even some substantive law in the renegotiation process or other dispute situations. Moreover, we can see that arbitration clauses and other ADR clauses are increasingly used in some areas of financial transactions and it can be expected that they will play an increasing role in this area. Arbitration in international securities transactions leads to problems of investor protection. This reminds us that there is no single ideal solution for the problem of dispute settlement. Different types of disputes require different approaches.

Growing Importance of Arbitration in International Finance

Ambassador Roberto MacLean
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Conference
Non-Judicial Dispute Settlement in International Finance Transactions

Law Centre for European and International Cooperation (R.I.Z.)

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Outline of Presentation

The Growing Importance of Arbitration in International Finance

by Roberto MacLean

- I. Introduction
- II. A View of the Landscape
- III. A Sobering Reflection
- IV. The Context for Arbitration
- V. Why is Arbitration Growing in Importance
 - a) The Social Cost of Arbitration
 - b) The Administration of Arbitration
 - c) The Nature of the Procedures
 - d) The Training for Arbitration
 - e) Participation by the Community
 - f) Impact of Arbitration in Society
- VI. The Social Responsibility of Arbitrators
- VII. Conclusion

THE GROWING IMPORTANCE OF ARBITRATION IN INTERNATIONAL FINANCE¹

by Roberto G MacLean²

- I - Introduction
- II - A View of the Landscape
- III - A Sobering Reflection
- IV - The Necessary Context for Arbitration
- V - Why is Arbitration of Growing Importance
 - A - The Cost of Arbitration
 - B - The Administration of Arbitration
 - C - The Nature of the Procedures
 - D - The Training for Arbitration
 - e)- Participation of the Community
 - f)- Impact of Arbitration on Society
- VI.- The Social Responsibility of Arbitrators
- VII - Conclusion

¹This article is dedicated to Carlos Morante and Ricardo del Risco who taught me a great deal on the subject

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I - INTRODUCTION

The solution of controversies is one of the services offered by the State to the community that has as one of its main characteristics—at least in some of the areas it serves, such as criminal law or divorces, that it is supposed to be, in principle, an exclusive service, a State monopoly, that allows no other server in the market. In the area of financial, economic or commercial disputes, legal and judicial systems have not been, in most cases, as jealous, as in the cases mentioned, in keeping the absolute monopoly of conflict resolution. But whatever the case may be, the principle of state exclusivity in conflict resolution holds valid only as far as the judicial system is socially efficient, because otherwise society itself provides its own alternative solutions. However, as we shall see, alternative ways of solving disputes work well in some situations, but not in others. The purpose of this article is to explore what is happening in this respect in the area of financial disputes.

From a different perspective, the relationship between law and the judicial system on the one hand, and the economic and financial community on the other has become clearer for many people in the last few years. For a good while it was thought, in many parts of the world, that the legal and judicial systems were the outcome of an economic order that determined them. Positivist jurists saw the two of them unrelated, at least for serious scientific legal purposes. What economists have been telling us during the last decade is that the economy of a country is the result of what the legal and judicial systems allow it to be. Apart from a rich bounty of legal

literature, two recent Nobel Prizes in Economics (North and Coase) sustain just that ³ An inefficient judicial system reduces the opportunities of access and increases the costs of transaction Preliminary studies by the World Bank staff and other economists tentatively quantify the economic impact of a judicial system in society at around fifteen to twenty percent of the growth rate of a country ⁴

II.- A VIEW OF THE LANDSCAPE.

From the windows of the offices of a corporate international lawyer, or of a comparative legal scholar, or of an officer of an international financial institution, it is possible to see a panorama in which the great bulk of financial disputes rather than by arbitration or other non-judicial ways is still dealt by the national courts of different countries. Not only that, but along with torts they are the great bulk of the civil cases handled by those courts. In Norway, Denmark, New Zealand, Switzerland, Finland, Ireland, Austria, Australia, Germany, Singapore, Hong Kong -among other

³ See RONALD H. COASE, *INSTITUTIONAL STRUCTURE OF PRODUCTION* (1992); DOUGLAS C. NORTH, *EMPIRICAL STUDIES IN INSTITUTIONAL CHANGE* (1996); DOUGLAS C. NORTH (INSTITUTIONS, INSTITUTIONAL CHANGE, AND ECONOMIC PERFORMANCE (1990). See also DOUGLAS G. BAIRD ET AL., *GAME THEORY AND THE LAW* (1994); ROBERT COOTER AND THOMAS ULEN, *LAW AND ECONOMICS* (1988); RICHARD A. ESPSTEIN, *SIMPLE RULES FOR A COMPLEX WORLD* (1995); WILLIAM M. LANDES AND RICHARD A. POSNER, *THE ECONOMIC STRUCTURE OF TORT LAW* (1987); RICHARD A. POSNER, *THE ECONOMICS OF JUSTICE* (1981); RICHARD A. POSNER, *THE PROBLEMS OF JURISPRUDENCE* (1990); RICHARD A. POSNER, *ECONOMIC ANALYSIS OF THE LAW* (4th ed. 1987).

⁴Robert M. Sherwood *et al.*, *Judicial Systems and Economic Performance*, 34 Q. REV. ECON. & FIN. 101 (1994).

countries- the perception by users, both national and foreign, is that the courts are doing either an excellent or a very good job.⁵ But the easy flow of efficient facilitation of international finance in a global society requires more. It requires that the social efficiency of both the legal and the judicial systems is a reality not only in certain parts of the globe, but at the very least in a very substantial part of it. And this is far from being the case

In Peru, for instance, business people consider that it is not worthwhile for them to go to court to collect debts below five or ten thousand U.S. dollars, according to the size of their firms. In inflationary economies, like Venezuela or Ecuador in the seventies or eighties, after two or three years in court, creditors collected minimal amounts of their loans. In Egypt, to obtain a final judgment for the payment of a debt is not even half of the battle to actually obtain payment. In Indonesia, the reduced percentage of debts that can be effectively collected after a judgment is rather small. In Poland, the debt collection process is so long, costly and cumbersome that the government, to prevent the collapse of its banking system, has had to exonerate banks from the need to resort to a judge to collect privileged debts, the payment of which they can demand directly from the debtor through the sheriff of the court. Needless to say, this privilege is not enjoyed by other institutions which feel rather bad about it. In Russia, a number of bank insolvencies during the early nineties created chaos in the courts, with long lines of complainants waiting all night for several weeks to present their complaints. In Albania, the collapse of the pyramid system in some financial institutions created havoc that required intervention from abroad to calm the riots that followed. And it can get even worse. In some cases, mobsters and gangsters

⁵World Competitiveness Report (1993/94).

have moved into the scene and began to act as court enforcers.⁶ In all such cases, business people and the general population look for alternatives. Not merely for auxiliaries or complements, but for true alternatives. The question is, can arbitration really be a valid alternative?

Changes have not been happening only for the worse. All of those mentioned and many other similar events have created concern to look for valid alternatives, although most of the formulas found were more related to trade than to finance. But the debt crisis of the seventies and eighties in Latin America caused the reversal of a long and solid tradition that had reached in many countries the rank of a constitutional principle, namely, the Calvo Clause, which prevented States to resort not only to arbitration but also to foreign jurisdictions. According to this, in any contract that a State signed with foreigners or foreign corporations these had to submit to local law, and also to local jurisdiction, which excluded national or international arbitration. Another important development was the changes in the doctrine of sovereign immunity that created a barrier for creditors to sue sovereign debtors and resort much less to arbitration in these matters. Two other events, the approval of the New York Convention and the approval of the Panama Convention, both by a large number of States, have also made much easier the international recognition and enforcement of arbitral awards. And these encouraged more other developments. The World Bank sponsored the creation of ICSID as a forum for investment disputes. James R.

⁶*BBC Summary of World Broadcasts: Russian Bankers Demand Legislation to Protect them from Assassination Attempts* (British Broadcasting Corporation, Aug. 4, 1995), available in LEXIS, News Library, Curnws File. Between 1993 and 1995, the Russian Mafia was suspected of eighty-three assassination attempts and forty-five assassinations of bankers in Russia. The Russian Mafia has in fact settled down somewhat because in order to “operate,” they demand of the person “hiring” them the production of a valid and conclusive judgment.

Butler Jr notes that from a late start in the financial services industry, arbitration seems to be gaining momentum quickly now.⁷ “A few years ago,” he mentions, “a number of prominent financial institutions committed to resolve their internal disputes by binding arbitration. Then financial institutions tentatively began to take customer disputes to arbitration.”⁸

III.- A SOBERING REFLECTION.

But neither courts of justice must feel that only they are able to solve legal conflicts nor that an arbitrator is always the best solution. We should not be prevented to recognize without prejudices that courts are still best in some cases while in others the time has come to privatize justice. As much as business people are resorting more and more to arbitration, that does not mean that all type of financial disputes are equally suitable to be solved outside of a courtroom. For one, arbitration implies in principle that all parties to a suit - at a given moment- agree to arbitrate, and that there are not reluctant litigants. On the other hand, sometimes it might be necessary to resort to preventive coercive measures, that arbitration can not generally provide. Within financial disputes, there is probably nothing more pressing and important—as far as volume of number of cases is concerned—than debt collection. And probably, nothing is as ill suited to the classical and traditional forms of arbitration. For small claims, also, arbitration might result in almost unaffordable expenses that make litigation uneconomical outside of court. On claims by a

⁷See JAMES R. BUTLER, JR., *ARBITRATION IN BANKING* (1988).

⁸*Id.* at 24.

large number of depositors against their bank, the psychological elements involved in mass behavior, do not create the climate in which arbitration can be most effective. But differences on technical financial matters like currency exchange, particular types of interest, negative pledge, devaluations or swaps are outside of the general training and experience of the average judge in developing nations, where lawyers are better trained in constitutional, civil, criminal or procedural matters rather than in financial, monetary or economic problems. However, to get around these obstacles banks with big syndicated loans more often resort to include a clause by which borrowers submit to the jurisdiction of the lender banks, or if of different jurisdiction, to that of the agent or leader, according to the case, that very often is New York or London where judges are better qualified in these areas. This is a field in which the advantages for resorting to arbitration would seem more evident. The Permanent Court of International Arbitration at the Hague has also modified its statutes in order to be able to hear cases in which one of the parties is not a State, opening a new acceptable forum for sovereign debtors. But in many countries, for governments to become part in arbitration procedures it is still required such a long list of approvals and authorizations that in practice often defeat the purpose of arbitrations.

IV.- THE NECESSARY CONTEXT FOR ARBITRATION.

The social efficiency of international non-judicial means of solving disputes like arbitration, mediation and conciliation, depends on more than in just writing a good law. A good law, of course, can provide the adequate tools and a clear frame within which the controversy can

unfold, as we shall see later. A good law is necessary but not sufficient because arbitration requires other external elements in order to fulfill its true role in society. Countries as diverse as Russia, Egypt, Indonesia, Guatemala and Peru all have quite reasonably good arbitration laws and institutions, and yet it is a far cry from being able to say that arbitration is successful and is working well in those countries. Which is not to say that a very good arbitration can not take place in there, but that in those countries arbitration is not socially, politically or economically significant and that therefore it can not fulfill its important and transcendental role there. What happens in those countries is simply that people do not resort to arbitration as a practical solution in significant numbers; that arbitration is still elitist. Because if it is true that people can go to arbitration on account that parties enjoy more confidentiality, can expect greater expertise from arbitrators than from judges or juries, that arbitration can save time, that it can be final many times, it is less expensive in most of the cases, and is less formal;⁹ on the other hand many times people are not aware of this. There is a lack of response and involvement by the community for lack of an adequate approach. And, because of that, people can also think that arbitration, especially that sponsored by business associations, is bound to be biased to the bank or the broker against the customer, or that the awards granted tend to be smaller than those given by courts.¹⁰

Nevertheless, the need to look for alternatives is there. In many countries the general public distrusts the judicial system as a way to satisfy their legal claims. But in most of these countries

⁹*See generally* DAVID E. ROBBINS, SECURITIES ARBITRATION PROCEDURE MANUAL 1-42 (LEXIS Law Publishing 3d ed. 1998); BUTLER, *supra* note 5, at 21, 33.

¹⁰*See* RICHARD A. BALES, COMPULSORY ARBITRATION 15 (1997).

there is more of a culture of authority than of a culture of service - with all that it implies¹¹ So that, instinctively, when people look for an alternative they look for an option with authority and power, in the political or physical sense of the words, instead of the moral or social one, that would be the natural choice in a culture of service and freedom

In Guatemala, many of the peasants instead of resorting to the local ordinary judges, as would be normal, feel better if they present their claims to the Mayor of the town, or even to the head or the duty officer of the local regiment who they consider more effective. In Albania, the elders of the towns in the mountains exercise a natural and effective authority in their communities, but that is of little consequence as far as financial operations are concerned. So that, lacking a valid alternative, when Albanians faced a financial crisis that courts of justice were not able to handle, the outcome was an eruption of violence. In Peru, Indonesia, the Philippines and Egypt alternative informal ways are found to solve disputes affecting large sectors of the population that distrust the official system, but that do not trust enough either the alternatives offered by other institutions.¹² One way of getting out of this situation is, of course, compulsory arbitration by law. This can take place, for example, by forcing parties to submit to arbitration or conciliation, before going to court, so that actually going to court would be the last resort when everything else is exhausted. The fault with this solution is that it could, if not applied well, end up in what it happened in many countries in Latin America when new procedural codes were enacted at the

¹¹See Roberto G. MacLean, *The Culture of Service in the Administration of Justice*, 6 *Transnat'l L. & Contemp Probs.* 139 (Spring 1996).

¹²See HERNANDO DE SOTO, *OTHER PATH: THE INVISIBLE REVOLUTION IN THE THIRD WORLD* (June Abbot trans., 1991).

beginning of the century. These codes included in their provisions a conciliatory hearing at the beginning of the procedure. The idea was a very good one but the legal culture of lawyers and judges converted it, in a few years, in a mere formality, in one step more that made the procedure even longer than it was before. Another way of implementing compulsory arbitration is that used in labor cases in the U.S. Compulsory arbitration provisions can be created as stand-alone agreements, or inserted as part of broader written employment agreements. They can be broad enough to encompass virtually every employment dispute imaginable, or drawn narrowly to encompass only a limited range of disputes (such as those involving discharge from employment).¹³ A fairly designed compulsory arbitration system has a great deal to offer to employees. Many employees, especially lower-income workers, are shut out of the current litigation process because their low salaries make their receiving large damage awards unlikely, and this in turn makes it difficult to attract attorneys who will handle these cases on a contingency basis.¹⁴

Another form of replacing the image of authority to which many cultures are used to as an icon of trust and reliability is, I suppose, replacing it by some type of institution that sponsors the arbitration or arbitrations. Official institutions like the Permanent Court of International Arbitration, The International Center for the Settlement of Investment Disputes (ICSID) of The World Bank, The World Trade Organization (WTO) or The North American Free Trade Agreement (NAFTA) are examples of this, with their systems of dispute resolution. Or private

¹³See BALES, *supra* note 7, at 3.

¹⁴See *id.* at 9.

well established institutions like the International Chamber of Commerce (ICC) and the InterAmerican Commercial Arbitration Commission, or even local chambers of commerce like the Stockholm Chamber of Commerce, among several others, that enjoy a well deserved international reputation . It is convenient to be aware, however, that ,in spite of its name, the “Arbitrazh” system in the Russian Federation it is not an arbitration system but a commercial court system for corporations and other legal persons

There are also other national more specialized type of institutions that sponsor arbitration in more limited fields like, in the U.S., the National Association of Securities Dealers, the New York Stock Exchange, the American Stock Exchange, the Municipal Securities Rulemaking Board, and the Securities Industry Conference on Arbitration. There are also institutions that deal with arbitration not in one particular country or in a particular field, like commerce, securities or investments, but in general, and their authority and reputation covers all type of cases, like the American Arbitration Association (AAA), the Center for Public Resources (CPR) Institute for Dispute Resolution, the London Court of International Arbitration, and the Hong Kong International Arbitration Center. Arbitration can also be sponsored by individual corporations or entities that carry on businesses with large number of persons, like banks, insurance companies, transport companies, which can include in their contracts an arbitration clause. And finally, judges, lawyers and scholars can play an important part in developing arbitration as a valid alternative, especially attorneys at the time of drafting contracts.

V Why is Arbitration of Growing Importance

It has been repeated, again and again, that arbitration is growing in importance because it offers parties more confidentiality and expertise, less expenses and formality, and on top of it all, it saves time. And so it is, and it might be enough, were it not that this list presents only a one-sided and partial view, a view that although correct neglects other important elements that should also be considered.

A The Cost of Arbitration

We have just mentioned that among the widely recognized advantages of arbitration is that it is less expensive for the parties. Even though that assertion is not necessarily true always, and even though there are cases in which rather the contrary is the truth, the real economic advantages of arbitration for society is that it shifts the economic cost of litigation from the taxpayer to the user of the service.

Normally, financial litigation is part of the cost of the financial business, together with risk assessment, credit information and collecting agencies. The inefficiency of the judicial system can increase for the general public the cost of transactions and reduce the opportunities of access, but the efficiency of the system does not benefit equally the general public and the user as it would be the case with criminal justice or family cases and some labor litigation. So that it makes sense that the users of the system should absorb a major part of the expense of solving their disputes, and

taxpayers a minor one. We have seen that financial disputes are, with torts, the majority of civil cases dealt by the courts. Some countries, like Russia and Egypt, charge large percentages of the amounts in disputes, as court fees for plaintiffs. There is in the U.S. at least one state, Tennessee, that in judicial fees and fines collects from the users a sum larger than the judicial budget of that state. But arbitration also, if developed properly, can take off part of that burden from the taxpayer. The economic cost of arbitration to the rest of society is nothing, compared to amounts that range from 0.9% to 6% from national or state budgets for the overall cost of judicial systems. Financial disputes are possibly a good example in favor of the privatization of justice.

B The Administration of Arbitration.

From the administrative side, the advantages of arbitration for society are many-sided. To begin with, the problem of the adequate selection of judges and all its political, administrative, cultural and financial implications is eliminated and the choice of those who judge is based on the trust parties feel for those who are going to judge. As it was in the very beginning. When Moses wandered for forty years in the desert, people spontaneously took to him all their conflicts; so much that for long periods of time he spent days solving disputes, as it is described in the book of Exodus, since very early in the morning till very late at night, to the point where upon the advice of his father-in-law, Jethro, he was forced to appoint deputies. In arbitrations the problem is taken away from society and each party selects its own arbitrator. To follow with another advantage – except in special cases, like WTO or NAFTA, ICSID or perhaps ICC – arbitration does not require as complicated an organization as judicial systems do, not such large archives,

not as complicated dockets, not such large numbers of support staff, not large requirements of infrastructure and technology. The administrative expenses to run arbitrations – except in very special cases – is not comparable to courts and they are not paid by the public. But the most important advantage in administration is that it reduces not only bureaucracies but inefficiency and with it the main cause of corruption in judicial systems. The transparency that arbitration offers to the parties in a dispute makes that if ever occurs cases of corruption that would be indeed very exceptional.

C. The Nature of the Procedure

Not few of the problems of international litigation in a court of justice have to do with procedural matters. First, the malady of “Forum Shopping” is eliminated if the jurisdiction is established by mutual agreement, as is usually the case in arbitration. Second, the problem of assignment of cases to a particular judge, source of many irregularities is also eliminated. Third, arbitrators are more service conscious toward the parties than judges, simply for the fact that the jurisdiction of arbitrators is not compulsory like that of judges, and is only the result of the agreement of the parties. As Judge Roger Warren President of the National Center for State Courts in the U.S. said once, he would like to instill in every judge the ideal that there is a court a hundred yards away offering exactly the same service that that judge offers. The “motto” of arbitrators could well be in this respect: “we never forget that you can make a choice.” Fourth, submission and assessment of evidence does not take as long as in courts of law. Fifth, arbitrators can be much less formalistic than judges in the procedure, with the result that in many cases it is easier to reach

a settlement in arbitration than in a court of law, especially in countries without discovery. Sixth, as decisions of arbitrators are not binding on future cases, there is more flexibility for arbitrators than for judges, if circumstances change, specially in common law countries, if circumstances change.

D. The Training for Arbitrators

At present there are numerous institutions around the world dedicated to train judges and their support staff at the expense of the taxpayer, with different kinds of results; while the training of arbitrators; when it takes place, if even, it is at the expense of the arbitrator or sponsoring institutions. There is a good deal more to say about this, but we will deal with it later in Section VI.

E. Participation by the Community.

One of the features of conflict resolution systems in developed industrial countries is the involvement of the community in the process of solution. In a conversation with U.S. Supreme Court Justice Abe Fortas, years ago, he mentioned that judicial systems do not have either their own economic sources or their own armed forces, and that their true authority resides in the backing they receive from the community and public opinion. Their true force -he said- is their power of persuasion and of moving public opinion. As a result of shortcomings in their decision and law making processes, developing countries suffer a fracture between their legislative bodies,

their judiciaries and the community¹⁵ The flow of currents of public opinion between them is not fluid, and as a result the public perception of them is rather poor In the evaluation made by the World Competitiveness Report 1993-1994 the large numbers of conflict resolution systems of developing countries were evaluated by users below a mark of 5 over a maximum of 10. As Luis Pasara notes, in a Gallup survey in Argentina 49% of those interviewed thought that the system was either “bad” or “very bad”, 40% thought it was “medium” and 80% did not find any positive aspect in it. In Peru, in a survey made under the auspices of the United Nations Development Program, 3 out of each 4 crime victims thought that the system was corrupt.¹⁶ The general perception in Jakarta, Indonesia, is that “justice” belongs to the highest bidder, and the system in Russia is evaluated at 2 over 10. Coincidentally, in all of these countries participation by the community is almost non-existent.

The difference with arbitration is that arbitration does not exist without participation. It is based in voluntary participation. So, the growing importance of arbitration in international finance, and its shortcomings have to be measured mainly by the participation of the community. And the efficiency, success, planning, training, development of arbitration have to be measured also that way. But, this is an aspect in which arbitration could be more successful with a much larger capacity to grow. For all of its impressive achievements arbitration remains elitist to a certain degree, with the exception, of course, of informal arbitration that grows and develops without

¹⁵See Roberto MacLean, *The Social Efficiency of Laws as an Element of Political and Economic Development*, 4-SP6 NAFTA: L. & Bus. Rev. Am. 6 (1998).

¹⁶See Luis Pasara, *Jueces y Justicia en tela de Juicio* (1995) (I should see this, to cite it better—is it an article or book? Do you have a page #?).

connection and relation to the established ways and institutions mentioned here. There is a whole new field to cultivate, and there is the need to be more aggressive in developing new markets..

F. The Impact of Arbitration in Society.

The question appears then, that what is the role of arbitration in society. What is the importance of arbitration beyond the individual cases. Why should everybody be concerned that arbitration works and works well. First, at the most elementary level, arbitration is important as a relief from the gigantic pressures of backlogs of cases in the great majority of courts all over the world. At a meeting of the LawAsia Conference in Manila in 1997 one of the Vice-presidents of the People's Supreme Court in China, said that in that country there are around 360 million cases pending in the courts. In India the number of cases is estimated at around 45 million. And in other countries, even though with not such impressive numbers in the whole system, the backlog is concentrated in some particular courts that damage the performance of the overall system. So, the first role for arbitration in society is like auxiliary to judicial systems to help them to deal with heavy loads of cases.

The second role and impact of arbitration in society is as a complement to fill in for the recognized limitations and shortcomings that the organization of jurisdictions and the training of judges suffers in the majority of countries in the world today. The training of judges and even of lawyers is very deficient and with massiveness, is becoming increasingly formalistic and inadequate for the needs of society. The requirements of international trade, investment and

finance are not satisfied in a very large number of countries around the world. Matters like maritime cases, insurance, finance, futures, securities have become so sophisticated and specialized that someone who is not familiarized with the trade can not cope easily with them. So, arbitration with its rich and almost unlimited resources can provide ideally answers and solutions almost in any conceivable field.

The third and most important role and impact of arbitration in society, is as Nemesis of judicial systems. The emergence of arbitration in the field of conflict resolution responds to the fact that something is being done wrong in judicial systems; to the shortcomings of judges. It is reminding of how courts of equity developed during the middle ages in England, except that in this case the response did not come from another office of the kingdom, but , as befits to more liberal and democratic times, from ordinary citizens, merchants, bankers, professionals, etc. Arbitrators and arbitration institutions rise thus from being mere auxiliaries of justice, to become specialized complementaries, and then to become finally the conscience of judicial systems, the guardians of justice, equity, freedom, exchange, development, distribution of wealth, and of understanding, in areas in which the general public may not easily perceive whether courts of justice are doing what is good or not. In the early middle ages errand knights were the mirror of rulers and judges. In the Golden Century of Spain in, “Don Quijote de la Mancha”, the earthly and common Sancho Panza became the mirror for centuries to come of how judges, mediators, conciliators or arbitrators should look at their business. The twenty-first century is the time for arbitrators to perform that function. This is the deepest impact that arbitrators can cause and their most important civic and political duty

VI - THE SOCIAL RESPONSIBILITY OF ARBITRATORS

Different from judges, arbitrators not always need to be lawyers. Some times, even in international conflicts, a panel is entirely formed by accountants or adjusters, just to mention two of the many possibilities, because above anything else arbitration is about solving disputes, and laws are only one of the tools to solve disputes. When King Solomon the Great was faced with a dispute between two prostitutes each of which claimed the maternity of the same child, he did not resort to the latest statute on the subject, the precedents set by several centuries of judges in Israel, or the many authorities that had written and interpreted mosaic law. Mocking formal justice he ordered the child cut in two, and ordered one half to be given to each of the alleged mothers. When one of them resigned to her right in order to save the child, he found who the real mother was. Granted that to cut a child in halves is not quite the same as cutting in halves forty million dollars, yens, marks, francs or rupees. But the point is that even apparent purely legal disputes are in fact not about laws but about values, whether political, economic, social, cultural, ethical or religious. If arbitrators do not understand the values that are at play in a conflict and do not have the intuitive lucidity to establish a balanced order, they will not be a true alternative. They will only be a transient incident, a foot note, a temporary detour in the history of conflict resolution, like the mediaeval ordeal.

Especially in the world of finance, laws and regulations reflect the reality of international relations from very much the perspective of capital exporting countries. They are truly international laws,

and work well in sectors of society and areas of the world, but are not prepared yet for a truly global society. In finances there is lacking the equivalent of The Hague Rules, Hague-Visby Rules or Hamburg Rules for maritime trade; or the several international conventions for the Sale of Goods; or for international air transport. In all these fields the actors are moving ahead towards a global community. The rules for wire transfers are a change. But for loans we are a far way out. One of the lessons that the debt crisis of the eighties ought to have taught us is the inadequacy of the existing rules to meet the needs of a plural and global society.¹⁷ Who can find the way? Judges?

One of the reasons we are discussing this subject today is, precisely, because as we have already seen, in the majority of the countries of the world today judges are not, unfortunately, prepared for it. And that is the challenge and the growing importance of arbitration in international finance.

VII.- CONCLUSION.

The inadequacy of existing rules and the overwhelming growth of financial developments around the world create a unique opportunity for leadership and creativity, for helping to shape a new society, to establish a new international order based on the awareness of others and of the fact that today's problems in Bolivia, Uzbekistan, Burundi and Tonga may be knocking at our doors

¹⁷See Roberto G. MacLean, *Legal Aspect of the External Debt*, 2 Recueil des Cours 35 (1989).

tomorrow morning. The limitations of judicial systems and the shortcomings of judges around the world present this extraordinary opportunity to arbitrators as hard realists, learned jurists, deep thinkers, but also as leaders, dreamers and peace lovers.

**Counterpoint: The Importance of Judicial Dispute Resolution in
Financial Transactions**

George Walker
London

Conference
Non-Judicial Dispute Settlement in International Financial Transactions
Law Centre for European and International Cooperation (R.I.Z.)

Cologne, March 22-23, 1999

**RECHTSZENTRUM FÜR EUROPÄISCHE UND INTERNATIONALE
ZUSAMMENARBEIT**

**NON-JUDICIAL DISPUTE SETTLEMENT IN INTERNATIONAL
FINANCIAL TRANSACTIONS**

BANKS AND LEGAL REDRESS

March 1999

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OUTLINE

**Banks and Legal Redress -
Alternative Resolution Options [AROs or ARMs]**

- 1. Structural Options**
- 2. Historical Development**
- 3. Banks and Legal Redress**
 - (a) Automatic or Non-Judicial Asset and Claims Protection**
 - (b) Formal Rights of Action and Recovery [JJs and AAs]**
- 4. Litigation and Arbitration - Advantages and Disadvantages**
- 5. Bank Product Development**
- 6. Conclusions**

SLIDE 1

- 1. Structural Options**
 - (1) Litigation**
 - (2) Arbitration**
 - (3) ADR**
 - (a) Conciliation**
 - (b) Mediation**
 - (4) Hybrid Resolution Structures**
 - (a) Mini Trial**
 - (b) ARB-MED**
 - (c) MED-ARB**
 - (5) Consensual Settlement**

SLIDE 2

2. Historical Development

(1) Principal Legal Processes or Systems

(a) Common Law

(b) Civil Law

**(c) Lex Mercatoria and
the Commercial Court**

(d) Scots Law

(e) United States Law

**(2) Arbitration and
Alternative Dispute Resolution**

3. Banks and Legal Redress SLIDE 3

**(1) Automatic or Non-Judicial
Asset and Claims Protection**

- (a) Right to Demand Repayment**
- (b) Right of Combination and
Appropriation of Accounts**
- (c) Right of Lien**
- (d) Closure of Account**
- (e) Enforcement of Security and
Guarantees**

(2) Legal Rights of Action and Recovery

- (a) Right to Sue**
- (b) Summary Judgement**
- (c) Mareva Injunction**
- (d) Enforcement and Anton Pillars**
- (e) Bankruptcy and Liquidation**

SLIDE 4

**4. Litigation and Arbitration -
Basic Advantages and Disadvantages**

(1) Litigation

(a) Certainty

(b) Finality

(c) Enforceability

(2) Arbitration

(a) Confidentiality

(b) Cost

**(c) Consensual or Co-operative
Recovery**

5. Functional Attributes of AROs

(1) Pre-Hearing Functions

- (a) Forum Selection**
- (b) Choice of Law**
- (c) Choice of Jurisdiction**

(2) Hearing Functions

- (a) Confidentiality**
- (b) Cost**
- (c) Party Involvement**
- (d) Formality** **(e) Delay**

(3) Post-Hearing Functions

- (a) Finality of Determination**
- (b) Appeal or Review**
- (c) Enforcement**

- 6. Banks and Arbitration -
Specific Product Development**
 - (1) Financial Transactions**
 - (a) Documentary Credits**
 - (b) Guarantees**
 - (c) Debt Rescheduling
and Public Sector Lending**
 - (2) Recovery Issues**
 - (a) Act of State Defences**
 - (b) Exchange Controls**
 - (c) Sovereign States**
 - (3) Securities**
 - (a) Broker Misbehaviour**
 - (b) Punitive Damages**
 - (c) Time Bars**

SLIDE 7

7. Conclusions

- (1) All legal systems have developed formal claims determination and enforcement procedures but all suffer number inherent deficiencies**
- (2) Separate more consensual or party controlled resolution mechanisms have accordingly been established to correct limits formal processes**
- (3) In terms of bank recovery, they have always had number specific rights and remedies at law to allow protect claims which supplement through carefully constructed contractual provision**
- (4) In event formal recovery required, banks have traditionally preferred litigation to arbitration or any other mechanism due to perceived certainty, finality and enforcement and custom and habit**
- (5) As range activities develop, however, banks necessary look at alternative mechanisms to ensure rights most fully protected especially in relation to complex international or monetary claims or where cross-border recovery otherwise threatened.**

DISPUTE RESOLUTION OPTIONS

[DRAFT]

(Apparent) Basic
Advantages/Disadvantages

(1)	<u>Litigation</u>	(2)	<u>Arbitration</u>	<u>Dr G A Walker</u>
	(a) <u>Certainty</u>	(a)	<u>Confidentiality</u>	
	(b) <u>Finality</u>	(b)	<u>Cost</u>	
	(c) <u>Enforceability</u>	(c)	<u>Consensual or Co-operative Recovery (Supposedly)</u>	

Note - Most Litigation Settles Before Final Hearing

(1) Pre-Hearing Functions

(a) Forum Selection

(i) Compulsory/Voluntary Submission

(ii) Location

(iii) Expertise and Perceived Bias/Predictability

(b) Choice of Law

(c) Choice of Jurisdiction

(2) Hearing Functions

(a) Confidentiality

(b) Costs

(c) Procedural Delays

(d) Party Representation and Involvement

(e) Procedural Formality/Informality (Adversarial/Inquisitorial Nature)

(3) Post-Hearing Functions

(a) Finality of Determination

(b) Appeal or Review

(c) Enforcement Options (i) Domestic

(ii) International

LITIGATION

Compulsory

Choice of Law Rules

Uncontrolled/Assumed

By Agreement and Choice of Law Rules

Choice of Law Rules

No Control (Subject Certain Exceptions)

Minimum apart Legal Fees

Limited apart Formal Hearing Dates

Controlled and Restricted/Prohibited

Adversarial

Final (Subject Appeal Point of Law)

Normal

Full Range Mechanisms Available

Depend Relevant Recognition and Enforcement of Judgment Convention

ARBITRATION

Voluntary but Agreements to Arbitrate Generally Enforceable (Stay of Proceedings)

By Agreement or Institutional Choice

By Agreement/Depend Arbitral Selection

No Restriction (Subject Occasional Restraint)

No Restriction (Subject Occasional Restraint)

Confidentiality Generally Protected (Subject Recent International Debate)

High especially if Three Party Tribunal

Depend Circumstances (Possibly Significant)

Uncontrolled and Generous

Adversarial and/or Inquisitorial

Generally Final under Domestic Laws (Subject Appeal Point of Law unless Excluded)

Generally Restricted under Domestic Laws

Generally Fully Enforceable under Domestic Laws

High Degree Cross-Border Enforcement especially under New York Convention

Mediation and Direct Negotiations in International Financial Conflicts

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MEDIATION AND DIRECT NEGOTIATION IN INTERNATIONAL FINANCIAL DISPUTES

by

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ABSTRACT

Four basic dispute resolution processes are available to resolve international business and financial conflicts: 1) direct negotiations between the parties; 2) mediation, by which a third party assists the disputants to resolve their conflict; 3) arbitration, by which the disputants agree to submit their dispute to a third party for a decision; and 4) adjudication in some type of court. In negotiation and mediation, the parties maintain control over their dispute, and its resolution is dependant on their joint decision. In arbitration and adjudication, the disputants have lost control of their dispute to a third party, who now has the power of decision to settle the conflict. Lawyers, legal scholars, and financial executives have tended to view arbitration and adjudication as the principal ways of resolving international business and financial disputes. These two dispute resolution processes, however, suffer from several disadvantages in that they are costly, time consuming, destructive of business relationships and, in some cases, lacking in finality. Accordingly, given the ever-present potential for conflict in any international transactions, the parties to international transactions, particularly long-term transactions, should consider the role of direct negotiations and mediation in resolving eventual disputes and might even build these processes into their transaction from the very beginning.

Direct Negotiations. Although lawyers like to believe that the „deal is done“ and that negotiations end when the contract is signed, in reality negotiations between the parties continue throughout the life of the transaction. Rather than to view an international transaction as frozen at the time the contract is signed, it is more realistic to coceive of an international business transaction as a continuing negotiation. In particular, negotiations occur at three stages in the life of an international transaction: 1) the deal-making stage; 2) the deal-managing stage; and 3) the deal-breakdown stage. Participants in international financial transactions need to recognize these facts and develop mechanisms to deal with them.

Although hard evidence on the subject is lacking, anecdotal evidence suggest that contractual instability is more prevalent in international transactions than in the purely domestic setting. This is because of the special factors present in the international setting, including the instability of the international environment itself, the less sure or more costly mechanisms for enforcing transactions in the international setting, the presence of foreign governments as participants in international transaction, and the different meanings that the world's diverse legal systems and cultures give to the nature of contracts and the reason justifying their avoidance.

International business transactions are constantly subject to changes in circumstances which can increase or decrease costs for one of the parties. As a general rule, when changes in circumstances mean that the cost of respecting the contract for one of the parties is greater

than the cost of abandoning it, the result is usually rejection of the contract or a demand for its renegotiation. When this occurs, the conflict is most often solved through negotiation, rather than arbitration or adjudication. Participants in international financial transactions should recognize this fact and be prepared to renegotiate in as advantageous a way as possible. Various approaches to renegotiation are possible. A first approach is to be sure that the deal is good for both sides from the outset. Experience has shown that unbalanced transactions which benefit only one side in the transaction will inevitably result in conflict, demands for renegotiation, and ultimately arbitration or litigation. A second approach is to provide in the transaction for the possibility of renegotiation upon the occurrence of certain specified events like dramatic changes in currency values or commodity prices. A third approach is to negotiate the intervention of a mediator.

Mediation, one may define a mediator as a third person who helps the parties to a dispute negotiate an agreement. Mediators play a variety of roles and use a variety of techniques.

Mediation is an entirely voluntary process, and the parties are free to accept or reject the mediator's suggestions. Sometimes, a mediator actively seeks to create a new relationship between the parties. In other cases a mediator, also called a conciliator, only gives his evaluation of how a court or arbitral panel is likely to decide the matter in dispute. In still other cases, a mediator may merely facilitate a meeting between the two sides.

Like negotiation, mediation may take place at any one of three stages in the life of a financial transaction: 1) the deal-making stage; 2) the deal-managing stage; and 3) the deal-break-down stage. Case examples of mediation in each of these phases drawn from the international entertainment, construction and petroleum industries are examined. Effective international business negotiation requires three things: disputant motivation, mediator opportunity and mediator resources, including skills. While the use of mediators in deal-making is fairly extensive and their use in deal-managing seems to be growing, mediation in deal-break-down situations, is much less frequent. Because of the costs associated with international arbitration and litigation in financial disputes, mediation of varying types offers international financial institutions a possible attractive alternative, an alternative that they should explore at the time they negotiate financial transactions. They might include in transaction contracts from the outset mechanisms such as dispute advisors to help in the problem of deal management, and they might also commit themselves to try mediation or conciliation before they take the usually irrevocable step of submitting their disputes to arbitration.

DIRECT NEGOTIATION AND MEDIATION IN INTERNATIONAL BUSINESS
CONFLICTS

by

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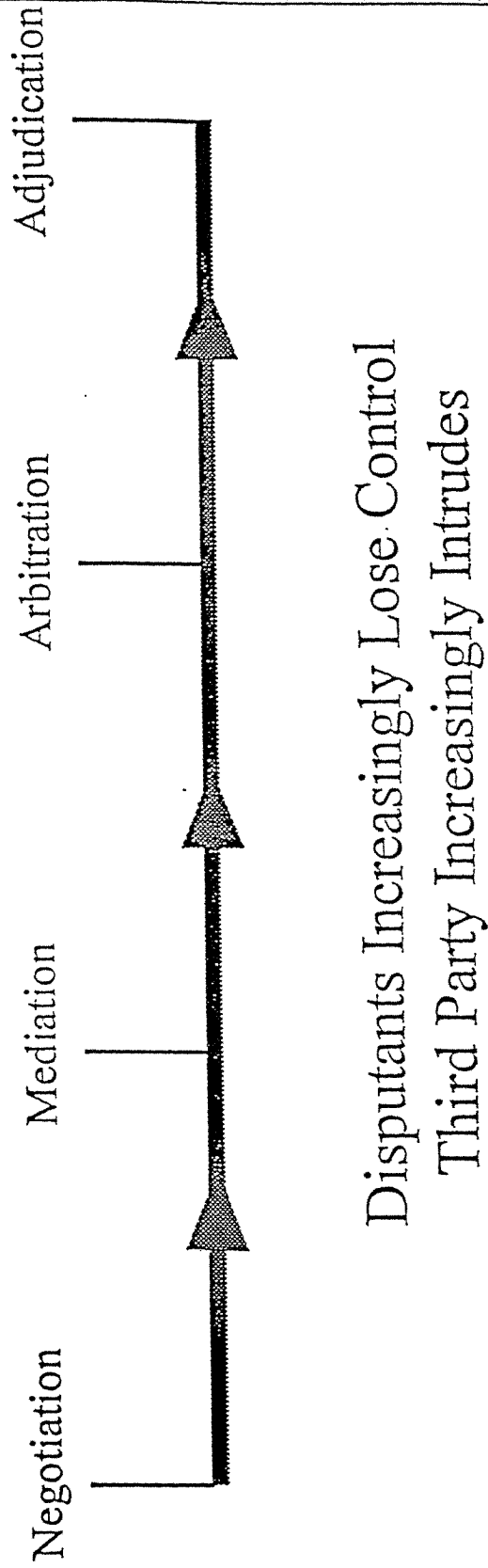
I. CONFLICT IN INTERNATIONAL BUSINESS

A. The Potential For Conflict

The playing field for finance and business has become the globe. National boundaries are no longer business boundaries. The expansion of international business has been accompanied by vastly increased organizational and transactional complexity. Today, international business transactions extend over long periods of time, often many years; create complex legal, financial, and technical relationships; and involve numerous participants, both public and private, from many different countries and cultures. Parties from countries throughout the world are negotiating and carrying out these complex transactions in an environment of diverse cultures, unstable political systems, conflicting ideologies, differing bureaucratic and organizational traditions, inconsistent laws, and constantly

FIGURE 1

Continuum of Dispute Resolution Processes



changing monetary and economic variables.¹ As a result, the potential for conflict in the world of global business and finance is expanding along with the growth in the magnitude, diversity, and complexity of its transactions. It is therefore important for participants in those transactions to think about and plan for the resolution of conflict not only when the dispute occurs but also from the beginning of their dealings together and throughout the life of the transaction.

B. Dispute Settlement Processes

Four basic dispute resolution processes, with numerous variations, are available to resolve international business and financial conflicts: 1) direct negotiations between the parties; 2) mediation, by which a third party assists the disputants to resolve their conflict; 3) arbitration, by which the disputants agree to submit their dispute to a third party for a decision; and 4) adjudication in some type of court. As shown in Figure 1, these four dispute resolution processes form a continuum from negotiation on the one hand to adjudication on the other. As the parties in conflict move along the continuum, they increasingly lose control of their dispute and are increasingly subject to the actions of a third party. In negotiation, the parties maintain complete control over their dispute; its resolution is dependant on their joint decision alone. In mediation, which one may define, as a "voluntary, non-binding process in which a third

¹ See generally JESWALD W. SALACUSE, MAKING GLOBAL DEALS (1991).

persons tries to help the parties reach a negotiated settlement"², the parties still maintain control over their dispute but the very presence a third party changes the dynamic between them and can influence their actions. Arbitration, of course, requires the agreement of the parties who may also shape by agreement the arbitral process. But once the dispute is referred to arbitration, the arbitral panel now controls the dispute and has the power to impose a decision. In adjudication, the jurisdiction and procedure of the court is based on the law, rather than the parties's agreement as is the case in arbitration.

Lawyers, legal scholars, and business executives have tended to view arbitration and adjudication as the principal ways of resolving international business and financial disputes. These two dispute resolution processes, however, suffer from several disadvantages in that they are costly, time consuming, destructive of business relationships and, in some cases, lacking in finality. Accordingly, given the ever-present potential for conflict in any international dealing, the parties to international transactions, particularly long-term arrangements, should consider the role of direct negotiations and mediation in resolving eventual disputes. Moreover, they might even build these dispute settlement processes into their transaction from

² For a similar, but more elaborate, definition of mediation, see JACOB BERCOVITCH AND JEFFREY Z. RUBIN, *MEDIATION IN INTERNATIONAL RELATIONS: MULTIPLE APPROACHES TO CONFLICT MANAGEMENT* 7 (1992).

the very beginning of their dealings together. The paper will therefore explore the application of direct negotiations and mediation to the settlement of international business and financial disputes.

II. DIRECT NEGOTIATION AND RENEGOTIATION

A. The Role of Negotiation in the Life of the Transaction

All international transactions are the product of a negotiation -- the result of deal making -- among the parties. Although lawyers like to think that negotiations end when the participants agree on all the details and sign the contract, this view hardly ever reflects reality. In truth, an international deal is a continuing negotiation between the parties to the transaction as they seek to adjust their relationship to the rapidly changing international environment of civil strife, political upheavals, military interventions, monetary fluctuations, and technological change in which they must work.

No negotiation, particularly in a long term transaction, can predict all eventualities that the parties may encounter, nor can any negotiation achieve perfect understanding between the parties, especially when they come from differing cultures. If they do encounter changes in circumstances, misunderstandings, or problems not contemplated by their contract, the parties need to resort to negotiation, at least in first instance, to handle their difficulties. In short, negotiation is a fundamental tool for managing their deal. And when the parties to a deal become embroiled in genuine conflict -- for example, the failure by one

side to perform in accordance with other side's expectations -- negotiation may be the only realistic tool to resolve the controversy--particularly if the parties want to preserve their business relationship. Thus, negotiation, at least initially, is a means to mend a broken deal. In the life of any international deal, as Figure 2 shows, one may therefore identify three distinct stages when conflict may arise and the parties must rely in first instance on negotiation to achieve their goals: deal making, deal managing, and deal mending. In each phase, as will be seen below, the parties may also have recourse to a mediator to assist them in their negotiations.

B. The Sources of Conflict

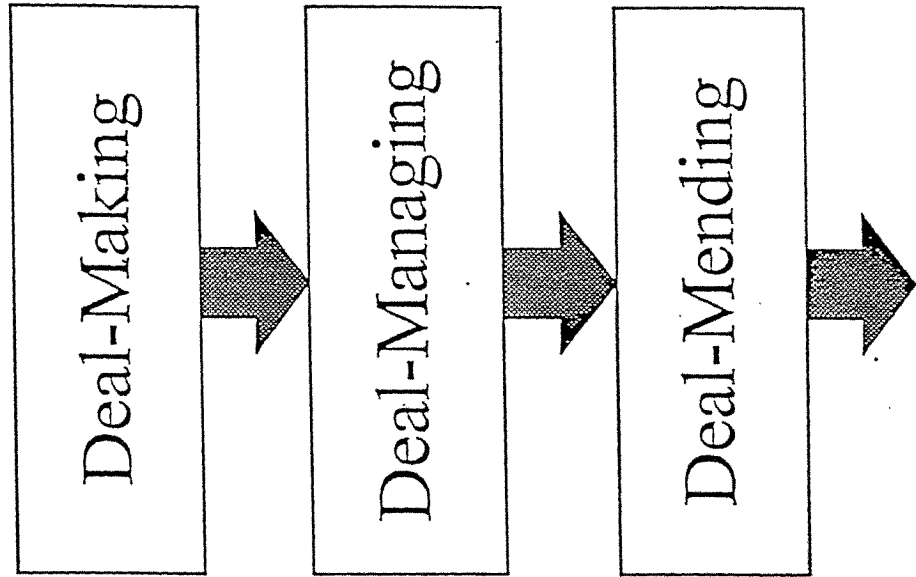
The causes of conflict in international business and financial transactions are numerous, perhaps too numerous to be catalogued. Nonetheless, the effective negotiator who is seeking to create a stable, long-term business relationship with another firm should be aware of potential sources of conflict and should seek to develop mechanisms to cope with them. Among the most important causes of conflict are: 1) changing circumstances and 2) lack of common understanding due to the parties' differing goals, cultures, political systems, ideologies and law.

1. Changing Circumstances

Experienced deal makers know that the challenge of international business and financial negotiations is not just "getting to yes," but also staying there. International financial agreements, solemnly signed and sealed after hard

FIGURE 2

Three Types of Negotiation in the Life of a Deal



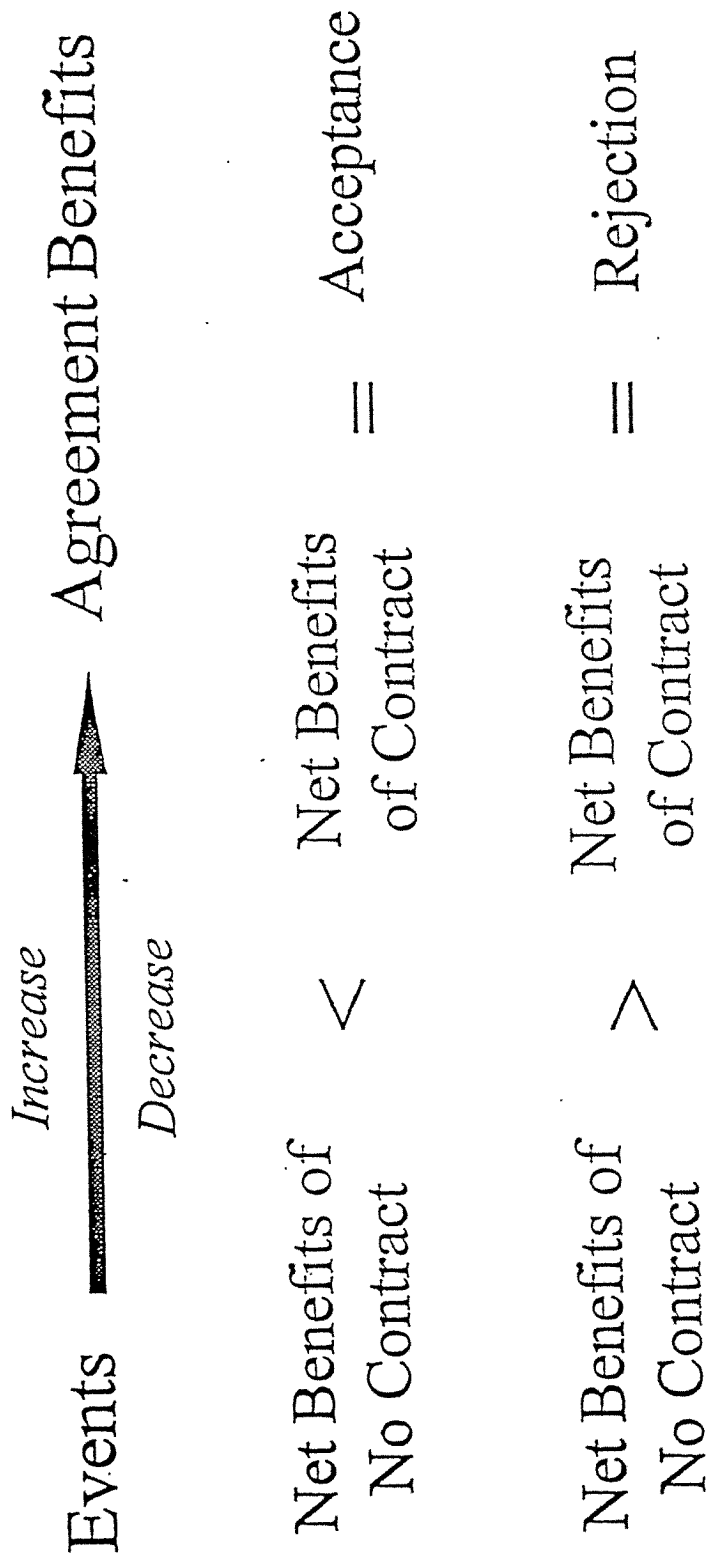
bargaining, often break down because of changes in circumstances affecting the transaction. Changes in circumstances, such as sudden falls in commodity prices or the outbreak of civil war, can either increase or decrease the costs and benefits of the agreement to the parties. As Figure 3 shows, when a change in circumstances means that the cost of respecting a contract for one of the parties is greater than the cost of abandoning it, the result is usually rejection of the deal or a demand for its renegotiation. A traditional theme in international business circles is the lament over the "unstable contract," the profitable agreement for one side that the other side refuses to respect.

Although hard data on the subject is lacking, anecdotal evidence suggests that contractual instability is more prevalent in international business than in the domestic setting. Certainly one can say that international business transactions involve special factors not present in domestic deals and that these factors heighten the risk in contractual instability. First, because the international environment itself is so unstable, international business dealings seem particularly susceptible to sudden changes such as currency devaluations, coups, wars and radical shifts in governments and governmental policies.

Second, mechanisms for enforcing agreements are often less sure or more costly in the international arena than in the domestic setting. If one side in an international transaction

FIGURE 3

The Effect of Changing Circumstances



does not have effective access to the courts or arbitral tribunals to enforce a contract or to seize assets, the other party to a contract that it judges burdensome may feel it has little to lose in rejecting the contract or demanding its renegotiation.

Third, foreign governments are often important participants in international financial transactions. They often reserve to themselves, either explicitly or implicitly, the power to repudiate agreement on grounds of protecting national sovereignty and public welfare.

Finally, the world's diverse cultures and legal systems attach differing meanings and degrees of binding force to a signed contract and recognize varying causes to justify avoidance of onerous contractual burdens.³ For example a Spanish company in a long-term transaction with an Indian firm may view their signed contract as the essence of the deal and the source of the rules governing their relationship in its entirety. The Indian partner, however, may see the deal as a partnership that is subject to reasonable changes over time, a partnership in which one party ought not to take advantage of purely fortuitous circumstances like radical and unexpected movement in exchange rates or the price of raw materials.⁴

³ JESWALD W. SALACUSE, Renegotiations in International Business, 4 NEGOTIATION JOURNAL 347-354 (1988).

⁴ See JESWALD W. SALACUSE, Ten Ways that Culture Affects Negotiating Style, 14 NEGOTIATION JOURNAL 221, 222 (1998), in which the author's survey of over 300 executives and lawyers found that whereas 74% of the Spanish respondents viewed the goal

Other than through the use of force majeure clauses, most contracts implicitly deny the possibility of change and therefore make no provision whatsoever to meet changing circumstance. This assumption of contractual stability has proven false time and again. For example, most mineral development agreements assume they will continue unchanged for period of up to 99 years, yet they rarely remain unmodified for more than a few years.⁵ The traditional approach in international business has been to assume and insist on the stability of international agreements and only grudgingly and bitterly agree to renegotiations in the face of changing circumstances.

2. Lack of Common Understanding Between the Parties

A second major cause for conflict is that the parties, because of their differing cultures, business practices, ideologies, political systems and laws, despite long negotiations and detailed contracts, never really achieve a true common understanding and therefore do not create an adequate basis for a working relationship. One encounters this problem particularly in long-term business and financial arrangements.

Although the parties to alliances, joint ventures and mergers usually announce them with great fanfare at the start, they often become disappointed within a short time and in many

of a negotiation as concluding a contract (instead of creating a relationship), 67% of the Indians claimed that a relationship, rather than a contract, was their negotiating goal.

⁵. DAVID N. SMITH AND LEWIS L. T. WELLS, NEGOTIATING THIRD-WORLD MINERAL AGREEMENTS 18 (1975).

cases terminate them earlier than expected. Various studies have found that between 33% and 70% of international alliances surveyed eventually broke up and that business executives generally consider joint ventures to be notoriously unstable.⁶

Once the contract has been signed and the parties begin to work together numerous conflicts, caused by a lack of common understanding, can arise to threaten the very existence of the transaction. Here are a few examples drawn from experience around the world:

- ▶ A small emerging-market company in a joint venture with a large U.S. multinational corporation feels that it is much weaker than its partner, and is therefore afraid that it will be taken advantage of. Consequently, in all dealings with the U.S. company, it is extremely guarded and slow to reach agreement, an attitude that is hampering the development of the venture.
- ▶ A U.S. firm has created a pharmaceutical company in Russia with a local partner and wants to confine the venture to narrow and specific areas; however, its Russian partner wants to expand into activities unrelated to the U.S. company's competence, like the production of television programs. Disagreement over this question is causing tension in the relationship.
- ▶ A European company and Chinese enterprise have established a

⁶ BENJAMIN GOMES-CASSERES, THE ALLIANCE REVOLUTION 52 (1996).

joint venture that has clear mutual benefits, but both parties are very cautious about sharing information. The Chinese partner withholds information about customer problems with products and requests for new product features. In response, the Europeans have slowed the transfer of technology badly needed by the venture. The two sides are also in conflict over advertising expenses. The Europeans want to spend heavily on advertising while the Chinese oppose these expenditures as unnecessary.

- ▶ A U.S. pharmaceutical firm with a long tradition of strong presidents and top-down management, has acquired a Swedish firm with a management style that entails getting the whole management group's approval before making a big decisions, rather than handing down orders -- alla aer i baten, "getting everybody in the boat," according to the Swedes. The difference in style is causing severe internal conflict and the possible loss of talented managers and scientists.

None of these problems can be solved by contractual provisions alone. None can be settled by invoking arbitration or other dispute settlement clauses. One may argue therefore that these issues are management problems or personnel questions, matters that have nothing to do with law or the lawyer's work in negotiating and structuring international transactions. On the other hand, if the lawyer's fundamental task is to help the client establish the best possible basis for an international

transaction, not just to draft a contract, then these issues should be of concern from the very start of negotiations. Rather than to see his or her basic objective in an international business negotiation as merely securing an advantageous contract for the client, an international lawyer ought also to strive for the goal of negotiating a basis for the client to work productively with a foreign partner and to help the parties find an overriding mutuality of purpose. Had the negotiators in the transactions mentioned above kept that aim in mind, perhaps their clients would have avoided the problems they later encountered -- problems which led to severe conflict and in some cases breakup. Throughout negotiations, international business lawyers must keep asking themselves a basic first question: After the contract, what?

C. Some Negotiation Principles to Reduce Conflict

To negotiate productive working relationships in an international transaction and thereby reduce the potential for conflict, the following are a few principles to bear in mind.

1. A Signed Contract Does Not Necessarily Create an International Business Relationship. In long-term transactions, the parties are seeking to create a business relationship, a complex set of interactions characterized by cooperation and a minimum degree of trust. A relationship implies a connection between the parties. Just as a map is not a country, but only an imperfect description thereof, a contract is not a business relationship. A contract may be a necessary condition for a

business relationship in some, but not all countries; however, it is never a sufficient condition for a business relationship in any country. A business negotiator, while necessarily concerned about contractual provisions, should also be concerned that a solid foundation for a business relationship is in place. Accordingly, a negotiator should also ask a variety of non-legal and non-contractual questions: How well do the parties know one another? What mechanisms are in place to foster communications between the two sides after the contract is signed? Is the deal balanced and advantageous for both sides?

While a contract may seem the essence of a business relationship in North America, other cultures give it less far importance. Indeed, different cultures may tend to view the very purpose of a negotiation differently. For North Americans, the goal of a business negotiation, first and foremost, is usually to arrive at a signed contract between the parties. They consider a signed contract as a definitive set of rights and duties that strictly binds the two sides, an attitude succinctly summed up in the statement "a deal is a deal."

Japanese and other cultural groups in Asia, on the other hand, often consider that the real goal of a negotiation is not a signed contract, but the creation of a relationship between the two sides. Although the written contact expresses the relationship, the essence of the deal is the relationship itself. For Americans, signing a contract is closing a deal; for many Asians signing a contract might more appropriately be called

opening a relationship. This difference in view may explain why Asians tend to give more time to negotiation preliminaries, while Americans want to rush through this first phase in deal making. As will be seen below, negotiation preliminaries, whereby the parties seek to get to know one another thoroughly, are a crucial foundation for a good business relationship. They may seem less important when the goal is merely a contract.⁷

2. Provide For Renegotiation in Appropriate Transactions.

If the risk of change and uncertainty is constant in international business, how should deal makers cope with it? The traditional method is to write detailed contracts that seek to foresee all possible eventualities. Most modern contracts deny the possibility of change. They therefore rarely provide for adjustments to meet changing circumstances. This assumption of contractual stability has proven false time and time again.

As suggested above, rather than to view a long-term transaction as frozen in the detailed provisions of a lengthy contract, it may be more realistic and wiser to think of an international deal as a continuing negotiation between the parties to the transactions as they seek to adjust their relationship to the rapidly changing international environment in which they must work together. Accordingly, another approach to the problem of contractual instability is to provide in the contract that at specified times or on the happening of specified

⁷ See JESWALD W. SALACUSE, Making Deals in Asia, PRIVATE INVESTMENTS ABROAD-- PROBLEMS AND SOLUTIONS IN INTERNATIONAL BUSINESS IN 1995 23-1 (1995).

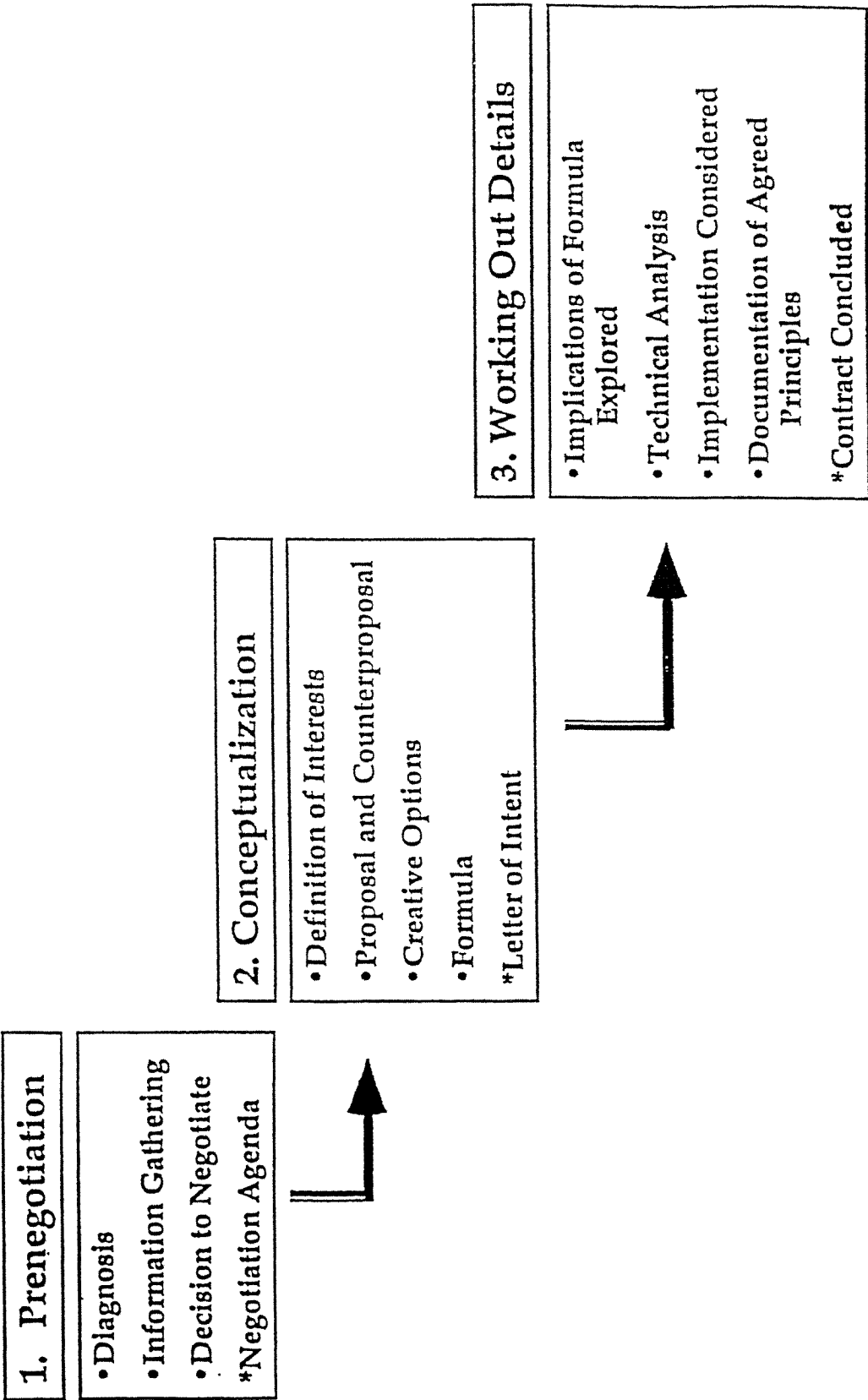
events, the parties may renegotiate or at least review certain of the contract's provisions. In this approach, the parties deal with the problem of renegotiation before, rather than after, they sign their contract. Both sides recognize at the outset that the risk of changed circumstances is high in any long-term relationship and that at sometime in the future either side may seek to renegotiate or adjust the contract accordingly. Rather than dismiss the possibility of renegotiation and then be forced to review of the entire contract at a later time in an atmosphere of hostility between the partners, it may be better to recognize the possibility of renegotiation at the outset and set down a clear framework within which to conduct the process. Although commentators⁸ have urged this approach in long-term business relationships, it is rarely used. Perhaps the new era of global finance and business requires a re-examination of renegotiation provisions.

3. Take Full Advantage of Prenegotiation. The initial phase of any international business negotiation is prenegotiation, a phase in which the parties to a potential deal determine whether they want to negotiate at all and, if they do, what they will negotiate about, and how, when, and where they will go about it. (See Figure 4) This phase is vital if the parties are to know one another well. Prenegotiation may begin in letters, telephone calls, and faxes, even before the parties sit down together, but

⁸ E.g., M. BARTELS, CONTRACTUAL ADAPTATION AND CONFLICT RESOLUTION (1985); W. A. STOEVER, RENEGOTIATIONS IN INTERNATIONAL BUSINESS TRANSACTIONS (1981).

FIGURE 4

Deal-Making Phases



it may continue for many meetings thereafter. The prenegotiation phase is characterized by information gathering and efforts by each of the parties to evaluate the other. It ends when each side make a decision to negotiate a deal with the other, or when one informs the other, directly or indirectly, that it no longer wishes to continue discussions.

As a general rule, North American executives and lawyers generally want to "dispense with the preliminaries" and "to get down to cases". As a result they have a tendency to rush through prenegotiation and to view it as not really important to building a strong deal. Asians tend to devote more time and attention to the prenegotiation phase of deal-making than do Americans. Most Asians view prenegotiation as an essential foundation to any business relationship; consequently they recognize the need to conduct prenegotiation with care before actually making a decision to undertake substantive negotiations of a deal. One of the consequences of this difference in approach is that North Americans sometimes assume that discussions with Asian counterparts have passed from prenegotiation to a subsequent stage when in fact they have not because the Asians have not yet decided to undertake substantive negotiations. This type of misunderstanding can lead to suspicions of bad faith, resulting ultimately in total failure of the talks. It is therefore important to be sure that you and your counterparts are always in the same phase of the deal-making process.

4. Consider a Role for Mediation or Conciliation in the Deal.

A third party can often help the two sides with their negotiations in deal making, deal managing and deal mending. Third parties, whether formally called mediators, conciliators, advisors or something else, can assist in building and preserving business relations and in resolving disputes without resort to arbitration or adjudication. Let us now examine mediation in its various dimensions.

III. MEDIATION IN INTERNATIONAL TRANSACTIONS

If one defines mediation as a process by which a third person assists the parties in their negotiations, there is a role for mediation throughout the life of the transaction-- in deal-making, deal-managing and deal-mending. This section of the paper will look at the application of mediation in each of these phases, drawing on examples and cases from international business.

A. Deal-Making Mediation

The usual model of an international business negotiation is that of representatives of two companies from different countries sitting across a table in face-to-face discussions to shape the terms of a commercial contract. While many transactions take place in that manner, many others require the services of one or more third parties to facilitate the deal-making process. These individuals are not usually referred to as "mediators." They instead carry a variety of other labels: consultant, adviser, agent, broker, investment banker, among others. These deal-making mediators usually have some sort of a contractual

arrangement with one of the parties, and in rare cases both; however, they are not formally employees of either party in the strict sense. Although it could be argued that consultants and advisors should not be considered mediators since they are not independent of the parties, a close examination of their roles in the negotiation of an international business deal reveals that they exercise mediator's functions as defined above in that they assist the parties to change, affect or influence their behavior so as to manage conflicts or potential conflicts arising in the course of a negotiation. Even if a deal-making mediator has a contract with and is paid only by one side, his or her ability to play an effective mediating role is crucially dependent on the willingness of the other side to accept that person as a participant in the deal-making process. Indeed, in most cases, one of the principal assets of deal-making mediators is the fact that they are known and accepted by the other side in the deal.

Deal-Making Mediation in Hollywood

The acquisition in 1991 by Matsushita Electric Industrial Company of Japan, one of the world's largest electronics manufacturers, of MCA, one of the United States' biggest entertainment companies, for over \$6 billion illustrates the use of mediators in the deal-making process.⁹ Matsushita had determined that its future growth was dependent upon obtaining a source of films, television programs, and music,-- what it termed

⁹ For an excellent case study of the MCA-Matsushita negotiations, see C. BUCI, The World of Business -- Leap of Faith, THE NEW YORKER, September 9, 1991, pp. 38-74.

"software",-- to complement its consumer electronic "hardware " products. Matsushita knew that it could find such a source of software within the U.S. entertainment industry, but it also recognized that it was virtually ignorant of that industry and its practices. "For Matsushita executives, embarking on their Hollywood expedition may have felt almost interplanetary. They were setting out for a place that was ... foreign to their temperament, culture, and business experience..."¹⁰ They therefore engaged Michael Ovitz, the founder and head of Creative Artists Agency, one of the most powerful talent agencies in Hollywood, to guide them on their journey.

After forming a team to assist in the task, Ovitz, a man who was fascinated by Asian cultures and who had been a consultant to Sony when it had purchased Columbia Pictures, first extensively briefed the Japanese over several months, sometimes in secret meetings in Hawaii, on the nature of the U.S. entertainment industry, and he then proceeded to propose three possible candidates for acquisition, one of which was MCA. Ultimately, Matsushita chose MCA, but it was Ovitz, not Matsushita executives, who initiated conversations with the MCA leadership, men whom Ovitz knew well. Indeed, Ovitz assumed the task of actually conducting the negotiations for Matsushita. At one point in the discussions, he moved constantly between the Japanese team of executives in one suite of offices in New York City and the MCA team in another building, a process which one

¹⁰ Id., at 39-40.

observer described as "shuttle diplomacy," a clear reference to the mediating efforts of Henry Kissinger in the disengagement talks between the Israelis and the Arabs following the 1973 October War. Although Matsushita may have considered Ovitz to be their agent in the talks, Ovitz seems to have considered himself to be both a representative of Matsushita and a mediator between the two sides.

Because of the vast cultural and temperamental differences between the Japanese and American companies, Ovitz's strategy was to limit the actual interactions of the two parties to a bare minimum. During the first six weeks of negotiations, the Japanese and Americans met only once in a face-to-face meeting. All other interactions took place through Ovitz. He felt that to bring the parties together too soon would create obstacles that would inevitably derail the deal. He was not only concerned by the vast differences in culture between the two companies but also by the greatly differing personalities in their top managements. The Japanese executives, reserved and somewhat self-effacing, placed a high value on the appearance if not the reality of modesty, while MCA 's president was an extremely assertive and volatile personality. Like any mediator, Ovitz's own interests may also have influenced his choice of strategy. His status in the entertainment industry would only be heightened by making a giant new entrant into Hollywood dependent on him and by the public image that he had been the key to arranging one of the biggest deals in the industry's history. It should also be

noted that Ovitz's primary interest was in making the deal happen, and only secondarily in creating a foundation that would result in a profitable long term acquisition for Matsushita.

Although Ovitz launched the deal-making process and moved it a significant distance, he was not able to bring it to completion alone. Eventually the talks stalled over the issue of price, and meetings between the two sides ceased. At this point, a second deal-making mediator entered the scene to make a crucial contribution. At the start of the negotiation, Matsushita and Sony together had engaged Robert Strauss, a politically powerful Washington lawyer who had been at various times U.S. Ambassador to the Soviet Union and U.S. Trade Representative, as "counsellor to the transaction." Strauss, a member of the MCA board of directors and a close friend of its chairman, was also friendly with the Matsushita leadership and did legal and lobbying work in Washington for the Japanese company. In effect, his strong personal and business relationships with the two sides led them to appoint him to represent them both. Although his letter of appointment merely stated that Strauss was to "co-ordinate certain government relations matters," and even excluded his participation in the negotiations themselves, it appears that both MCA and Matsushita felt that he might be useful in other, unspecified ways.

When the talks stalled on the question of price, Strauss' close relationship to the two sides allowed him to act as a trusted conduit of communication who facilitated a meeting

between the top MCA and Matsushita executives that ultimately resulted in an agreement on what Masushita would have to pay to acquire the American company. In arranging that meeting over some fifteen hours, he apparently gained an understanding of the pricing parameters acceptable to each side and then communicated them to the other party. The Japanese, at that point, apparently had greater trust in Strauss, particularly because of his former role as high U.S. government official, concerning the delicate issue of price than they did in Ovitz, who they sensed had a dominant interest in simply getting the deal done, regardless of the price the Japanese would have to pay for it.¹¹ In the end, as a result of that meeting, the two sides reached an agreement by which Matsushita acquired MCA.

The Matsushita-MCA case shows clearly how two mediators facilitated the deal making process, a deal that the parties probably would not have achieved by themselves. The factors that allowed Ovitz and Strauss to play successful roles were their knowledge of the two parties and their industries, their personal relationships with the leadership of the two sides, their respective reputations, the trust that they engendered, and their skills and experience as negotiators. On the other hand, although Matsushita did succeed in purchasing MCA, the acquisition proved to be troubling and ultimately a disastrous financial loss for the Japanese company. One may ask whether Ovitz' strategy of keeping the two sides apart during

¹¹ Id., at 66.

negotiations so that they did not come to know one another contributed to this unfortunate result. It prevented the two sides from truly understanding the vast gulf which separated them and therefore from realizing the enormity -- and perhaps impossibility -- of the task of merging two such different organizations into a single coordinated and profitable enterprise.

Other Deal-Making Mediators

An opposite mediating approach from that employed by Ovitz is the use of consultants to begin building a relationship between the parties before they have signed a contract and indeed before they have actually begun negotiations. When some companies contemplate long-term relationships, such as a strategic alliance, which will require a high degree of cooperation, they may hire a consultant to develop and guide a program of relationship building, which might include joint workshops, get-acquainted sessions, and retreats, all of which take place before the parties actually sit down to negotiate the terms of their contract. The consultant will facilitate and perhaps chair these meetings, conduct discussions of the negotiating process, make the parties recognize potential pitfalls, and discuss with them ways to avoid possible problems. Once negotiations start, the consultant may continue to observe the process and be ready to intervene when the deal-making

process encounters difficulties.¹²

Not all mediators in an international business negotiation have the reputation and prestige of a Robert Strauss or a Michael Ovitz or receive specific authorization to engage in relationship building. Sometimes persons involved in the negotiation because of their technical expertise or specialized knowledge may assume a mediating function and thus help the parties reach agreement. For example, while language interpreters ordinarily have a limited role, they may facilitate understanding by explaining cultural practices that seem to complicate discussions or by finding linguistic formulas that lead to agreement, formulas that the parties would not be able to arrive at on their own. Similarly local lawyers or accountants engaged by a foreign party to advise on law or accounting practices in connection with international negotiation may assume a mediating role in the deal making process by serving as a conduit between the parties, by suggesting approaches that meet the other side's cultural practices, by explaining why one party is behaving in a particular way, and by proposing solutions that are likely to gain agreement from the other side.

B. Deal-Managing Mediation

Once the deal has been signed, consultants, lawyers, and advisers may continue their association with one or both parties and informally assist as mediators in managing conflict that may

¹² C. BUHRING-UHLE, ARBITRATION AND MEDIATION IN INTERNATIONAL BUSINESS 318-319 (1996).

arise in the execution of the transaction. In some cases, the parties to a complex or long-term transaction, seeking to minimize the risk of conflict, may include specific provisions in their contract stipulating a process to manage conflict and prevent it from causing a total break down of the deal. For example, the contract may provide that if a conflict cannot be settled at the operational level, senior management of the two sides will engage in negotiations to resolve it. Generally, top management, not directly embroiled in the conflict and with a broad view of the transaction and its relationship to the company's overall strategy, may be in a better position to resolve a dispute than persons at the operating level, who have come to feel that they have a personal stake in "winning" the dispute. Once top management of the two sides have reached an understanding, they may have to serve as mediators with their subordinates to get them to change behavior and attitudes with respect to interactions at the operational level.¹³

Deal-Managing Mediation in the Construction Industry

The international construction industry has developed an important form of deal-managing mediation that employs a designated third person, such as a consulting engineer, to resolve disputes that may arise in the course of a major construction project, such as a dam or a power plant. International construction projects typically include many parties, involve highly technical complexities, and take a long

¹³ Id. at 317.

time to complete. The possibilities for conflict among the participants are virtually endless, yet it is essential for all concerned that disputes among the parties not impede the progress of the project. The construction contract will therefore usually designate a consulting engineer, review board, permanent referee, or dispute advisor, with varying powers, to handle disputes as they arise in a way that will allow the construction work to continue. Sometimes, as in the case of a consulting engineer, the third person will have the power to make a decision, which may later be challenged in arbitration or the courts; sometimes as in the case of dispute advisor the third person plays the role of a mediator, by engaging in fact finding or facilitating communication among the disputants.

One particular type of mediator worthy of note is the Dispute Review Board, which was used in the construction of both the Channel Tunnel between England and France and the new Hong Kong Airport and is now required by the World Bank in any Bank-financed construction project having a cost of more than \$50 million.¹⁴ Under this procedure, a board, consisting of three members, is created at the start of the project. One member of the board is appointed by the project owner and a second by the lead contractor. The third member is then selected either by the other two members or by mutual agreement between the owner and the contractor. The Board functions according to rules set down

¹⁴ NAEL G. BUNNI, Major Project Dispute Review Board 1 IN-HOUSE COUNSEL INTERNATIONAL 13, 14 (June-July 1997).

in the construction contract. Generally, it is empowered to examine all disputes and to make recommendations to the parties concerning settlement. If the parties to a dispute do not object to a recommendation, it becomes binding. If, however, they are dissatisfied, they may proceed to arbitration, litigation or other form of mandatory dispute settlement.

Deal-managing mediators in the international construction industry approach their task with advantages that mediators in other domains usually lack. First, the parties designate them at the time they sign their contract and before any specific conflict arises. Thus, the mediators have a clearly defined role, and their acceptance by the parties is assured. They approach their task with a high degree of legitimacy. Second, they are intimately familiar with the transaction from its very start and are in continuing contact with the parties through meetings and visits to the construction site. Third, they have recognized technical expertise which is applicable to most disputes that may arise in the course of the project.

The use of such dispute review boards or dispute advisors in construction contracts has proved to be a cost-effective means of settling disputes while permitting a continuation of the construction project in an expeditious manner. This mechanism would seem to have application in other areas of international business. For example, in a complex multi-party strategic alliance, the participants might designate a person or organization to serve as a permanent mediator to assist the

parties to manage conflicts that may arise in the course of their business relationship. Thus far, however, this device does not appear to have reached much beyond the construction industry.

C. Deal-Mending Mediation

The parties to an international business relationship may encounter a wide variety of conflicts that seem irreconcilable. A host government may expropriate a foreign investor's factory. A poor developing country may stop paying its loan to a foreign bank. Partners in an international joint venture may disagree violently over the use of accumulated profits and therefore plunge their enterprise into a state of paralysis. Here then would seem ideal situations in which mediation by a third party could help in settling conflict. In fact, mediation is relatively uncommon once severe international business conflicts break out. To understand why, one must first understand the basic structure of international business dispute settlement.

International Commercial Arbitration

The dispute resolution mechanism of choice in most international business transactions is international commercial arbitration. The parties invoke arbitration in much the same circumstances that in a domestic deal they would invoke litigation: when they judge the deal to be broken. International commercial arbitration is much like litigation in that it is expensive, adversarial, and in most cases lengthy. It usually results in a dissolution of the business relationship, not in its reconstruction.

Most international business contracts today provide that any disputes that may arise in the future between the parties are to be resolved by international commercial arbitration. The parties choose this option for a variety of reasons: to avoid the vagaries of national courts, to secure a neutral and expert forum for their disputes, to conduct dispute resolution in private, and to have legal assurance that arbitral awards will be enforceable. International arbitration is of two types: ad hoc, which is basically administered by the parties themselves according to an agreed upon set of rules, or institutional, which is administered by an established institution such as the International Chamber of Commerce, the London Court of Arbitration, the American Arbitration Association, the Stockholm Chamber of Commerce, or the International Centre for Settlement of Investment Disputes, an affiliate of the World Bank.

The parties by agreement are free to shape the arbitral process as they wish. Normally, most opt for a three-person arbitral panel consisting of an arbitrator appointed by each of the disputants, and the third, the panel's chairman, selected by the two arbitrators. By virtue of the Convention on the Recognition and Enforcement of Arbitral Awards, now signed by over a hundred countries, both arbitration agreements and arbitral awards are enforceable throughout most of the world.

At the outset, one should emphasize the differences between arbitration and mediation as separate and distinct processes. International commercial arbitration is a legalistic, adversarial

process whose purpose is to decide on the respective rights and obligations of the parties to the dispute, not to help them change their attitudes and behavior to resolve their conflict while maintaining their business relationship. Essentially it is private litigation. The failure of arbitrators to decide a dispute according to the applicable law is grounds for a court to invalidate an arbitral award.

Thus in the background of virtually all international business disputes is the prospect of binding arbitration (or adjudication) if the parties, alone or with the help of a third person, are unable to resolve the conflict themselves. This factor influences the ways in which the parties deal with their dispute and it also affects the strategy of any mediator who may be invited to help the disputants settle their conflict. In this regard, international business disputes are unlike virtually all international political disputes between states where no such adjudicative process is waiting in the wings to impose a binding decision. As result, when parties to an international business transaction find themselves embroiled in a dispute which they judge to be irreconcilable, they will invariably commence arbitration to settle the matter.

Arbitrating a dispute is not, however, a painless, inexpensive, quick solution. Like litigation in the courts, it is costly, may take years to conclude, and invariably results in a final rupture of the parties' business relationship. Even when an arbitral tribunal makes an award in favor of one of the

parties, the losing side may then proceed to challenge it in the courts, thus delaying or even preventing a final resolution of the dispute. For example, one arbitration between Egypt and foreign investors took five years in its first phase and resulted in legal and administrative costs of nearly \$1.5 million dollars.¹⁵ But thereafter, the arbitral award was appealed in the courts and the case was rearbitrated in another forum. The parties finally settled the matter through negotiation fourteen years after the dispute began.

The prospect of such a costly, lengthy and potentially destructive process does encourage the two sides in many cases to negotiate a settlement of their dispute. For example, approximately two-third of all arbitration cases filed with the International Chamber of Commerce Court of Arbitration are settled by negotiation before an arbitral award is made.¹⁶ Third persons, whether called mediators or otherwise, could in theory help parties embroiled an international business dispute settle their conflicts without the intervention of an arbitrator's decision.

Initially, one may ask whether the arbitrators themselves

¹⁵ INTERNATIONAL CHAMBER OF COMMERCE COURT OF ARBITRATION, Award in the Arbitration of S.P.P. (Middle East) Limited, Southern Pacific Properties Limited, and the Arab Republic of Egypt, the Egyptian General Company for Tourism and Hotels (March 11, 1983), 22 INTERNATIONAL LEGAL MATERIALS 752 (1983).

¹⁶ ERIC SCHWARTZ, International Conciliation and the ICC, 10 ICSID REVIEW 98, 99 (1995).

can and should seek to facilitate a negotiated settlement of the dispute. In short, should arbitrators, in appropriate cases, seek to act as mediators. On this question, practice seems to vary considerably among countries. Generally, Americans and some Europeans consider it improper for an arbitrator to facilitate a settlement of the dispute. In their view, an arbitrator should do no more than to suggest the possibility of settlement but should not actively engage in mediating efforts. In other cultures, for example China and Germany, arbitrators often take a more active role by proposing at the parties' request possible formula for settlement, by participating in settlement negotiations, and even meeting separately with the parties with their consent. In Asian cultures, which have a particular aversion to confrontation, arbitrators are even more energetic than their European and American counterparts in seeking to facilitate agreement among the disputants rather than merely imposing a decision.¹⁷

Generally speaking, an arbitrator's efforts, however minimal to facilitate settlement, tend to have the effect of persuading the parties that if they allow the dispute to be arbitrated they will not achieve all that they hope. Such mediating efforts by arbitrators have a predictive effect. When arbitrators strongly encourage settlement, they are actually saying to the claimant company that it probably will not receive all that it claims, and

¹⁷ C. BUHRING-UHLE, ARBITRATION AND MEDIATION IN INTERNATIONAL BUSINESS 127-217 (1996).

they are also telling the respondent that if the case goes to an award it will have to pay something. The strategy of arbitrators who seek to play a mediating role is to give the parties a realistic evaluation of what they will receive or be required to pay in any final arbitration award.

Mediation in International Business Disputes

Traditionally, companies engaged in an international business dispute have not actively sought the help of mediators. They first try to resolve the matter themselves through negotiation, but when they judge that to have failed, they immediately proceed to arbitration. Various factors explain their failure to try mediation: their lack of knowledge about mediation and the availability of mediation services, the fact that companies tend to give control of their disputes to lawyers whose professional inclination is to litigate, and the belief that mediation is merely a stalling tactic that only delays the inevitability of an arbitration proceeding.

With increasing recognition of the disadvantages of arbitration, some companies are beginning to turn to more explicit forms of mediation to resolve business disputes. Increasingly, when a dispute can be quantified, for example the extent of damage to an asset by a partner's action or the amount of a royalty fee owed to a licensor, the parties may engage an independent third party such as an international accounting or consulting firm to examine the matter and give an opinion. The opinion is not binding on the parties but it has the effect of

allowing them to make a more realistic prediction of what may happen in an arbitration proceeding.

Conciliation

One type of deal-mending mediation used occasionally in international business is conciliation. Many arbitration institutions, such as the International Chamber of Commerce and the International Centre for Settlement of Investment Disputes, offer a service known as conciliation, which is normally governed by a set of rules.¹⁸ The United Nations Commission on International Trade Law has also prepared a set of conciliation rules which parties may use without reference to an institution.¹⁹

Generally, in institutional conciliation, a party to a dispute may address a request for conciliation to the institution. If the institution concerned secures the agreement of the other disputant, it will appoint a conciliator. While the conciliator has broad discretion to conduct the process, in practice he or she will invite both sides to state their views of the dispute and will then make a report proposing an appropriate settlement. The parties may reject the report and proceed to arbitration, or they may accept it. In many cases,

¹⁸ E.g., ICC, RULES OF OPTIONAL CONCILIATION (1995).

¹⁹ UNCITRAL, Conciliation Rules. See DORE, Peaceful Settlement of International Trade Disputes: Analysis of the Scope of Application of the UNCITRAL Conciliation Rules, 21 COLUMBIA JOURNAL OF TRANSNATIONAL LAW 339 (1983); EISEMANN, Conciliation as a Means of Settlement of International Business Disputes: The UNCITRAL Rules as Compared With the ICC System, in THE ART OF ARBITRATION (Schultsz & van den Berg eds. 1982).

they will use it as a basis for a negotiated settlement. Conciliation is thus a kind of non-binding arbitration. Its function is predictive. It tends to be rights-based in its approach, affording the parties a third person's evaluation of their respective rights and obligations. Conciliators do not usually adopt a problem-solving or relationship-building approach to resolving the dispute between the parties. The process is confidential and completely voluntary. Either party may withdraw from conciliation at any time.

Deal-Mending Mediation in Trinidad

Since conciliation is confidential, public information on the process itself is scant. One of the few published accounts concerns the first conciliation conducted under the auspices of the International Centre for Settlement of Investment Disputes (ICSID).²⁰ ICSID, an affiliate of the World Bank created by treaty²¹ in 1964, provides arbitration and conciliation services to facilitate the settlement of investment disputes between host countries and foreign investors. One such dispute, between Tesoro Petroleum Corporation and the government of Trinidad and Tobago, arose out of a joint venture which the two sides established in 1968, each with a 50% interest, to

²⁰ L. NURICK AND S.J. SCHNABLY, The First ICSID Conciliation: Tesoro Petroleum Corporation v. Trinidad and Tobago, 1 ICSID REVIEW 340-53 (1986).

²¹ Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, done at Washington, March 18, 1965, [1965] 17 U.S.T. 1270, T.I.A.S. no. 6090, 575 U.N.T.S. 159. As of 1998, 144 states had signed the Convention and 129 had ratified it. ICSID, 1998 ANNUAL REPORT 4 (1998).

develop and manage oil fields in Trinidad. By their joint venture contact and subsequent agreements, the two partners developed a complex arrangement on the extent to which profits would be paid as dividends or reinvested to develop additional oil properties. Their joint venture agreement also provided that in the event of a dispute the parties would first attempt conciliation under ICSID auspices, but if the dispute was not settled within six months from the date of the conciliation report, either party could then commence ICSID arbitration.

By 1983, following the rise of oil prices and continued turbulence in world petroleum industry, Tesoro and the Government of Trinidad and Tobago were embroiled in a conflict over whether and to what extent to use accumulated profits for payment of dividends to themselves or for reinvestment to develop new oil properties. Finally, Tesoro decided to sell its shares and pursuant to their agreement offered them first to the Trinidad and Tobago government. The two parties then began to negotiate a possible sale, but appeared to make little progress. In August 1983, Tesoro filed a request for conciliation with the ICSID Secretary-General, claiming that it was entitled to 50% of the profits as dividends and that the government had breached the joint venture agreement on dividend payments.

The ICSID rules, recognizing the importance of a conciliator in whom the parties have confidence, gives the parties wide scope in the conciliator's appointment. The rules allow them to choose anyone, provided he or she is "of high moral character and

recognized competence in the fields of law, commerce, industry, or finance, who may be relied upon to exercise independent judgment." Tesoro and the Trinidad and Tobago government agreed to a single conciliator (instead of a commission of three or more conciliators as the Rules allow) and through direct negotiations chose Lord Wilberforce, a distinguished retired English judge, in December 1983 to serve as their conciliator.

Lord Wilberforce held a first meeting of the parties in March 1984 in London, where they agreed upon basic procedural matters, including a schedule for the filing of memorials and other documents by the parties in support of their positions. The parties proceeded to file their memorials and then met once again with Lord Wilberforce in July 1984 in Washington, D.C. In this meeting, at the conciliator's suggestion, they agreed that no oral hearing or argument by the parties would be necessary, that the parties could submit to Lord Wilberforce their views in confidence on what might constitute an acceptable settlement, and that thereafter Lord Wilberforce would give them his recommendation.

In February 1985, Lord Wilberforce delivered a lengthy written report to the parties, in which he stated that his task as a conciliator had three dimensions: 1. to examine the contentions raised by the parties; 2. to clarify the issues in dispute; and 3. to evaluate the respective merits of the parties' positions and the likelihood of their prevailing in arbitration. Thus, he saw his task as giving the parties a prediction of their

fate in arbitration, with the hope that such prediction would assist them in negotiating a settlement. He concluded his report with a suggested settlement, which included a percentage of the amount sought by Tesoro, based on his estimate of the parties' chances of success in arbitration on the issues in dispute.

Following receipt of the report, Tesoro and the Trinidad and Tobago government began negotiations, and by October 1985 they had reached a settlement by which the joint venture company would pay dividends to the two partners in cash and petroleum products totaling \$143 million. The conciliation thus helped the parties reach an amicable settle of their dispute with minimum cost, delay, and acrimony. The whole conciliation process from start to finish took less than two years to complete, and administrative costs and conciliator fees amounted to less than \$11,000. Equally important, conciliation preserved the business relationship between the parties. After the conciliation, the Trinidad and Tobago Government purchased a small portion of Tesoro's shares so as to gain a majority interest, but Tesoro continued as a partner in the venture. Had the matter proceeded to arbitration, without conciliation, the case would have lasted several years, cost many hundreds of thousands of dollars and perhaps more, and would have resulted in a complete rupture of business relationships between Tesoro and the Government.

Thus far, few disputants in international business avail themselves of conciliation. For example, out of a total of ten cases on the docket of ICSID in 1996, only one was for

conciliation.²² Similarly, from 1988 to 1993, a period in which over 2000 arbitration cases were filed at the International Chamber of Commerce, the ICC received only 54 requests for conciliation. Of that number, the other party in the dispute agreed to conciliation in only 16 cases; however, the ICC appointed only 10 conciliators, since the parties settled the dispute or withdrew the request in six cases. Of the ten conciliations, nine had been completed by 1994, five resulting in complete settlement.²³

IV. CONCLUSION

A. The Required Pre-Conditions For Mediation

The use of mediators in international business is fragmented and uneven. If one defines a mediator broadly as a third person who helps the parties negotiate an agreement, then their use in deal-making is fairly extensive. Their use in deal-managing seems to be growing, particularly in the international construction industry, but in deal-mending, where the parties to a transaction are embroiled in a genuine conflict, the use of mediators is relatively rare. In all three types of negotiations, mediators participate only because the parties have specifically sought them out and invited them into the process. It is extremely rare for persons to volunteer their services as mediators in an international business transactions. In all

²² ICSID, 1996 ANNUAL REPORT 3.

²³ E. SCHWARTZ, International Conciliation and the ICC 10 ICSID REVIEW 98, 107-117 (1995).

cases, mediators in international business are private individuals, rather than organizations, institutions, or governmental officials. Institutions such as the International Chamber of Commerce or the International Centre for Settlement of Investment Disputes only facilitate the search for an appropriate mediator or conciliator. They do not themselves participate in mediation. Once on the job, the mediator works independently of these organizations, is not their representative, and does not operate under their direction.

Like any mediation, effective international business mediation requires three things: 1. disputant motivation, 2. mediator opportunity, and 3. mediator resources, including skills.²⁴

1. Disputant Motivation

No mediation can take place unless the parties to the business conflict want or at least acquiesce in the presence of a mediator. Variations in the degree of disputant motivation in deal-making, deal-managing, and deal-mending may explain the difference in the frequency of use of mediators in these three types of negotiation. Motivated to achieve a deal because of expectations of profit, parties have a strong incentive to use third persons to achieve their deal-making goals and may view the alternatives as the loss of the deal with no compensation.

²⁴ JEFFREY Z. RUBIN, Conclusion: International Mediation in Context in MEDIATION IN INTERNATIONAL RELATIONS: MULTIPLE APPROACHES TO CONFLICT MANAGEMENT 251 (Bercovitch & Rubin, eds., 1992).

Similarly, agreement to use mediators in deal-managing may be a condition for achieving agreement or for securing financing from institutions such as the World Bank; consequently, disputant motivation may also be high in these cases. However, in the case of a broken deal, at least one of the parties will lack motivation so long as it believes that it can obtain compensation or secure enforcement of its version of the deal in the courts or in international commercial arbitration. In short, that party does not see the failure to mend a deal through mediation as an absolute loss. So long as it considers litigation or arbitration as an acceptable alternative to a mediated agreement, it will have little motivation to accept the presence of a mediator. Unfortunately, most of the time, one of the parties to a business dispute does in fact believe that it will gain more in litigation or arbitration than it could through the services of a mediator.

2. Mediator Opportunity

Mediators have an opportunity to mediate international business disputes only if both parties invite them into the process. Parties to international business transactions can enhance mediator opportunity by agreeing at the time they make their contract to use third persons, such as a dispute review board or a conciliator, to help them with future disputes; however, outside of the international construction industry, such provisions are relatively rare. To a certain extent, the low degree of disputant motivation to use mediators in international business disputes is also caused by the general lack of knowledge

by businesses and their lawyers of the potential value of mediation, their presumed difficulty in identifying and agreeing upon an acceptable mediator, and their belief that mediation will be used by one of the parties merely to delay the inevitability of a law suit or arbitration case.

3. Mediator Resources

To be effective, mediators in international business, like mediators in other domains, must possess certain resources, including skills. The essence of their resources resides in their ability to influence the parties to arrive at an agreement. Mediators in international business transactions derive their power to influence the parties from various factors. Unlike some mediators in the political arena, business mediators generally have no coercive power. The basis of their power first and foremost resides in their expertise. The power of Ovitz, Strauss, Wilberforce, and consulting engineers in major construction projects to influence the parties clearly resided in their knowledge about the respective industries and issues and the trust the parties placed in them. In the kind of rights-based mediation engaged in by Wilberforce, where the source of his influence was to give the parties a clear prediction of how they might fare in arbitration, expertise in the law and the functioning of the arbitral process was an important source of mediator power.

Mediators may also have power because of their relationships with the disputants. This referent power is particularly present

in deal-making mediation in international business. Thus, the relationships of Ovitz and Strauss with both sides in the MCA-Matsushita negotiation gave weight to their advice and recommendations to both sides. And finally, international business negotiators may also rely on legitimacy in influencing the parties to a dispute. Wilberforce had legitimacy because the parties specifically selected him to make a recommendation, a Dispute Review Board for a major construction project has legitimacy because the parties created it at the time they signed the construction contract to resolve future disputes, and Strauss had great legitimacy because MCA and Matshushita had designated him in a formal document as "counselor to the transaction."

Mediation and the Future of Global Business

The magnitude, complexity, and duration of international business transactions create substantial and continuing risks of conflict. International commercial arbitration, the primary dispute settlement mechanism designed for international business, has proven itself to be expensive, destructive, time consuming, and in some cases lacking in finality. Mediation of varying types offers international business executives a possible attractive alternative, an alternative that they should explore at the time they negotiate their transactions. They might include in their contracts from the outset mechanisms such as dispute advisors to help in the problem of deal management, and they might also commit themselves to try mediation or conciliation before they take the usually irrevocable step of

submitting their disputes to arbitration.

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NAFTA and Financial Dispute Resolution

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REGIONAL TRENDS RESPECTING NON-JUDICIAL DISPUTE
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**International Commercial Arbitration in Greater China:
Problems and Prospects**

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Publications and Research

A. Books & Book Chapters

Books:

Co-Author along with Philip Smart & Anna Tam, *Hong Kong Company Law: Cases, Materials and Comments*, May 1997, Butterworths Asia, 563 pp. Responsible for Chapters 1 (Introduction), 4 (The General Meeting), 5 (The Board of Directors), 6 (Directors), 7 (Duties & Obligations of Directors), 8 (Insider Dealing) and 15 (Chinese Company Law).

(Editor) *Gender Issues and Curriculum Reform*, Proceedings of a Workshop convened on 4 April 1998 by the Women's Studies Research Centre and the Centre of Asian Studies, University of Hong Kong, August 1998, 52 pp.

Book Chapters:

Stock Market Crises and Insider Dealing in Hong Kong: The Need for Regulatory Reform, 37 pp. Accepted in October 1998 for publication in Hong

INTERNATIONAL COMMERCIAL DISPUTE RESOLUTION IN GREATER CHINA:
THE PROSPECTS AND PROBLEMS FOR INTERNATIONAL
COMMERCIAL ARBITRATION : ONE COUNTRY, THREE SYSTEMS?*

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INTRODUCTION

When sovereignty over the colony of Hong Kong was transferred from the United Kingdom ("UK") to the People's Republic of China (the "PRC") on July 1, 1997², Hong Kong became a Special Administrative Region within the PRC (the "HKSAR")³. On December 20, 1999 the PRC will also resume sovereignty over the Portuguese colony of Macau with the creation of the Macau Special Administrative Region (the "MSAR").⁴ The resumption of sovereignty over Hong Kong (and Macau) by the PRC implements the "one country, two systems" principle⁵, referring to the continuance of the capitalist system in the HKSAR within the socialist system of the PRC.⁶ The

* Portions of the research on which this paper is based were presented by the author at a conference hosted by the Center For International Legal Studies entitled "Lawyering in the International Market" (February 8 - 15, 1999).

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² Pursuant to the terms of the Joint Declaration signed in December 1984 between the Prime Ministers of the UK and the PRC. The text of the 1984 Sino-British Joint Declaration on the Question of Hong Kong was registered at the United Nations by the British and Chinese governments on June 12, 1985. The key principles of the Joint Declaration were subsequently enacted by the National People's Congress of the PRC (the "NPC") on April 4, 1990 in the Basic Law of the Hong Kong Special Administrative Region ("HKSAR"). The full text of the Joint Declaration and Basic Law is set out in Yash Ghai, *Hong Kong's New Constitutional Order: The Resumption of Chinese Sovereignty and the Basic Law* (Hong Kong, Hong Kong University Press, 1997).

³ The constitutional authority for the PRC to establish special administrative regions is Article 31 of the PRC Constitution 1982 which allows for considerable differences in the structures and policies for different special administrative regions.

⁴ Pursuant to the Joint Declaration on the Question of Macau, March 26, 1987 between the governments of Portugal and the PRC. See also the provisions of the Macau Basic Law adopted at the First session of the 8th NPC on March 31, 1993 to take effect in December 1999.

⁵ Article 5 of the Basic Law provides that the socialist system and policies shall not be practiced in Hong Kong and that the previous capitalistic system and way of life shall remain unchanged for 50 years (until June 30, 2047). To reinforce this, Article 8 of the Basic Law provides that "The laws previously in force in Hong Kong, that is, the common law, rules of equity, ordinances, subordinate legislation and customary law shall be maintained, except for any that contravene this [Basic] law, and subject to any amendment by the legislature of the HKSAR".

⁶ The principles of autonomy for HKSAR established in the Basic Law have been resoundingly affirmed by a recent unanimous decision of the HKSAR Court of Final Appeal rendered on January 29, 1999, Ng Ka-ling et al v The Director of Immigration [1999] 1 HKLRD 315 which upheld the notions of the autonomy of Hong Kong, judicial independence and the rule of law. This case concerned a PRC regulation requiring a one-way permit for settlement in Hong Kong which effectively placed the exercise of the right of abode granted in the

basis of the reunification of the PRC with both Hong Kong and Macau – the “one country, two systems” principle – was initially devised by the PRC for reunification with Taiwan, the Republic of China (“Taiwan”). Under this model, Taiwan would become a special administrative region enjoying even more autonomy than the HKSAR and the MSAR (it would keep its own laws and enjoy legislative autonomy, judicial independence and the power of final adjudication).⁷ It was only after Taiwanese expressed resistance to the terms of the proposed reunification that it was decided to apply the principle to Hong Kong and Macau.⁸ The PRC is still committed to the idea of future reunification with Taiwan and there are on-going negotiations concerning various political and economic issues associated with potential reunification and other cross-strait problems. However, cross-strait tensions remain high given the PRC’s launch of missiles across the Taiwan straits in 1996, the PRC’s apparent campaign to isolate Taiwan diplomatically and Taiwan’s emerging role as a creditor to the troubled economies of Southeast Asia.⁹

Since the introduction of its “open-door” economic policy in 1978, the PRC has taken major steps in transforming and modernising its economy and is now steadily progressing towards the creation of a “socialist market economy”.¹⁰ The last twenty years has been a unprecedented period of legal

Basic Law at the discretion of the PRC authorities. In the course of its decision, the Court of Final Appeal held that it has jurisdiction to: (a) review laws passed by the NPC of the PRC which effect the HKSAR; and (b) to refuse to enforce those laws which are inconsistent with the Basic Law. For commentary on this decision and the controversy surrounding the criticism of the judgment by four leading Chinese law professors, see Yash Ghai, Editorial, [1999] 1 HKLRD 360 and Albert Chen, “The Court of Final Appeal’s Ruling in the ‘Illegal Migrant’ Children Case: Congressional Supremacy and Judicial Review”, (March 1999) University of Hong Kong Law Working Paper Series, Paper No. 24.

⁷ See discussion in Yash Ghai, “Hong Kong and Macau in Transition: Exploring the New Political Order” (1995) Vol. 2:3 Democratization 291 – 312 and Jin Huang and A. Xuefeng Qian, “‘One Country, two Systems’ Three Law Families, and Four Legal Regions: The Emerging Inter-Regional Conflicts of Law in China”, (1995) Vol 5, Duke Journal of Comparative and International Law 289, at pp. 301 – 303.

⁸ There have been contentious arguments in Taiwan and elsewhere in response to the PRC’s proposed reunification with Taiwan. The Democratic Progressive Party in Taiwan have placed Taiwanese independence at the top of their political agenda, whereas the current Nationalist Kuomintang Party favors the “one China, one Taiwan and “two China” policies. Not surprisingly, the PRC has strongly criticized these proposals. See discussion in Huang and Xuefang, above note 7, at p 302 and Ghai, above note 7.

⁹ In April 1993 representatives from Taiwan and the PRC met in Singapore leading to a series of negotiations between Taiwan’s Strait’s Exchange Foundation and its PRC counterpart, the Association for Relations Across the Taiwan Strait (“ARATS”). After a meeting in October 1998 between Taiwanese and PRC officials, ARATS officials announced in January 1999 that the PRC would forge ahead with negotiations with Taiwanese officials in an effort to narrow the differences and find solutions to cross-strait problems. See Fong Tak-ho, “Small step on long road to mutual respect”, (October 15, 1998) Hong Kong Standard and Agenesis, “Taiwan ‘can keep democratic style’”, (January 18, 1999) South China Morning Post.

¹⁰ In March 1999 delegates to the NPC approved amendments to the PRC Constitution which will enshrine the

reform in the PRC with new laws introduced in the corporate, commercial and other areas.¹¹ The HKSAR has played an important role in the transformation of the PRC economy, serving as its window to the international financial system.¹² Economic co-operation between the HKSAR and the PRC has steadily increased and the two economies and financial systems are now inextricably linked.¹³ At the same time, Taiwan has emerged as one of the world's most successful "newly industrialized economies" with substantial growth and internationalization of its domestic economy and financial system.¹⁴ As a result of the internationalization of its economy, Taiwan has also emerged as a significant exporter of capital, particularly within the Asia Pacific region.¹⁵ After the HKSAR, Taiwan is the second largest investor in the PRC and Taiwan's investment in the PRC is estimated to exceed US\$35Billion.¹⁶

Both bilateral trade between the PRC and Taiwan and direct Taiwanese investment in the PRC is likely to increase under the appropriate political and economic framework between the two regimes. The potential reunification of Taiwan with the PRC will result in a large regional economy consisting of Taiwan, HKSAR, MSAR, and the southern PRC provinces of Guangdong

Deng Xiaoping Theory to the level of state dogma and upgrade the status of the private sector in the PRC. See M. O'Neill, "Changing laws threaten socialism", (March 10, 1999) South China Morning Post.

¹¹ For example, the Company Law, Criminal Law, Labour Law, Securities Law and the draft Unified Contract Law which is expected to be introduced in 1999.

¹² See Joseph J Norton, "Toward an International Financial Center for Greater China: Hong Kong and Infra-structural Reform", (1998) 28:2 Hong Kong Law Journal 209.

¹³ Certain statistics indicate the degree of this linkage: by the end of 1997 Hong Kong's direct investment in China totaled HK\$800 billion, an amount representing 57 % of total foreign investment in the PRC. During 1996, investments from the PRC in Hong Kong was US\$20.87 billion, out of a total Chinese foreign investment of US\$54.8 billion. See Norton, above note 12, at pp. 212 – 213.

¹⁴ In 1998 the gross national product ("GNP") for Taiwan was US\$262 billion. The Taiwanese Legislative Yuan has passed several important pieces of legislation designed to reform and liberalize its financial system, including the Securities and Exchange Law (1988), the Banking Law (1989), the Insurance Law (1992), the Foreign Futures Trading Law (1992) and the newly enacted Arbitration Law (1998) discussed further below. See B. W. Semkov, *Taiwan's Capital Market Reform: The Financial and Legal Issues* (Oxford, Clarendon Press, 1994) at pp. 5 – 12.

¹⁵ The PRC is estimated to be Taiwan's second largest export market after the USA. See Semkov, above note 14, at p. 2.

¹⁶ Although Taiwanese investment in the PRC in 1998 was reduced due to investors' fear of increasing business risks in the PRC. See Fong Tak-ho, "Taipei may help traders on mainland", (September 28, 1998) Hong Kong Standard, Dennis Engbarth, "Growing Risk and uncertainty set barrier to Taiwanese investment", (January 14, 1999) South China Morning Post and Semkov, above note 14, at p. 4

and Fujian representing a population of over 120 million people with a GNP exceeding US\$400 billion.¹⁷ The HKSAR and Taiwan may become the financial catalyst for an emerging, de facto, "Greater China Economic Community" a significant economic trading bloc within the international economy.¹⁸

It is against the backdrop of this potential reunification of Greater China that the distinctive features of the law and practice of international commercial arbitration within the HKSAR, the PRC and Taiwan are explored. The practical operation and potential problems arising from the "one country, two systems" principle are exemplified by the distinct regimes governing international commercial arbitration in the HKSAR, the PRC and Taiwan. The paper begins by reviewing the development of the legislative framework governing international commercial arbitration in the HKSAR (including the recent 1996-97 amendments), highlights some of the distinctive features of the arbitral regime and considers the recognition and enforcement of arbitral awards prior to and after the resumption of sovereignty by the PRC in July 1997. The dual nature of the PRC arbitral regime is then considered, with particular emphasis on the jurisdiction of the PRC's two main international arbitration institutions – the China International Economic and Trade Arbitration Commission ("CIETAC") and the China Maritime Arbitration Commission ("CMAC"). The provisions of the PRC's national Arbitration Law adopted in 1995 are examined in some detail, along with the recent revisions to the CIETAC Arbitration Rules. The paper then considers the important changes introduced in the newly enacted Taiwanese Arbitration Act 1998, with comparisons drawn to the comparable legislative provisions in the HKSAR and the PRC. The current problems surrounding the continuance of obligations to recognize and enforce arbitration awards in the HKSAR and the PRC since the transfer of sovereignty are then considered. The proposed agreement between the governments of the PRC and HKSAR on mutual judicial assistance in the recognition and enforcement of arbitral awards is discussed by way of conclusion.

INTERNATIONAL COMMERCIAL ARBITRATION IN THE HKSAR

In recent years the HKSAR has emerged as an important forum for international commercial arbitrations in the South East Asia region. Due to the increased volume of international trade and investment with the PRC, arbitration has been increasingly used to resolve commercial, maritime and international trade

¹⁷ See Semkov, above note 14, at p. 4.

¹⁸ See Semkov, above note 14, at p. 6.

disputes between foreign companies and entities in the PRC.¹⁹ The increased use of arbitration is also due in part to the services and expertise provided by the Hong Kong International Arbitration Centre (the "HKIAC") established in 1985, as well as unique arbitration legislation which makes the HKSAR an attractive venue for arbitrations.²⁰ The Model Law on International Commercial Arbitration (the "Model Law"), a uniform law on arbitration procedure drafted by the United Nations Commission on International Trade Law ("UNCITRAL"), was adopted with minor amendments in Hong Kong on April 6, 1990 in an effort to attract more international arbitrations and to make the Hong Kong arbitration law more accessible to international parties.²¹ The HKSAR now has an international arbitral regime that respects the consensual nature of arbitration, upholds the primacy of the arbitral tribunal, endorses the finality of the international arbitration awards and ensures minimal judicial intervention.²²

Arbitration Ordinance

The HKSAR's Arbitration Ordinance creates two separate regimes governing domestic and international arbitrations²³. Domestic arbitrations are governed primarily by Part II of the Ordinance, whereas international arbitrations are governed by Part IIA which incorporates Chapters I - VII of the Model Law.²⁴ Under the Ordinance, an arbitration will be considered "international"²⁵ if:

¹⁹ It has also been adopted by the HKSAR and PRC securities regulators to resolve disputes between foreign investors and cross-border listed mainland companies and their management and shareholders. See discussion of these procedures in Peter Caldwell, "New Arbitration Procedures for China Securities Disputes", (August 1993), *The New Gazette* 32.

²⁰ The HKIAC opened in September, 1985 with funding provided by the private sector and the Hong Kong Government and provides expertise and support for domestic and international arbitrations in the HKSAR. This role was strengthened when the HKIAC signed a cooperation agreement with its Beijing counterpart CIETAC. For further details on the HKIAC, see chapter 12 of N. Kaplan, J. Spruce and T.Y.W. Cheng, *Hong Kong Arbitration: Cases and Materials* (Hong Kong, Butterworths, 1991)

²¹ The Model Law was adopted by UNCITRAL on June 21, 1985 to encourage harmonization of national laws governing arbitrations.

²² For extensive discussion of Hong Kong arbitration cases up to 1991, see Kaplan, Spruce and Cheng, above note 20.

²³ For an in-depth analysis of the provisions of the Arbitration Ordinance, see R. Morgan, *The Arbitration Ordinance of Hong Kong: A Commentary* (Hong Kong, Butterworths, 1997) and N. Kaplan, J. Spruce and M. Moser, *Hong Kong and China Arbitration: Cases and Materials* (Hong Kong, Butterworths Asia, 1994).

²⁴ The Ordinance includes six schedules incorporating the following: the Protocol on Arbitration Clauses, 1923; the Geneva Convention on the Execution of Foreign Arbitral Awards, 1927; the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 1958; a schedule dealing with judge-arbitrators; and the UNCITRAL Model Law on International Commercial Arbitration as of April 6, 1990.

²⁵ See the definition of "international arbitration agreement" in section 2(1), Part I of the Arbitration Ordinance in conjunction with Article 1(3) of the Model Law.

- the parties have their places of business in different states at the time of concluding the arbitration agreement;
- the arbitration place (if determined in, or pursuant to the arbitration agreement) is outside that state in which the parties have their places of business;
- any place where a substantial part of the obligations of the commercial relationship to be performed or the place with which the subject matter of the dispute is most closely connected is outside the state in which the parties have their places of business; or
- the parties have agreed that the subject matter of the arbitration agreement relates to more than one country (although both parties may be resident in the HKSAR)²⁶.

Arbitrations conducted in HKSAR other than international arbitrations are considered to be domestic arbitrations and are governed by Part II of the Ordinance.²⁷ However, both types of arbitration awards (international or domestic), are subject to section 2GG of the Ordinance which provides that an arbitration award is enforceable in the same way as a judgement with the leave of the court.

Prior to the 1996/97 amendments to the Ordinance, the approaches of the two regimes were quite different. Hong Kong's domestic arbitration regime was more conservative in nature being modelled after the UK Arbitration Acts of 1950 and 1979. For example, the powers conferred on arbitrators to conduct the arbitration proceedings were much less than those conferred on international arbitrators under the Model Law. In addition, quite extensive supportive and supervisory powers were vested in the then High Court (now the Court of First Instance). By contrast, the international regime encouraged full party autonomy and finality in arbitrations by granting arbitrators in international arbitrations broad powers to control and conduct arbitrations and minimizing the intervention powers of the HKSAR courts. Coinciding with the transfer of sovereignty, however, substantial amendments to the Ordinance were introduced in 1997 resulting in greater harmonization of the two distinct arbitral regimes in the HKSAR.²⁸

²⁶ For example, in Fung Sang Trading Ltd v Kai Sun Sea Products & Food Co, [1992] 1 HKLR 40, the court held that although both parties were companies registered in Hong Kong, the arbitration was considered "international" and was governed by the Model Law because a substantial part of the disputed contract was to be performed in the PRC.

²⁷ Subject to the "opt in – opt out" provisions in sections 2L and 2M of the Ordinance that allow parties to choose whether to have their arbitration proceedings governed by the UNCITRAL Model Law. See further discussion below.

²⁸ See Arbitration (Amendment) Ordinance 1996 (No. 75 of 1996) and Law Reform (Miscellaneous Proceedings and Minor Amendments) Ordinance 1997 effective June 27, 1997 discussed in more detail below.

The Ordinance does not purport to provide a complete code for the conduct of arbitration and there are no detailed rules of arbitration procedure set out in the Ordinance. Parties to domestic and international arbitrations are free to apply domestic and international arbitration rules produced by the HKIAC or may choose other procedural rules to apply, eg. the International Chamber of Commerce Rules of Conciliation and Arbitration, London Court of International Arbitration Rules or Chartered Institute of Arbitrator Rules.²⁹ In addition, they may create their own ad hoc rules of procedure. The Ordinance is divided into seven constituent parts with six Schedules attached³⁰:

Part I: Preliminary

Contains the interpretative provisions of the Ordinance and most of the definitions apply both the domestic and international arbitrations and to the enforcement of arbitration awards under the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the “New York Convention”).³¹

Part IA: Provisions Applicable to Domestic and International Arbitrations

Contains provision applying to both domestic and international arbitrations held in the HKSAR relating to issues such as powers of arbitration tribunal regarding interim orders, security for costs, dismissal for want of prosecution, interests and costs.

Part II: Domestic Arbitrations

Contains provisions governing domestic arbitrations and largely re-enacts the 1963 version of the Ordinance as amended. This part contains unique “opt in – opt out” provisions in section 2L and 2M allowing the parties in domestic and international arbitrations to “opt in” and “opt out” of the Model Law. Section 2L allows parties to a domestic arbitration to have its proceedings governed by the Model Law. By contrast, section 2M provides that unless the contracting parties decide to “opt out” of the Model Law at the time of drafting the arbitration clause or when a dispute arises, they are bound by the Model Law provisions.

²⁹ The HKIAC has produced its own rules for both domestic and international arbitrations and has published Short Form Arbitration Rules for parties who agree to make use of a short form arbitration procedure. The HKIAC has also adopted the Securities Arbitration Rules effective as of 1 July 1993 for arbitration of securities disputes. See Kaplan, Spruce and Moser, above note 23 at Appendices 3, 6 and 12.

³⁰ For more detailed discussion of the provisions of the Arbitration Ordinance, refer to the following reference texts: Morgan, above note 23, Kaplan, Spruce and Cheng, above note 20 and Kaplan, Spruce and Moser, above note 23.

³¹ 1958, 330 UNTS 38, No 4739 (1959).

Part IIA: International Arbitrations

Applies the Model Law to international arbitrations conducted in HKSAR (see the Fifth Schedule), with the exception of Article 35 (concerning the recognition and enforcement of awards made abroad) and Article 36 (setting out the grounds for refusing the recognition and enforcement of such awards).³² The Sixth Schedule to the Ordinance incorporates the 1985 Commentary on the Draft text of the Model Law, the 1985 UNCITRAL Report and the 1987 Hong Kong Law Reform Commission Report on the Adoption of the UNCITRAL Model Law³³, all of which a court may refer to in interpreting the provisions of the Model Law.³⁴

Part III: Enforcement of Certain Foreign Awards

Contains provisions dealing with the enforcement in the HKSAR of arbitration awards made overseas under legislation enacted prior to the New York Convention – specifically, the Geneva Protocol on Arbitration Clauses (1923) and the Geneva Convention on the Execution of Foreign Arbitral Awards (1927).³⁵

Part IV: Enforcement of New York Convention Awards

Governs the enforcement in the HKSAR of arbitration awards rendered overseas pursuant to the New York Convention (see sections 41 – 46 and the Third Schedule).

Part V: General

Provides that the HKSAR Government is bound by Parts I – IIA of the Ordinance.

Legislative History of the Arbitration Ordinance

The Arbitration Ordinance was first enacted in Hong Kong in 1963 and as with most early legislation enacted in Hong Kong, it was identical in its terms to the 1950 English Arbitration Act.³⁶ Like its English counterpart, the Ordinance contained provisions for extensive judicial review, both during and

³² See Robert Morgan, “The Transition of Sovereignty to the People’s Republic of China and the Arbitration Regime in Hong Kong”, Vol 12: 5, (May 1997), Mealey’s International Arbitration Report.

³³ See Hong Kong Law Reform Commission, *Report on the Adoption of the UNCITRAL Model Law on International Commercial Arbitration*, 1987 (the “1987 Report”).

³⁴ See sections 2(3) and 25 of the Arbitration (Amendment) (No.2) Ordinance, 1989 (“1989 No.2 Ordinance”).

³⁵ See the First and Second Schedules to the Ordinance discussed further below.

³⁶ The Arbitration Act, 1950, 14 Geo., c.27 was a consolidation of various earlier English legislation on arbitration. For a detailed review of the legislative history of Hong Kong’s arbitration legislation, see Kaplan, Spruce and Cheng, above note 20, at pp. xxvii – xxxiii, N. Kaplan, “The History and Development of the Arbitration in Hong Kong”, *Yearbook of International Financial and Economic Law 1996* (London, Kluwer Law International, 2003), and Morgan, above note 23, at pp. 2 – 4.

after arbitration, including the "special case - stated case" procedure under which either party to the arbitration could apply to the arbitrator to state a special case to the High Court for a judicial opinion on some point of law arising in the course of the arbitration.³⁷ Due to such extensive judicial control over the arbitral process, both the UK and Hong Kong were not popular venues for international arbitration. In 1975 the English Arbitration Act was amended to give effect to the 1958 New York Convention which provides a mechanism for direct recognition and enforcement of foreign arbitral awards. Later that same year, Hong Kong amended the Ordinance to enact the New York Convention that the UK acceded to on behalf of Hong Kong on April 21, 1977.

The Ordinance was substantially amended in 1982 and 1989 to achieve a greater balance between finality of arbitral awards and judicial supervision. These amendments followed the recommendations of the Hong Kong Law Reform Commission in its two reports on arbitration law, the 1981 Report on Commercial Arbitration (the "1981 Report")³⁸ and the 1987 Report dealing with the adoption of the UNCITRAL Model Law.³⁹ In recognition of the fact that conciliation is a feature of many trade agreements in Asia, including the PRC, section 2A was added in 1982 providing that: (i) the court may appoint a conciliator where an arbitration agreement provides for appointment of a conciliator but such appointment is not made; and (ii) if an arbitration agreement provides for appointment of a conciliator who is to act as an arbitrator in the event that conciliation fails, no objection can be taken to the appointment of such a person as an arbitrator.⁴⁰ In an effort to reduce and eliminate unnecessary and intentional delay in arbitration proceedings, section 29A was introduced providing that there is an implied term in every arbitration agreement (subject to express contrary intention) that claimants will exercise due diligence in the prosecution of their claims. In the case of undue delay in instituting or prosecuting an arbitral claim, the High Court was given power to make an order terminating the arbitration proceedings and prohibiting commencement of further arbitral proceedings.⁴¹

³⁷. Section 21 of the Arbitration Act, 1950.

³⁸ In 1981 the defunct Law Reform Commission was resurrected by Attorney General, John Griffiths, Q.C. and charged with considering the changes required to enable Hong Kong commercial arbitration law to meet the needs of the local and international community. The main recommendation of the 1981 Report was the adoption of the UK Arbitration Act, 1979 with some additional changes to the legislation.

³⁹ The 1987 Report recommended the adoption of the Model Law with minor changes.

⁴⁰. See Kaplan, Spruce and Cheng, above note 23, at pp. 223 - 226.

⁴¹. See section 11, Arbitration (Amendment) Ordinance, 1982. Note that only the High Court, not the arbitrator, was granted power under section 29A to make an order of dismissal for want of prosecution. Also introduced was section 6B under which the High Court has discretion to order consolidation of related arbitral

The 1982 amendments also reduced the scope of judicial review by abolishing both the "special case - stated case" procedure and the power of the High Court to remit or set aside an award on the grounds of error of fact or law on the face of the record.⁴² Following the English Arbitration Act, 1979, the Ordinance substituted a limited right of appeal from an arbitrator's decision to the High Court on questions of law only, either with the consent of the parties or leave of the court. The court was given jurisdiction to entertain an appeal when it decides that "...having regard to all the circumstances, the determination of the question of law concerned could substantially affect the rights of one or more of the parties to the arbitration agreement...".⁴³ However, the Hong Kong legislation was further amended to allow parties to both domestic and international arbitration agreements to agree to exclude the jurisdiction of the Hong Kong courts.⁴⁴ The amendments were widely praised for achieving a difficult balance between the public interest in judicial supervision and the more laissez-faire policy demanding finality in arbitration without recourse to the courts.⁴⁵

In 1989 the Arbitration Ordinance was further amended by the adoption of the UNCITRAL Model Law which, with the exception of Chapter VIII concerning the enforcement of foreign arbitral awards, was incorporated into the Fifth Schedule to the Ordinance.⁴⁶ Minor deviations from the Model Law included the following:

- the word "commercial" was omitted from the definition of international commercial

proceedings. See section 3 of the Arbitration (Amendment) Ordinance, 1982. In 1985 this section was further amended with the addition of ss.3 which expressly ends the appointment of one of the two arbitrators when two arbitrations are consolidated.

⁴² Section 10 of the Arbitration (Amendment) Ordinance, 1982.

⁴³ Sections 23(3) and 23(4).

⁴⁴ In other words, under section 23B(2) parties may contract out of judicial review irrespective of the subject matter of the dispute. For international arbitrations, exclusion agreements may be prospective, or may be concluded once an arbitration has begun. See section 10 of the Arbitration (Amendment) Ordinance, 1982.

⁴⁵ Other amendments to the Arbitration Ordinance between 1982 and 1989 include:

- adding section 22A which grants arbitrators discretion to award interest for period prior to payment;
- adding section 6B(3) to consolidation section; and
- section 27 concerning power of court where arbitrator is removed or authority is revoked.

Note that the 1989 No.2 Ordinance incorporated an earlier No.1 Ordinance in 1989 that made it clear that there was no restriction whatsoever on representation at an international or domestic arbitration held in Hong Kong. See J. Scott, "Getting to Grips With Arbitration Amendments", (July 1990), The New Gazette 24.

⁴⁶ In accordance with Law Reform Commission's recommendations in the 1987 Report, implementing legislation was enacted in Arbitration (Amendment) (No.2) Ordinance, 1989 (the "1989 No.2 Ordinance") which came into operation on April 6, 1990.

arbitration;⁴⁷

- articles 35 and 36 of Chapter VIII dealing with the recognition and enforcement of arbitral awards were not adopted due to the application of the New York Convention in Hong Kong;⁴⁸ and
- arbitrators under the domestic arbitration legislation could award either costs or interest or both but the Model Law was silent on this issue. To remove any doubt, section 34D was enacted to provide that the costs of the reference and the award, as well as the pre- and post-award of interest, are in the discretion of the arbitral tribunal.⁴⁹

To provide for flexibility between the domestic arbitral legislation and the Model Law, sections 2L and 2M were enacted to allow parties in domestic and international arbitrations to "opt-in" and "opt-out" of the Model Law.⁵⁰

Another round of major reforms coincided with the transfer of sovereignty over Hong Kong from the UK to the PRC at the end of June 1997⁵¹, with the incorporation of more Model Law provisions for common application to both domestic and international arbitrations.⁵² Some of the more important

⁴⁷ The Law Reform Commission did not want to limit the Model Law's scope by excluding certain transactions that would otherwise be considered commercial. See pp. 28 - 29 of the 1987 Report.

⁴⁸ If this chapter had been adopted then the reciprocity reservations made by the UK when acceding to the New York Convention for itself and its dependent territories (including Hong Kong) would have been overridden.

⁴⁹ Another important addition to the legislation was section 2(3) that stresses the international origin of the Model Law, as well as the need for its uniformity interpretation. Furthermore, despite a general reluctance in the UK and Hong Kong to have regard to such matters, section 2(3) directs the court to refer to the Model Law's travaux preparatoires in interpreting the Model Law. Hong Kong courts have referred to the travaux preparatoires of the Model Law listed in the Sixth Schedule to the Ordinance, see for example, Fung Sang Trading Ltd. v. Kai Sun Sea Products & Food Co. Ltd., [1992] HKLR 40.

⁵⁰ To facilitate court assistance in international arbitrations, the Ordinance was further amended in June 1991 by the enactment of section 34E which provides that sections 14(4), (5) and (6), under which the court has power to award interim relief (eg. interim preservation of property and injunctions etc.), apply to Model Law arbitrations.

⁵¹ In 1992 the then Attorney General of Hong Kong invited the HKIAC to establish a committee (the "Arbitration Law Committee") to consider whether or not the Arbitration Ordinance required any amendment in view of the provisions of the new UK Arbitration Bill of 1991 (which was eventually enacted in the UK as revised in June 1996). The Arbitration Law Committee recommended the harmonization of the two arbitral regimes by incorporating more provisions of the Model Law for common application to both domestic and international arbitrations. In 1998 the HKIAC Arbitration Law Committee was disbanded and a new committee established under the auspices of the Hong Kong Institute of Arbitrators, the Committee on Hong Kong Arbitration Law.

⁵² See above note 28.

amendments and additions to the existing provisions include⁵³:

- The object of the amended Ordinance is expressly stated in section 2AA is to “facilitate the fair and speedy resolution of disputes by arbitration without unnecessary expense”. This is achieved by reinforcing the obligations of the arbitrators and enhancing their powers to control the arbitration procedure;
- Arbitrators have legal duties to act fairly and impartially, to give parties a reasonable opportunity to present their cases, and to use appropriate procedures [see section 2GA(1)];
- Arbitrators’ powers are extended and clearly expressed in section 2GB (a) – (e) including the power to: extend time for commencement of an arbitration (section 2GD), order security for costs, require money in dispute to be secured, direct the discovery of documents or the delivery of interrogatories, and direct that evidence be given by way of affidavit (section 2GB). Arbitrators are also given powers to rule on their own jurisdiction (section 13B), to dismiss arbitrations for want of prosecution (section 2GE), to award any civil remedies or relief that may be rendered by a court (section 2GF), and to award compound interest if appropriate and limit the amount of recoverable costs (section 2GL). There is a corresponding reduction in the powers of the Court of First Instance to make orders during the arbitration proceedings, including a repeal of its power to order discovery (see section 2GC)⁵⁴;
- To avoid some of the problems encountered with the definition of an “agreement in writing” as set out in Article 7(2) of the Model Law, section 2AC replaces Article 7(2) and expands the definition to include arbitration agreements contained or evidenced in writing but not necessarily signed by the parties⁵⁵;
- The default power to appoint arbitrators has now been taken from the HKSAR courts and given to the HKIAC (section 12); and
- Orders, directions, and awards of arbitrators shall be enforced as orders or judgements of the court with leave of the court (section 2GG).

⁵³ For a thorough discussion of these reforms, see R. Morgan, “The Arbitration Act of 1996 and Arbitration Law Reform in Hong Kong and Singapore: A Brave New World?”, (July 1997), The Arbitration and Dispute Resolution Law Journal 177.

⁵⁴ The powers retained by the court include making evidentiary orders affecting third parties and issuing interim orders of protection affecting third parties.

⁵⁵ This avoids the difficulties thrown up by such cases as Smal Ltd v Goldroyce Garment Ltd, [1994] 2 HKC 526. Although it is important to note that Article II(2) of the New York Convention still has a fairly restrictive definition of an arbitration agreement “in writing”.

It is hoped that further reforms suggested by the Arbitration Law Committee, but not enacted prior to reunification with the PRC, will be enacted in the future⁵⁶ (dealing with issues such as umpires, security for costs, rights of appeal and exclusion agreements, and consolidation powers of the Court of First Instance).⁵⁷

Recognition and Enforcement of International Arbitral Awards

An international arbitration award may be enforced in the HKSAR under section 2GG and Parts III and IV of the Ordinance depending on whether they are a "foreign" award or a "Convention" award pursuant to the terms of the New York Convention. Part IV of the Ordinance, sections 41 to 46, deal with enforcement of "Convention" awards, that is, awards to which the New York Convention applies. Prior to the hand-over, Hong Kong was a party to the Convention by reason of the UK's accession on September 24, 1975 and its subsequent accession to the Convention on behalf of Hong Kong on April 21, 1977.⁵⁸ The PRC ratified the New York Convention on January 22, 1987. The British and the Chinese sides of the Joint Liaison Group agreed that the Convention would continue to apply to the HKSAR after June 30, 1997.⁵⁹ From July 1, 1997 onwards the New York Convention continues to apply to the HKSAR on the basis of the reciprocal reservation made by the PRC government (meaning that the Convention awards will be recognized and enforced in the HKSAR only if they are made in the territory of another contracting state).⁶⁰

A Convention award is enforceable in the HKSAR with the production of the authenticated original award and the original arbitration agreement.⁶¹ The grounds for refusing enforcement of a Convention

⁵⁶ Although there appears to be some doubt as to whether the Department of Justice has included this issue in its future agenda. See Zhang Xian Chu, "Enforcement of Arbitral Awards Between Mainland China and Hong Kong: Before and After Reunification", p 8 (forthcoming publication April 1999).

⁵⁷ For an excellent discussion of future reform prospects, see R. Morgan, "Hong Kong Arbitration: Getting the Legislation Right", (1998) 2 The Arbitration and Dispute Resolution Law Journal 1 - 20.

⁵⁸ See the Declaration by the UK to the Secretary-General of the United Nations dated January 21, 1977.

⁵⁹ See discussion in Wang Sheng Chang, "The Mutual Enforcement of Arbitral Awards in the HKSAR and the Mainland China", Paper presented at the November 1997 International Commercial Arbitration Conference, Hong Kong (on file with author).

⁶⁰ See Depository Notifications to the Secretary-General of the United Nations by the Governments of the PRC and the UK Relating to Hong Kong, (June 6 and June 10, 1997 respectively) CN273.1997. Note that when the PRC ratified the New York Convention the government invoked both the reciprocity and commercial reservations, whereas the UK government registered only the reciprocity reservation. The PRC declaration in 1997, however, states only that only the reciprocity reservation is applicable to the HKSAR.

⁶¹ A certified copy of a translation of an award is also required if it is rendered in a foreign language. See

award are set out in section 44(2) of the Ordinance (which replicates the grounds set out in Article V(1) of the New York Convention) and includes: (a) incapacity of the parties, (b) invalidity of the arbitration agreement, (c) improper notice of appointment or composition of the arbitral tribunal, (d) award dealing with matter not covered by the arbitration agreement, (e) inability to present case before arbitral tribunal; and (f) that the award is not yet binding on the parties.⁶² The court retains a residual discretion to grant leave to enforce the award in any case.⁶³ Section 44(3) further provides that enforcement may also be refused if the award is in respect of a matter not capable of settlement by arbitration or if it would be contrary to public policy to enforce the award.⁶⁴ By contrast, the term “foreign” award” as used in the Ordinance refers to an award which is enforceable on the basis of international treaties other than the New York Convention, such as the 1923 Geneva Protocol on Arbitration Clauses and the 1927 Geneva Convention on the Execution of Foreign Arbitral Awards.⁶⁵ Many commentators, however, feel that such treaties have become obsolete given the provisions of Article VII of the New York Convention that provide that such treaties shall cease to have effect between contracting states being bound to the New York Convention.⁶⁶

Recognition and Enforcement of International Arbitral Awards Prior to the Transfer of Sovereignty

Prior to July 1, 1997 arbitration awards rendered by CIETAC and CMAC in the PRC could be enforced directly in Hong Kong pursuant to the terms of the New York Convention. In enforcement decisions prior to the hand-over, the Hong Kong courts indicated a definite pro-

sections 42 and 43, Part IV, Arbitration Ordinance. In accordance with Order 73, Rules 10(1) and (6) of the Rules of the High Court, the enforcement process proceeds in two stages: the party seeking leave to enforce a Convention award must initially make an ex parte application for leave to enter judgment based on the terms of the arbitration award. The order of the court is then served on the other party subject to a fourteen day period within which that party may seek an order setting aside leave to enter judgment.

⁶² When Hong Kong originally adopted the Model Law in 1990 it did not adopt Chapter VIII of the Model Law (Articles 35 and 36 which govern recognition and enforcement of foreign awards) because the effect of Article 35(1) would be to override the reciprocity reservation made by the UK on behalf of itself and Hong Kong.

⁶³ See Qinhuangdao Tongda Enterprise Development Company et al. v. Million Basic Company Limited, [1993] HKLD A7.

⁶⁴ Section 44(3) replicates the provisions of Article V(2) of the New York Convention. To date, the Hong Kong courts have not refused to recognize and enforce a Convention award solely on the basis of public policy. See further discussion of this point below and in Wang Guiguo, “One Country, Two Systems: Recognition and Enforcement of Arbitral Awards in Hong Kong and China”, (March 1997) 1 Journal of International Arbitration 5, at p 30.

⁶⁵ See definition of foreign award” in section 2(1) and Schedules 1 and 2 of the Ordinance.

⁶⁶ See discussion in Kaplan, Spruce and Moser, above note 23, p. 232 and Morgan, above note 32, at p. 10.

enforcement bias towards foreign arbitration awards, especially awards rendered by CIETAC.⁶⁷ Up until 1994 63 CIETAC and CMAC awards had been brought to the Hong Kong courts for recognition and enforcement.⁶⁸ It appears that arbitral awards from the PRC constituted approximately one-half to two-thirds of the total applications to enforce awards and set them aside.⁶⁹

In accordance with the provisions of the New York Convention, Hong Kong courts consistently limited their judicial scrutiny of awards to procedural issues (i.e. procedural irregularities of the arbitral proceedings violating due process principles). Challenges on the ground of public policy met with little success. For example, in Werner A Bock K G v The N's Co. Ltd., [1978] HKLR 281 the Hong Kong Court of Appeal held that the public policy exception for refusing to recognize and enforce arbitral awards should be narrowly interpreted.⁷⁰ In another decision enforcing a CIETAC arbitral award, Qinhuangdao Tongda Enterprise Development Co et al v Million Basic Co Ltd., [1993] 1 HKLR 173, the issue was whether the defendant was deprived of the opportunity to present its case by the arbitral tribunal which refused to consider evidence provided by the defendant after the deadline for adducing evidence. In rejecting the defendant's argument, the High Court stated that the public policy ground for refusal to enforce Convention awards must not be seen as a catch-all provision to be used wherever convenient and is limited in scope and be sparingly applied.⁷¹

Prior to 1 July 1997 only two applications to enforce CIETAC awards were denied on the ground of due process. The first case was Paklito Investment Ltd. v. Klockner East Asia Ltd., [1993] 2 HKLR 39

⁶⁷ See discussion in Wang Guiguo, above note 64, at p. 8 and Kaplan, Spruce and Moser, above note 23, at p. 226.

⁶⁸ See discussion in Zhang, above note 56, at p. 12 citing Chen Dejung, M. J. Moser and Wang Sheng Chang, *International Arbitration in the PRC: Commentary, Cases and Materials* (Hong Kong, Butterworths, 1995) at pp. 79 – 80 and Kaplan, Spruce and Moser, above note 23, at p. 226.

⁶⁹ See Morgan, above note 232, at p 13.

⁷⁰ See also Zhejiang Province Garment Import and Export Company v. Siemssen & Co (Hong Kong) Trading Limited, [1992] H.K.L.D. F8, in which Kaplan J. (as he then was) dismissed the defendant's appeal of an ex parte order granting leave to enforce a CIETAC arbitration award. The defendant argued that award was not binding because an alleged condition precedent had not been met (return of defective goods to the defendant) and that it was contrary to public policy to enforce that part of the award dealing with the reimbursement of Chinese import duties.

⁷¹ The High Court stated that the New York Convention does not provide for a re-hearing of the merits of the case by the enforcing court. See [1993] 1 HKLR 173, at pp 177-178. Similar comments were made by Kaplan J. in Paklito Investment Ltd. v Klockner East Asia Ltd., [1993] 2 HKLR 39 discussed further below. See discussion of this point in Wang Guiguo, above note 64, at p. 31.

which involved a dispute over a sale and purchase of goods that allegedly did not comply with contractual quality requirements. The dispute went to arbitration before CIETAC and an award was rendered in favour of the plaintiff who sought enforcement of the award in Hong Kong under section 44 of the Ordinance. The enforcement was opposed by the respondent under section 44(2)(c) on the ground that a number of aspects of the procedure adopted by CIETAC prevented them from presenting their case. In particular, after the hearing, CIETAC appointed its own expert to carry out investigations. This was objected to by the respondent who wrote to CIETAC objecting to this appointment because one and a half years had elapsed since the goods were delivered. However, the expert's report was prepared and a copy was received by the respondent. One week later, CIETAC rendered its arbitration award without any opportunity being given to either party to comment on the expert's report.

Kaplan J. refused to enforce the CIETAC arbitration award because the award was based on the appraisal of experts and the party against whom the application was made did not have any opportunity to plead its own case, raise objection, refute the evidence, or provide new evidence. This was held to be contrary to the PRC Civil Procedure Law and the CIETAC Arbitration Rules which allow the parties an opportunity to challenge expert evidence collected by the arbitration tribunal.⁷² Kaplan J. concluded that this was a serious procedural irregularity amounting to a breach of due process and, therefore, he declined to exercise his discretion to enforce the award.⁷³

The second case to refuse enforcement of a CIETAC arbitration award, Apex Tech Investments Ltd v Chuang's Development (China) Ltd. [1996] 2 HKC 293, involved an arbitration before CIETAC of a dispute over payments arising from a cross-border property transaction between parties in Hong Kong and the PRC. The main issue in dispute was whether the contract for purchase and sale of certain flats in Hui Yang County, PRC was valid under Chinese law. This was dependent upon whether the Chinese defendant had originally acquired the right to sell the land to the Hong Kong plaintiff. The defendant had

⁷² In common law jurisdictions, the concept of the tribunal appointed expert is rare but it is acceptable in civil law jurisdictions. See Chrome Resources SA (Switzerland) v. Leopold Lazarus Ltd. (UK), 1986, Vol. XI, *Yearbook of Commercial Arbitration*, 532 and International Standard Electric Corporation (US) v. Bidas Sociedad Anonima Petrolera (Argentina), 1992, Vol. XVII, *Yearbook of Commercial Arbitration*, 639 in which the Court upheld arbitral awards despite the fact that the tribunal had appointed independent experts to advise them on legal and factual issues arising in the arbitration. See (1993), Vol 1, Asia Law & Practice, 13.

⁷³ Kaplan J. held that enforcement of foreign arbitral awards under section 44(3) of the Ordinance may be denied only where enforcement would violate the forum's state most basic notions of morality and justice. This case was held not to involve public policy grounds and was decided solely on the breach of the requirement of an opportunity to present a case.

obtained a “Certificate for the Use of State-Owned Land” issued by the Hui Yang County State-Owned Land Bureau in 1989 which stated that the permitted use of the land was “industrial estate by foreign investors solely”. The issue was whether this certificate enabled the defendant to transfer his right to use the land to the plaintiff buyer from Hong Kong.

The CIETAC arbitral tribunal ruled against the Hong Kong party relying on the opinion it had sought from the Land Bureau that that the certificate had been issued for foreign investment rather than for real property transactions which might be sold outside of the PRC. However, the Hong Kong party was never given a copy of the Bureau’s opinion nor were they allowed to respond to it. The judge at first instance, Leonard J. of the High Court, initially allowed the enforcement of the CIETAC arbitral award, notwithstanding his acknowledgement of the procedural irregularity.⁷⁴ However, the Hong Kong Court of Appeal subsequently reversed the decision holding that the nature of the certificate under dispute was inconclusive and that the Hong Kong party should have been given an opportunity to respond to the opinion rendered by the Land Bureau.⁷⁵

Impact of the Transfer of Sovereignty on the Recognition and Enforcement of International Arbitral Awards in the HKSAR

The impact of the transfer of sovereignty over Hong Kong on July 1, 1997 from the UK to the PRC was viewed with some anxiety because of the large number of arbitration awards rendered abroad, including those from the PRC, which are sought to be enforced in Hong Kong. The main point of concern involved the status and law of domestic and international arbitration awards made or enforced in Hong Kong. Article 8 of the Basic Law provides that the laws previously in force in Hong Kong shall be maintained, except those that contravene the Basic Law (and subject to amendment by the HKSAR legislature. The resumption of sovereignty, however, has created a gap in the mechanism for the recognition and enforcement of arbitration awards between the HKSAR and the PRC.

⁷⁴ Leonard J. concluded that the outcome of the arbitration could not have been different even if the plaintiff had been granted an opportunity to be heard and thus he exercised his discretion to order enforcement of the arbitral award.

⁷⁵ The arbitration proceeded under the old 1988 CIETAC Arbitration Rules which were subsequently amended in 1994 to state that copies of expert reports should be sent to the parties concerned who should be given an opportunity to express their opinions on the reports and question the experts about their conclusions. For a critical analysis of the judgment in this case, see Wang Guiguo, above note 64, at pp. 23-26 (arguing that the decision of the Court of Appeal demonstrates a “lack of understanding of Chinese law and the Chinese legal system, and perhaps a lack of proper respect for these.”)

As discussed above the recognition and enforcement of arbitral awards between Hong Kong and the PRC prior to July 1, 1997 was governed by the New York Convention on the basis of the accession of both the UK and the PRC to the Convention. After July 1, 1997 the Convention continues to apply to the HKSAR on the basis of the reciprocal reservation made by the PRC government. The application of the Convention between the HKSAR and other contracting states to the Convention does not give rise to any problems. However, problems arise in the mutual cross-border recognition and enforcement of HKSAR arbitral awards in the PRC under the New York Convention and vice versa. On July 1, 1997 the New York Convention ceased to apply to the cross-border recognition and enforcement of such arbitral awards since the HKSAR is now part of the PRC and can no longer be regarded as an extended application of the Convention under the UK's' umbrella jurisdiction. The PRC has declared, by virtue of its reciprocal reservation, that only arbitral awards made "in the territory of another Contracting State" can be recognized and enforced in accordance with the Convention's provisions. As the HKSAR cannot be considered "another Contracting State" to the New York Convention, the reciprocal reservation poses a practical problem to application of the Convention between the HKSAR and the rest of the PRC.⁷⁶ Thus, a legal vacuum exists with respect to post-1997 reciprocal enforcement of arbitral awards between the HKSAR and the PRC.

It was initially hoped that PRC arbitral awards would continue to be enforceable in the HKSAR at the discretion of the Court of First Instance under the new section 2GG of Part IA the Arbitration Ordinance introduced in June 1997 (discussed above). However, in Hebei Import-Export Corp v Polytek Engineering Co Ltd (No 2), [1998] 1 HKC 192 Chan CJHC held (in obiter statements) that arbitral awards made in the PRC but only sought in ex parte proceedings to be enforced after July 1, 1997 and awards actually made after July 1, 1997, should no longer be treated as Convention awards.⁷⁷ Later in Ng Fung Hong Ltd v ABC [1998] 1 HKC 213⁷⁸, Findlay J held (expressing

⁷⁶ For a detailed discussion of this problem, see Morgan, above note 32, and Wang Sheng Chang, above note 59.

⁷⁷ And thus they were not capable of being enforced under the New York Convention. In addition, the judge also considered that such awards should not be treated as domestic arbitration awards under Hong Kong's Arbitration Ordinance because of the distinct and separate features of Hong Kong's legal system. See [1998] 1 HKC 192 at pp 196-7 and discussion of case in Mark Lin, "Enforcement of Mainland China's Arbitration Award in the HKSAR After 1 July 1997", (Feb. 1999), Vol. 65: 1 Arbitration 56, at pp. 57-58.

⁷⁸ The judgment in this case was delivered a few days after the judgment in the Hebei case.

some regret) that neither the New York Convention, nor the rules of international arbitrations under the Arbitration Ordinance (section 2GG), may apply to the recognition and enforcement of arbitral awards rendered in the PRC. After July 1, 1997 section 2AD, Part IA of the Ordinance applied only to arbitrations conducted in the HKSAR and governed by the Ordinance. Since the place of arbitration was outside the HKSAR (in the PRC), the arbitration award could not be enforced directly in the HKSAR under section 2GG. As a result, the only option open to the plaintiff to enforce the award was to commence a separate action using the award as evidence of an unpaid debt. This type of time consuming and expensive common law enforcement procedure was certainly not the direct enforcement contemplated by the provisions of the New York Convention.⁷⁹ Despite concerted efforts and lobbying of the Hong Kong government by international and local practitioners prior to the transfer of sovereignty, there is now an unfortunate gap in the cross-border enforcement of HKSAR and PRC arbitration awards which seriously undermines the reputation of the HKSAR as an international financial and commercial center. The potential solutions which may resolve this troublesome problem and provide a mechanism for mutual enforcement of PRC and Hong Kong arbitral awards are discussed in more detail below.

INTERNATIONAL COMMERCIAL ARBITRATION IN THE PRC

As with the arbitral regime of the HKSAR, the PRC has a bifurcated arbitration system that has until quite recently treated domestic and international (or “foreign-related”) arbitrations separately, each having different rules and procedures, different enforcement systems and administered by different institutions.⁸⁰ Arbitration of “foreign-related” disputes are normally conducted before two main arbitration institutions: CIETAC and CMAC. Both CIETAC and CMAC are overseen by the PRC trade promotion body, the China Chamber of International Commerce (“CCOIC”), formerly called the China Council for the Promotion of International Trade (“CCPIT”).⁸¹ With the dramatic

⁷⁹ See comments of Findlay J. at [1998] 1 HKC 213, at p 216. See discussion of this case in Lin, above note 77, pp. 58-59 (arguing that the judge went too far in his judgment and that it is difficult to square this judgment with Article 20 of the UNCITRAL Model Law).

⁸⁰ For a detailed discussion of the arbitration regime in the PRC, see: Wang Sheng Chang, *Resolving Disputes in the PRC*, (Hong Kong, FT Law & Tax Asia Pacific, 1996), and Dejun, Moser, & Wang Sheng Chang, above note 68. See also Guo Xiaowen (Ed.), *Case Studies of CIETAC* (Hong Kong, FT Law & Tax Asia Pacific, 1996).

⁸¹ CIETAC traces its origins back to the mid-1950’s when the Central Government of the PRC issued a decree setting up a Foreign Trade Arbitration Commission under the CCPIT. Four years later, another decree was promulgated by the State Council to empower the CCPIT to organize CMAC to render awards in maritime disputes with foreigners. In 1980 the name of the Foreign Trade Commission was changed to Foreign Economic and Trade Commission and the Commission’s jurisdiction was expanded to cover not only trade

growth of China trade investment since 1990, CIETAC has emerged as one of the world's busiest arbitration commission handling approximately 900 arbitrations annually in Beijing and its sub-commissions in Shanghai and Shenzhen.⁸² The jurisdiction of CIETAC includes all types of commercial disputes arising not only from foreign trade, but also disputes from other kinds of economic co-operation with foreign parties, whereas CMAC's jurisdictions is limited to maritime disputes.⁸³

The different treatment of domestic and international arbitrations was emphasized in the enactment of the PRC's first national Arbitration Law in September 1995 which contain extensive provisions governing domestic arbitrations and a brief chapter of specific provisions dealing with foreign-related arbitrations (the Law is discussed in more detail below).⁸⁴ Although the term "foreign-related" appears to refer to the character of the dispute as involving foreign-elements, the term is not clearly defined in any PRC legislation.⁸⁵ However, the Supreme People's Court has stated that a "foreign-related" element is established by any of the following circumstances:

- either one party or both parties are foreigners, stateless persons, foreign enterprises or organisations;
- the legal facts that establish, modify or terminate the civil legal relationships between the parties takes place in a foreign country; or
- the subject matter of the dispute is located in a foreign country.⁸⁶

disputes with foreign countries and individuals, but also disputes arising from economic activities between the PRC and foreign states (i.e. joint ventures and financing). In 1988 the Commission was renamed to CIETAC to handle a whole range of international and economic trade disputes. For a detailed review of CIETAC's evolution, see M. J. Moser, "CIETAC Arbitration: A Success Story?", (1998) 15:1 Journal of International Arbitration 27.

⁸² See S. Lubman and B. Wajnowski, "International Commercial Dispute Resolution in the PRC: A Practical Assessment", (1993) 4 American Review of International Arbitration 107 and Roger Best, "Resolution of China Disputes", in *International Dispute Resolution* (Hong Kong, Asia Law and Practice, 1998) 6.

⁸³ See further discussion below concerning CIETAC's jurisdiction.

⁸⁴ Unlike the extensive provisions governing domestic arbitration, the new Arbitration Law contains only a few provisions concerning international arbitration. Articles 65-73 refer to "foreign-related arbitration" and contemplate the establishment of foreign-related arbitration commissions by the CCOIC that may engage arbitrators of foreign nationalities who are equipped with knowledge of law, economy, trade science, and technology.

⁸⁵ The expression "foreign-related" is found in the PRC's Civil Procedure Law, the Foreign Economic Contract Law, the General Principles of Civil Law, as well as the Arbitration Law.

⁸⁶ See the "Opinion of the Supreme People's Court on the Application of the Civil Procedure Law - Several Questions", issued July 14, 1992, as reported in (January 14, 1993) China Law & Practice.

As a result, CIETAC's jurisdiction extends to almost any sort of business dispute between a Chinese company and a foreign company, as well as between two foreign companies (assuming that a valid arbitration clause exists). It was unclear when the Arbitration Law promulgated whether CIETAC's jurisdiction extended to cover arbitration of disputes where both parties were Chinese legal entities. As the 1992 decision of the Beijing Intermediate People's Court in China International Construction and Consultant Corp v Beijing Lido Hotel Corporation illustrates, foreign investment enterprises (i.e. Sino-foreign equity joint ventures, Sino-foreign co-operative joint ventures and wholly foreign-owned enterprises) could find themselves within the domestic arbitration regime – rather than before CIETAC – if they agreed to submit to arbitration to settle disputes with other Chinese legal persons (particularly since foreign investment enterprises are regarded under Chinese law as Chinese legal persons).⁸⁷ However, in May 1998 CIETAC announced that in addition to jurisdiction over foreign-related disputes, CIETAC would have jurisdiction over disputes between foreign investment enterprises and other Chinese natural or legal persons (including Sino-foreign equity joint ventures, Sino-foreign co-operative enterprises and wholly foreign-owned enterprises).⁸⁸

The strict division between foreign-related and domestic arbitrations had been broken earlier in June 1996 when the General Office of the PRC State Council declared that while the primary responsibility of domestic arbitration commissions was to arbitrate domestic cases, they had jurisdiction to accept foreign-related disputes for arbitration if all parties agreed to refer them to the commissions.⁸⁹ The intention of the State Council was very clear: CIETAC's formerly exclusive

⁸⁷ For a report of the case, see China Institute of Applied Law of the Supreme People's Court, *Selected Cases of the People's Court*, Vol. 4, 1993, at p. 137. A CIETAC arbitration award was overturned by the court on the basis that CIETAC had exceeded its jurisdiction in accepting the case for arbitration. The court held that the legal nature of the Lido Hotel Corporation (a Sino-foreign joint venture) was that of a Chinese enterprise under PRC law. Since the other party to the dispute was also a Chinese legal enterprise and the disputed contract was signed and performed in China, there was no "foreign-related" element present enabling CIETAC to take jurisdiction over the case. See discussion of case in M. J. Moser, "People's Republic of China", in Michael Pryles (ed), *Dispute Resolution in Asia* (The Hague, Kluwer Law International, 1997) at p. 83.

⁸⁸ As a result, disputes between Chinese legal persons may now be accepted for arbitration by CIETAC. See Zhu Jianlin, "CIETAC Arbitration Practice and its New Rules", Paper presented at the November 1998 International Dispute Resolution Conference, Hong Kong, (on file with author).

⁸⁹ See "A Notice of the General Office of the State Council Concerning Several Issues to be Clarified for the Implementation of the Arbitration Law of the PRC", dated 8 June 1996 *Gazette of the State Council of the PRC* 701 discussed in Chen Min, "China: Latest Developments in Arbitration", (April 1998), IBA Arbitration and ADR 9.

monopoly over foreign-related cases was ended and the domestic arbitration institutions were empowered to handle foreign-related cases.⁹⁰ Thus, despite CIETAC's jurisdiction over foreign-related arbitrations, it is possible for parties to select a domestic arbitration commission to conduct the proceedings of a foreign-related arbitration. The exercise of this right is thought to be unlikely, however, due to concerns about the domestic arbitral commissions' inexperience with foreign-related arbitrations, concerns over local protectionism and due to the broader powers of the PRC courts to review arbitral awards rendered by domestic arbitration commissions.⁹¹

Enactment of the PRC Arbitration Law

Since the introduction of the "open-door" economic policy in 1978, the PRC has sought to modernize its economy with a massive increase in the amount of direct foreign investment. However, with such increased foreign investment came a dramatic rise in the number of disputes arising out of such investment. As a result, it was necessary to reform both the domestic and international arbitration systems in the PRC in line with international standards of arbitration practice. Although there were laws and regulations governing arbitration of foreign-related business, economic contracts, technical contracts, copyright, and labour disputes, as well as different arbitration bodies, the content of the PRC arbitration laws and the operation of the arbitration bodies was not based on any uniform or internationally accepted standard. Moreover, there were major differences in the institutional rules and procedures between domestic and international arbitrations in the PRC and the domestic system had fallen far behind the international system in modernising its governing rules and procedures.⁹²

Arbitration in the PRC was brought in closer conformity to international practices and standards, however, when the PRC promulgated its first national Arbitration Law on August 31, 1994 (after

⁹⁰ Accordingly, CIETAC is no longer confined to hearing only traditional foreign-related cases. See Zhu, above note 88, at p. 10 and S. Lubman, "The Legal and Policy Environment for Foreign Direct Investment in China: Past Accomplishments, Future Uncertainties", in *Private Investments Abroad* (New York, Matthew Bender, 1998), Ch. 3, at p. 50 (describing the rather "back-handed" manner in which CIETAC's monopoly over foreign-related cases was broken).

⁹¹ See Moser, above note 87, at p 84, Wang Sheng Chang, above note 59, at p 23 and further discussion below.

⁹² Prior to the enactment of the 1994 Arbitration Law, there were 14 laws, 80 administrative regulations and approximately 200 local regulations which contained provisions governing arbitration – although many of these provisions contradicted the fundamental principles of arbitration. See Wang Sheng Chang, above note 80, at p. 12.

an extensive drafting process) that became effective as of September 1, 1995.⁹³ The new Arbitration Law is the first relatively complete national law on arbitration in the PRC and attempts to incorporate internationally accepted principles and practices governing both domestic and international arbitration in one coherent framework.⁹⁴ The Arbitration Law substantially revised the domestic arbitration system to reduce the interference of local government and local protectionism and bring it more in line with the system of international arbitration. Rather than the previous centralised arbitration system with arbitration institutions established by administrative levels or regions (with different jurisdictions according to their hierarchial level and territorial limitations)⁹⁵, the provisions give power to the municipal governments and capital cities of the provinces and administrative regions to re-organise independent arbitral commissions.⁹⁶

Overview of PRC Arbitration Law

The Arbitration Law consists of eight chapters and 80 articles and is divided as follows:

Chapter 1: General Provisions (Articles 1 – 9)

Contains provisions dealing with the basic principles of arbitration and arbitrability of disputes.

Chapter 2: Arbitration Commissions and the China Arbitration Association (Articles 10 – 15)

Contains provisions governing the re-organization of the domestic arbitration commissions, qualifications of arbitrators, and the general functions of the independent, self-regulating China Arbitration Association.

Chapter 3: Arbitration Agreement (Articles 16 - 20)

⁹³ Despite the comprehensive Arbitration Law, there are other relevant laws and regulations concerning arbitration including: the 1991 PRC Civil Procedure Law, and notices of the Supreme People's Court such as "Some Opinions Concerning Implementation of the 1991 Civil Procedure Law", "Notice on the Implementation of China's Accession to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards" (1987) and "Notice on the Conscientious Implementation of the Arbitration Law and Enforcement of Arbitral Awards According to Law" (1995).

⁹⁴ The Arbitration Law is reproduced in The Legislative Affairs Commission of the Standing Committee of the National People's Congress of the PRC, ed., *Arbitration Laws of China* (Hong Kong, Sweet & Maxwell, 1997). For a critique of the provisions of the Arbitration Law, see B. Beaumont, D. Choi and J. Luk, *Commentary on the Chinese Arbitration Act* (London, Simmonds & Hill Publishing Ltd., 1995), Chen Min, "The Arbitration Act of the PRC: A Great Leap Forward", (1995) 12:4 *Journal of International Arbitration* 29; Katherine Lynch, "The New PRC Arbitration Law", (1996) 26 *Hong Kong Law Journal* 104; and Andrew Shields, "China's Two-Pronged Approach to International Arbitration: New Rules and New Law", (1998) 15:2 *Journal of International Arbitration* 67.

⁹⁵ This system had many disadvantages: see Kaplan, Spruce and Moser, above note 23, at Ch.14 and Jin Pengnian, 'On Framework of Arbitration Legislation in China', *1993-94 CIETAC Yearbook*.

⁹⁶ Chi Shaojie, 'Arbitration Mechanism to be Updated in China', (January 1995), Vol 23:1, *International Business Lawyer*, p. 16.

Contains provisions governing the form, validity and separability of arbitration agreements.

Chapter 4: Arbitration Proceedings (Articles 21 – 57)

Contains provisions governing the general arbitration procedure from initiation of the arbitration to its conclusion (application for arbitration to arbitration commission and its acceptance, interim measures of protection, formation of the arbitral tribunal, hearings (including procedural issues such as oral hearings or written representations, reception of evidence, settlement agreements, and conciliation by arbitral tribunal) and rendering of awards.

Chapter 5: Application for Setting Aside Arbitration Awards (Articles 58 – 61)

Establishes the grounds upon which the People’s Court may set aside an arbitration award and remedial measures.

Chapter 6: Enforcement of Arbitration Awards (Articles 62 – 64)

Contains provisions governing the enforcement of arbitration awards and sets out grounds for the refusal of enforcement of awards and remedial measures. The Law does not deal with the recognition and enforcement of arbitral awards under the New York Convention.⁹⁷

Chapter 7: Special Provisions for Arbitration Involving Foreign Elements

Contains a few provisions concerning foreign-related arbitrations such as the establishment of foreign-related arbitration commissions, interim measures of protection, and enforcement of foreign-related arbitration awards.

Chapter 8: Supplementary Provisions

Miscellaneous provisions concerning arbitration rules of the China Arbitration Association, arbitration fees, and re-organization of domestic arbitration commissions.

Important Reforms Introduced in the PRC Arbitration Law

A number of important reforms were introduced in the national Arbitration Law including the following:

- Article 1 indicates that the Arbitration Law is formulated to guarantee the timely and impartial arbitration of the economic disputes, to protect the lawful rights and interests of the parties concerned and to ensure the healthy development of the socialist market economy⁹⁸;

⁹⁷ The relevant provision for enforcement is found in section 269, Civil Procedure Law which requires the party seeking enforcement of an arbitral award to apply to the Intermediate People’s Court in the location of the opposing party’s residence or property. See further discussion below.

⁹⁸ It is important to note that while Article 1 restricts the scope of arbitration to disputes arising out of ‘economic’ transactions, the term ‘economic’ is not defined in the new law and may be given a wide interpretation to cover disputes arising from or out of economic, trade, or business activities. This would

- Article 2 provides that any contract disputes or other disputes concerning property, rights, or interests between 'civil subjects with equal status,' be they citizens, legal persons, or organisations, are arbitrable⁹⁹;
- Article 15 provides for the establishment of the China Arbitration Association to serve as a non-governmental, self-regulating organization of arbitration commissions independent of any administrative control. It has supervisory control over its member arbitration commissions and arbitrators and must make its rules in accordance with the Arbitration Law and the Civil Procedure Law;
- Articles 10-15 provide for the establishment of independent arbitration commissions at the provincial level, with power given to the municipal governments in Beijing, Shanghai, Tianjin, and capital cities of the provinces and autonomous regions to re-organise independent arbitral institutions.¹⁰⁰ All arbitration commissions are to be free of interference from any administrative institutions, social organisations, and individuals (Article 8);¹⁰¹
- Article 19 endorses the separability of the arbitration clause;
- There is a limited recognition of the principle of party autonomy by requiring that there be a written arbitration agreement voluntarily entered into by the parties which describes the matters to be arbitrated and selects the arbitration commission to arbitrate the dispute -

presumably include all disputes subject to arbitration under the Economic Contract Law 1981 and the Foreign-related Economic Contract Law, as well as tort and environmental control matters. Following the PRC's accession to the New York Convention in 1987, the Supreme People's Court in its "Notice on the Implementation of China's Accession to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards" stated that 'commercial disputes' cover:

...economic relations of rights and duties arising from contracts, torts, or relevant legal provisions, such as sales of goods, property leases, project contracts, processing contracts, transfer of technology, equity joint ventures, contractual joint ventures, exploration and development of natural resources, insurances, labour services, agency, consulting services and transportation of passengers and goods by sea, air rail, land, as well as disputes regarding product liability, environmental pollution, marine accidents, property, etc., but not including disputes between foreign investors and the host country. (From *Gazette of the Supreme People's Court of the PRC*, June 20, 1987).

⁹⁹ Article 2 must be read in conjunction with Article 3, which provides that the following disputes are exempt from arbitration: (a) marital, adoption, guardianship, support, and succession disputes; and (b) administrative disputes that by law are required to be handled by administrative authorities.

¹⁰⁰ At present there are arbitration commissions established at Beijing, Shanghai, Tianjin, Xi'an, Shenzhen, Guangzhou, Changsha, Fushun, Huhhot, Kunming, Xiamen and Zibo. As of mid-1998 approximately 120 arbitral commissions had been established in the PRC. See Moser, above note 87, at p 83 and Zhu, above note 88, at p. 10.

¹⁰¹ It remains to be seen whether this freedom from influence by administrative agencies will in fact occur. At present, however, the commissions will be funded by the government and can only hope to gain financial independence at some future date.

although the parties are required to choose the arbitrators from the commission's panel of arbitrators (Articles 4 and 16). The consensual nature of an arbitration agreement is further strengthened by Article 17 which provides that an arbitration agreement reached by coercion of one of the parties is null and void. If no agreement is reached and one of the disputing parties applies for arbitration, the arbitration commission 'may' decline to accept its application;

- Article 43 provides that the parties must produce evidence or the facts on which their claim or defence is based, and the arbitration tribunal may, if it deems necessary, make investigation and collect evidence on its own initiative. Article 44 allows the arbitration tribunal to exercise its discretion in the appointment of an expert (or appraiser) to examine a specialist issue¹⁰²;
- Article 7 allows arbitrators to combine law and equity in hearing the cases and in making their awards;
- Article 13 sets out the minimum qualifications for commission arbitrators (either domestic or international)¹⁰³;
- Articles 34 – 35 provide for challenges to arbitrators on the basis that they have a material interest in the case or a relationship with one of the parties to the dispute, or that they have met privately with one of the parties or have accepted an invitation or gift;
- Articles 49 – 52 concern settlement agreements reached between the parties and the conduct of conciliation within the arbitration process. According to Chinese law and practice, the arbitration tribunal may, subject to agreement of the parties, conciliate the dispute within the context of the arbitration proceeding;
- Article 58 provides for setting aside an domestic arbitral award on various grounds, including forged or withholding of evidence, bribery and embezzlement. Article 70 applies to setting aside of foreign-related arbitrations (on the grounds set out in Article 260 of the Civil Procedure Law)¹⁰⁴; and

¹⁰² See above note 75. Note that Article 44 appears to grant discretion only to the arbitration tribunal to appoint an expert or appraiser. There is no provision allowing the parties to request appointment of an expert or appraiser (although it may be argued that the parties have inherent power to do so).

¹⁰³ Under Article 13 a person must satisfy one of the following basic criteria: have been engaged in arbitration business for more than eight years; have practised law as an attorney for no less than eight years (presumably private legal practice rather than working for the government); have been a judge for at least eight years; have been involved in legal research and teaching and have senior professional titles; or be a business person with legal knowledge and senior professional titles or an equivalent professional skill.

¹⁰⁴ See further discussion below.

- Article 9 establishes the finality of the arbitration award and prevents a party from applying to re-arbitrate or litigate a dispute for which an arbitration award has already been rendered.

Revisions to CIETAC Arbitration Rules

In addition to the enactment of the Arbitration Law, the CIETAC Arbitration Rules were also substantially revised in 1994 in an attempt to internationalise its arbitration procedures and enhance the acceptability of CIETAC arbitration awards.¹⁰⁵ The revised CIETAC Arbitration Rules replaced those of 1989 with provisions governing the jurisdiction of CIETAC, arbitration agreements, language used in the arbitral proceedings, disclosure of personal interests by arbitrators and their disqualification, investigation by the arbitration tribunal, waiver of the right to object, conciliation within arbitration, rendering of arbitration awards and summary arbitration proceedings.¹⁰⁶ The CIETAC Arbitration Rules were further modified effective as of October 1, 1995 to ensure the Rules conformed to the newly enacted Arbitration Law and to make certain of the Rules more practical.¹⁰⁷ With the end of CIETAC's monopoly over the arbitration of foreign-related disputes in June 1996, CIETAC decided to expand its jurisdiction and promulgated a new edition of its Arbitration Rules in May 1998 providing that disputes arbitrable before CIETAC include:

- international or foreign-related disputes¹⁰⁸;
- disputes involving the HKSAR, Macau and Taiwan;
- disputes between foreign investment enterprises and disputes between foreign investment enterprises and Chinese legal persons, natural persons and/or economic

¹⁰⁵ For detailed analysis of changes in the CIETAC Arbitration Rules of 1956 and 1989, see Zhang Yulin, "Towards the UNCITRAL Model Law: A Chinese Perspective", (January 1994) Vol 11(1) Journal of International Arbitration 87, at pp. 98 - 99; M Moser, "China's New International Arbitration Rules", (September 1994), Vol 11(3), Journal of International Arbitration 1, at pp. 6 - 7 and "CIETAC Issues New Arbitration Rules", (June 1994), The New Gazette, p 59.

¹⁰⁶ The new CIETAC Arbitration Rules were promulgated by the CCPIT on March 17, 1994 with effect from June 1, 1994 and are the third arbitration rules promulgated by the CCPIT. The first arbitration rules, the Provisional Rules of Arbitration Procedure of the Foreign Trade Arbitration Commission of the CCPIT, were promulgated in March 1956. Amendments to these Rules were adopted in September 1988 to accommodate economic reforms and the PRC's participation in the New York Convention. The revised Rules were effective from January 1, 1989 and were the second arbitration rules. Further revisions of the Rules occurred in 1995 and 1998 discussed below.

¹⁰⁷ These minor changes dealt with the jurisdiction and organisation of CIETAC, property preservative measures, appointment of arbitrators, preparation and execution of arbitral awards and summary arbitration procedure.

¹⁰⁸ See discussion above concerning meaning of "foreign-related" disputes.

organizations;

- disputes arising from project financing, invitation for tender, bidding, construction and other activities conducted by Chinese legal persons, natural persons and/or economic organizations through utilizing the capital, technology or services from foreign countries, international organizations or from HKSAR, Macau and Taiwan; and
- disputes that should be handled by CIETAC according to the special provisions or special authorization of the law or administrative regulations of the PRC.¹⁰⁹

The CIETAC Arbitration Rules were also revised to allow parties to the arbitration to tailor the arbitration procedure subject to approval by CIETAC. Under the pre-existing Rules, all arbitrations conducted under the auspices of CIETAC had to be conducted in accordance with CIETAC Arbitration Rules. In an effort to provide greater (although not complete) autonomy to the parties, Article 7 of the Arbitration Rules now provides:

“Once the parties agree to submit their dispute to [CIETAC] for arbitration, it shall be deemed that they have agreed to conduct the arbitration under these Rules. In case the parties have agreed otherwise which is also agreed by [CIETAC], the parties agreement shall be prevail”.

Thus, subject to the approval of CIETAC, the parties may choose to apply UNCITRAL Arbitration Rules, ICC Arbitration Rules or any other set of institutional arbitration rules to their arbitration proceeding. The previous CIETAC Arbitration Rules were vague as to whether the parties’ choice of arbitration would be respected by CIETAC. As a result, Article 35 of the Rules was amended to provide that the parties may choose the place of arbitration.¹¹⁰

The enactment of the Arbitration Law and the revision to the CIETAC Arbitration Rules have certainly brought the PRC arbitration system more in line with international practice. However, CIETAC still maintains a virtual monopoly over international commercial arbitration involving foreigners - although it is possible for parties to select a domestic arbitration commission to conduct the arbitration proceedings, this is unlikely due to concerns such as local protectionism.¹¹¹ Unlike the HKSAR,

¹⁰⁹ See discussion in Zhu, above note 88, at pp. 10 –11.

¹¹⁰ The Rules were also amended to provide that the People’s Court (rather than the Intermediate People’s Court) is the competent court for handling applications for interim measures of protection (see Article 23). Whether the application should be transmitted to the Intermediate People’s Court or the Basic Level of the People’s Court is dependent upon whether the dispute is foreign-related or domestic in nature. See discussion of these changes in Zhu, above note 88, at pp. 10 – 14.

¹¹¹ Article 16 of the Arbitration Law requires that arbitration agreements must contain particulars of a

where the doctrine of party autonomy allows parties complete freedom to choose between ad hoc and institutional arbitration and to adopt whatever rules they deem appropriate, a foreign-related arbitration in the PRC is normally a CIETAC administered arbitration following CIETAC arbitration rules.¹¹² The Arbitration Law stresses the voluntary nature of arbitration agreements and provides that the parties can choose the governing arbitration commission to resolve their dispute. However, whereas the Model Law is designed to provide a framework for the administration of all kinds of ad hoc and institutional arbitration, the PRC Arbitration Law is concerned mainly with arbitration under domestic and foreign-related arbitral commissions (CIETAC and CMAC) to which it refers and makes no express provision for ad hoc arbitration.¹¹³ As such the status of arbitration institutions other than CIETAC and CMAC remains unclear under the Arbitration Law.

While there is no express prohibition against other institutions conducting arbitrations, there is no provision expressly permitting it either.¹¹⁴ For example, while arbitration under ICC Arbitration Rules could theoretically be held in the PRC¹¹⁵, there is uncertainty over the validity of the ICC arbitration agreement, the arbitration procedure and the treatment of the arbitration award. The problem is that an ICC arbitration clause does not normally mention the arbitration institution but only refers to the ICC Rules. However, under section 16 of the Arbitration Law, an arbitration agreement must designate an arbitration institution, otherwise it will be invalid. If this provision is regarded as mandatory, some ICC arbitration clauses in which the PRC is selected as the site as arbitration may be viewed as invalid. Also, it is not clear which parts of the Arbitration Law are mandatory and as result, parts of the ICC arbitration procedure which differ from the Arbitration Law (e.g. appointment methods for arbitration) may not be enforceable in the PRC.¹¹⁶

designated arbitration commission. Article 18 states that an arbitration agreement is deemed invalid if it contains no clear provision concerning the choice of arbitration commission.

¹¹² Although the new Arbitration Law and the revised CIETAC Arbitration Rules were both influenced by the UNCITRAL Model Law, they give only limited recognition to the principle of party autonomy. See Zhang Yulin, above note 105, at p 89.

¹¹³ However, ad hoc arbitration awards rendered in foreign countries may be recognized and enforced in the PRC in accordance with the New York Convention of which the PRC is a contracting state.

¹¹⁴ See discussion of issue in Louise Barrington, "ICC Office in Action", (April 1998) *IBA Journal* 21.

¹¹⁵ See discussion above concerning revision to the CITEAC Arbitration Rules in May 1998.

¹¹⁶ See Chen Min, above note 89, at p 9. For a more detailed analysis, see also Chen Min, "Some Issues of ICC Arbitration in China", 1995-97 *CIETAC Arbitration Yearbook* 85.

Moreover, although the CIETAC Arbitration Rules allow the parties to appoint an arbitrator, the arbitrator must be chosen from the list of arbitrators maintained by CIETAC. Fortunately, the panel of arbitrators maintained by CIETAC is quite extensive, but the party autonomy principle requires that the parties should have complete freedom in their choice of arbitrators.¹¹⁷ Furthermore, both the Arbitration Law and the CIETAC Arbitration Rules still vest a sizeable amount of discretionary powers over the conduct of the arbitral proceedings in CIETAC and CMAC and the domestic arbitration commissions, rather than in the arbitral tribunal chosen by the parties themselves.¹¹⁸

Recognition and Enforcement of Foreign-Related Arbitral Awards

The Arbitration Law employs a “separate track” system for the supervision and enforcement of domestic arbitrations and foreign-related arbitrations. Domestic arbitrations are subject to both procedural and substantive supervision, whereas foreign-related arbitrations are subject only to procedural review.¹¹⁹ Enforcement of domestic arbitration awards are dealt with in Article 217 of the Civil Procedure Law and Articles 62 - 64 of the Arbitration Law which provide for enforcement of arbitral awards in a People’s Court where the party against whom the enforcement is sought is domiciled or has property.¹²⁰ Article 63 provides that the People’s Court may refuse to enforce an arbitral award if the respondent presents evidence which proves that an arbitral award involves any of the circumstances set out in the second paragraph of Article 217 of the CPL, including: (a) the parties have neither included an arbitration clause in their contract nor subsequently reached a written arbitration agreement; (b) matters decided in the award exceed the scope of the arbitration agreement or are beyond the arbitral authority of the arbitration organ; (c) the composition of the arbitral tribunal or the arbitration procedure did not conform to statutory procedure; (d) the main evidence for ascertaining the facts was insufficient; (e) the law was applied incorrectly; or (f) one or several arbitrators

¹¹⁷ CIETAC maintains a list of over 420 arbitrators, with approximately 1/3 of them being foreign nationals of over 20 different states. However, many argue that if CIETAC is ever going to be a truly international arbitration body, the list system must end or at a minimum it should remain as a list of recommendations only. See for example Moser, above note 81, at p. 30.

¹¹⁸ For example, under Article 4 of the Arbitration Law the Commission – not the arbitral tribunal – is given power to decide questions relating to the existence and validity of an arbitration agreement and of other jurisdictional matters.

¹¹⁹ See further discussion below and An Chen, “On the Supervision Mechanism of Chinese Arbitration Involving Foreign Elements and its Tallying with International Practices”, (Sept. 1997) Vol 14:3 Journal of International Arbitration 39.

¹²⁰ Article 62 states that the parties must automatically execute the award within the time limit specified in the award. It is mandatory for the People’s Court to enforce an award if the winning party applies for enforcement in accordance with the provisions of the Civil Procedure Law.

committed embezzlement, accepted bribes, practised favouritism, or made an award that perverted the law.

By contrast, foreign-related arbitral awards may be enforced in the PRC pursuant to: (a) provisions in the Civil Procedure Law; (b) international agreements to which the PRC is a party¹²¹; and (c) under the terms of the New York Convention.¹²² Article 259 of the Civil Procedure Law allows a party seeking enforcement to apply directly to the Intermediate People's Court in the location where the party against whom enforcement is sought either is domiciled or has property. Articles 70 and 71 of the Arbitration Law provide that a party may oppose enforcement of foreign-related awards under Article 260 of the Civil Procedure Law. On an application by the winning party to enforce the arbitral award, the Intermediate People's Court may refuse enforcement of the award if satisfied on the evidence tendered by the respondent that there has been a violation of one of the following conditions prohibited under Article 260 of the Civil Procedure Law (which are similar to the grounds in Article V of the New York Convention): (a) the parties have neither included an arbitration clause in their contract nor subsequently reached a written arbitration agreement; (b) the party against whom enforcement is sought was not notified to appoint an arbitrator or take part in the arbitration or was unable to state his opinions in the arbitration for reasons beyond his control; (c) the composition of the arbitral tribunal or the arbitration procedure did not conform to statutory procedure; (d) matters decided in the award exceed the scope of the arbitration agreement or are beyond the arbitral authority of the arbitration organ; (e) the subject of the matter is not arbitrable under Chinese law; or (f) the arbitration is against public policy.¹²³

¹²¹ The parties may seek enforcement of the award pursuant to judicial assistance agreements that the PRC has entered into with other states providing for the mutual recognition and enforcement of arbitral awards.

¹²² For a detailed discussion of the recognition and enforcement of domestic and foreign-related arbitration awards, see Kaplan, Spruce and Moser, above note 23 at pp. 332-4 and 343-4, and M. Moser, "China and the Enforcement of Arbitral Awards", Vol. 61 (No 1 & 2), Arbitration International.

¹²³ The potential problems associated with the vagueness of the "public policy" ground for refusing enforcement of a foreign-related arbitration award is exemplified by the case of Dongfeng Garment Factory of Kai Feng City and Tai Chu International Trade (HK) Company Limited v Henan Garments (Import and Export Group) Co (1992). In this case the Zhangzhou Municipal Intermediate People's Court refused to enforce a CIETAC award arising out of an arbitration of a dispute involving a joint venture established for the manufacture and export of fashion garments stating that the enforcement would seriously "harm the economic influence of the State and public interest of the society, and adversely affect the foreign trade order of the State". No doubt the court was influenced by the fact that the defendant in the case was a major economic force in Zhangzhou where the court was located. On appeal to the Supreme People's Court the court's decision was overturned and the CIETAC award enforced. See discussion of this case in Moser, above note 87.

As in the HKSAR, enforcement of arbitral awards may also be sought pursuant to the New York Convention which the PRC adopted in 1987 with two reservations – the reciprocity and commercial reservations.¹²⁴ As with the UK (and Hong Kong previously), the enforcement of Convention awards in the PRC is subject to the reciprocity reservation, under which the PRC will only apply the Convention with respect to arbitral awards made within the territory of another contracting state. Unlike the UK, however, the PRC also invoked the commercial reservation. As a result, the PRC will apply the Convention only to disputes arising out of defined legal relations which are viewed as “commercial relations of contractual and non-contractual nature” (referring to relations concerning economic rights and obligations arising out of contract, tort or relevant statutory provisions).¹²⁵

Despite the positive regulatory framework for the recognition and enforcement of arbitral awards in the PRC, there is considerable concern in the international community over the PRC’s track record in enforcement of arbitral awards. There is difficulty on obtaining accurate statistics on the record of enforcement of international arbitral awards, particularly because the enforcement takes place at the local level. However, in July 1998 the Arbitration Research Institute of the CCOIC carried out a study over the past decade relating to the experience of all PRC Intermediate People’s Courts with applications to enforce arbitral decisions (including but not limited to foreign arbitral awards to be enforced pursuant to the terms of the New York Convention). The results of this survey are certainly not exhaustive but they indicate that of 15 actions to enforce foreign awards in Chinese courts between 1990 to 1997, 10 were recognized, 4 were denied recognition and enforcement and 1 was undecided (due to irregularities in the arbitral procedure resulting in non-enforcement).¹²⁶

Despite these apparently encouraging statistics, there have been reported difficulties encountered in enforcing foreign arbitral awards in the PRC, including incidences of local protectionism (with local courts reluctant to enforce arbitral awards against local enterprises), administrative interference in the judicial enforcement process, lack of a legal environment supportive of the rule

¹²⁴ Adopted at the 18th Session of the Standing Committee of the Sixth NPC.

¹²⁵ See the “Notice on the Implementation of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards to which China has Acceded” dated April 10, 1987. See discussion in Moser, above note 87, at p. 93 and Morgan, above note 32, at p. 14.

¹²⁶ See Chen Min, above note 89, at 10.

of the law and corruption.¹²⁷ For example, there was international outcry over the difficulties encountered by a US corporation, Revpower, in enforcing a Stockholm arbitration award in the Intermediate People's Court in Shanghai.¹²⁸ Pursuant to an arbitration clause in the counter-trade contract between Revpower and East Aviation, Revpower submitted a dispute to arbitration before the Stockholm Chamber of Commerce. Prior to a default arbitration award being rendered which ordered East Aviation to pay US\$ 4.49 million plus interest, East Aviation filed a lawsuit in the Intermediate People's Court of Shanghai over the dispute which was accepted by the court. When East Aviation refused to comply with the arbitral award, Revpower filed an application for recognition and enforcement of its arbitral award in December 1993 but the court failed to act in a timely fashion. Unfortunately, the award was not recognized until after East Aviation went bankrupt in March 1996. The case attracted much international criticism of the Chinese courts and became a *cause celebre* for various US Congressmen who lobbied hard against the admission of the PRC to the World Trade Organization ("WTO").¹²⁹

To overcome such local protectionism, the Supreme People's Court took steps to improve the PRC's adherence to its treaty obligations by enacting a pre-reporting mechanism directing that the lower courts must not refuse to enforce the awards of foreign arbitration institutions without first obtaining the views of the Supreme People's Court. In August 1995 the Court issued its "Notice Concerning the Handling by the People's Court of Issues Relating to Foreign-Related and Foreign Arbitration Matters" which provides that whenever a People's Court deals with an application for enforcement of a foreign arbitral award and decides that the award does not conform with: (a) international conventions to which the PRC has acceded; or (b) the reciprocity principle, or (c) falls within any one of the bases for refusal under Article 269 of the Civil Procedure Law, the People's Court is required to submit the matter to the relevant Higher People's Court for its judicial opinion.¹³⁰ Should

¹²⁷ See further discussion in Morgan, above note 32, at p. 14 and comments in 1992 by the former President of the Supreme People's Court discussed in R. Morgan, "Mutual Enforcement of Arbitral Awards Between Hong Kong and the People's Republic of China – One Country, Still No System", (February 1999) Vol. 14:2 Mealey's International Arbitration Report 31, at p. 39. For more detailed discussion of problems associated with local protectionism in the PRC courts, see Lubman, above note 90, Ch. 3.

¹²⁸ Revpower Limited v Shanghai Far East Aerial Technology Import and Export Corporation, (unreported) discussed in [1995] Vol 6:7 World Arbitration and Mediation Report.

¹²⁹ See Zhang, above note 56, at p. 15.

¹³⁰ This direction does not apply to domestic arbitration awards however. A further Notice was issued on March 26, 1997 by the Supreme People's Court called the "Notice on Several Issues Concerning the Implementation of the Arbitration Act of the PRC" dealing with three points: the validity of arbitration agreements entered into prior to the adoption of the Arbitration Law, applications for preservation of property

the Higher People's Court agree with the refusal of enforcement, it must be submitted further to the Supreme People's Court for opinion and approval.¹³¹ Only after the Supreme People's Court confirms the findings may the Intermediate People's Court rule to refuse enforcement of the arbitral award.¹³²

INTERNATIONAL COMMERCIAL ARBITRATION IN TAIWAN

Until quite recently the practice of international commercial arbitration in Taiwan, Republic of China ("Taiwan") was hampered by the provisions of the Taiwanese Commercial Arbitration Act 1961 (as amended in 1982 and 1986) which were viewed as outdated and out of step with internationally accepted principles of international arbitration.¹³³ The Commercial Arbitration Act was criticized for failing to simplify the procedures for the recognition and enforcement of arbitral awards and for failing to follow the trends in international commercial arbitration.¹³⁴ In addition, the Taiwanese judiciary often exhibited a hostile attitude to arbitration. For example, in 1978 the Taiwanese Supreme Court held that an arbitration agreement between parties was invalid because the bill of lading of the main contract only had one party's signature that the court held did not show the necessary mutual consent. This decision was widely criticized for failing to consider international trade law and practices, and for failing to uphold an otherwise valid arbitration agreement.¹³⁵

in domestic and international cases, and the acceptance by the People's Court of applications for the enforcement of arbitral awards.

¹³¹ For a detailed discussion of this case, see Alberto Mora, "The Revpower Dispute: China's Breach of the New York Convention?", in (C. Hunter, ed.) *Dispute Resolution in the PRC: A Practical Guide to Litigation and Arbitration in China* (Hong Kong, Asia Law & Practice Ltd, 1995) and Zhang, above note 56 at p. 15 onward.

¹³² The Supreme People's Court has recently imposed a two-month time limit on People's Courts in determining applications to enforce foreign-related arbitration awards. The People's Court must either: (a) rule to enforce the award, or (b) decline to do so and make its report to the Supreme People's Court, within two months of the acceptance of the enforcement application. See the 1998 "Regulations of the Supreme People's Court Regarding the Issue of fees and Investigation Periods for the Recognition and Enforcement of Foreign Arbitral Awards", (October 21, 1998). See discussion in Morgan, above note 127, at p. 39.

¹³³ The Commercial Arbitration Act was first promulgated on January 20, 1961 and amended in 1982 in order to deal with the increasing volume of international trade and economic activities by Taiwanese companies. In 1986 it was subject to further amendment. In addition, there are Rules Governing the Organization of Commercial Arbitration Associations and Arbitration Fees which were enacted in April 1973 with subsequent amendments in November 1983, July 1988 and April 1992.

¹³⁴ See Yu Hong-lin, "The Taiwanese Arbitration Act 1998", (1998), Vol. 15:4 Journal of International Arbitration 107, at p. 108..

¹³⁵ See 67-Tai-Shang-Tze, 3762 Supreme Court ROC discussed in Yu Hong-lin, above note 134, at p. 108. See K.C. Fan, "Commercial Arbitration in Taiwan", Paper presented at the November 1997 International Commercial Arbitration Conference in Hong Kong (on file with author).

The process of arbitration came under greater scrutiny in Taiwan in the controversy following the ruling by an arbitration tribunal in October 1993 in the dispute between the Taipei Municipal Government's Department of Rapid Transit Systems ("DORTS") and a French company, S.A. Matra Transport ("Matra") in a dispute over a contract for construction of a 10.8 km. mass rapid transit system in Taipei. The arbitral award ordered DORTS to pay more than US\$30 million to Matra.¹³⁶ In response to the widespread negative publicity surrounding the arbitration award against DORTS, many Taiwanese government agencies announced they would eliminate arbitration clauses from all their future contracts. Furthermore, the government agencies also stated that if any contractors commenced arbitration proceedings against them, the contractor's ability to participate in any future construction projects would be at risk.¹³⁷ However, with Taiwan's rapidly developing domestic economy and financial system, the Taiwanese government has committed itself to a number of large-scale construction and engineering projects. Arbitration is an integral part of these construction projects given the need for an alternative to expensive and time-consuming litigation as a means of resolving any disputes arising from these construction contracts. Moreover, since Taiwan does not have official recognition of the majority of foreign states, few states will recognize a judgement rendered by a Taiwanese court and this lack of reciprocity has made Taiwanese courts reluctant to recognize and enforce foreign judgments.

In keeping with Taiwan's commitment to internationalization and liberalization of its financial markets and in view of its desire to promote Taiwan as the pre-eminent financial center of Asia, the Commercial Arbitration Act Reform Committee was established in 1994 under the supervision of the Taiwanese Ministry of Justice with a mandate to review and reform the Commercial Arbitration Act.¹³⁸ After four years of work and intensive debate among Taiwanese jurists, practitioners and government officials as to whether to adopt the UNCITRAL Model Law, the new Taiwanese

¹³⁶ In subsequent litigation commenced by DORTS, the arbitration award was annulled by the Taipei District Court. Matra subsequently appealed this annulment order. For detailed discussion of the case, see David W. Su, "Dispute resolution in Large-Scale Construction Projects - the Matra Arbitration in Taiwan, ROC", Paper presented at the November 1998 International Dispute Resolution Conference, Hong Kong (on file with author).

¹³⁷ See Wu, above note 136, at p. 1.

¹³⁸ Due to Taiwan's rapid economic development and the increase in international transactions within Taiwan, arbitration is becoming an important alternative form of the dispute resolution. The central arbitration institution in Taiwan is the Commercial Arbitration Association of the Republic of China which was established in September, 1955 as an independent non-profit organization. Its membership and workload has expanded rapidly since its inception in 1995 and in 1997 over 150 disputes were referred to it for arbitration. It has over 350 registered members and has entered into many bilateral agreements with various national and international arbitral associations and commissions.

Arbitration Act was promulgated on May 29, 1998 with effect from December 24, 1998¹³⁹ The Act is clearly a compromise between those who advocated in favor of the adoption of the UNCITRAL Model Law and those (including members of the Taiwanese judiciary) who actively opposed its adoption.¹⁴⁰

The new Arbitration Act endorses several internationally accepted principles of international commercial arbitration (as expressed in the Model Law) in giving prominence to the concept of party autonomy, expanding the scope of its application and the arbitrability of disputes, and restricting the intervention of the national courts in the arbitration process. It also endorses the separability of the arbitration clause, and grants broader powers to arbitrators in choosing the applicable law and granting interim measures of protection. Unlike the arbitration legislation of the HKSAR and the PRC, however, the new Act does not expressly distinguish between international and domestic arbitrations, with the same law and procedure applying to both. The new Arbitration Act is divided into eight distinct chapters as follows:

Chapter I: Arbitration Agreement

Contains provisions governing the form and substance of a valid submission agreement and arbitration agreement and provides that the arbitration clause is independent other terms of the contract and that arbitrators can rule on their own jurisdiction.

Chapter II: Composition of Arbitral Tribunal

Contains provisions governing the qualifications and training of arbitrators, appointment of arbitrators, independence and impartiality of arbitrators, and grounds for applying for challenging arbitrators.

Chapter III: Arbitral Proceedings

Contains provisions governing the commencement of arbitrations, the arbitration procedure (rules governing the procedure, confidentiality of the proceedings, language of the hearing, and examination of witnesses etc.), and making of the arbitral award.

Chapter IV: Recognition and Enforcement of Arbitral Awards

Confirms that an arbitration award has the same legal effect as a judgment of the Taiwanese courts, provides for the compulsory enforcement of arbitration awards following execution by the court,

¹³⁹ The draft Arbitration Act was adopted by the Taiwanese Executive Yuan and submitted to the Legislative Yuan in July 1997 for debate. For discussion of the reform process, see Yu Hong-lin, above note 134, at p. 107.

¹⁴⁰ See Yu Hong-lin, above note 134, at p. 108 and Fred Li and David S. Wu, "Dispute Resolution in Taiwan", in *International Dispute Resolution* (Hong Kong, Asia Law & Practice, 1997) 23 at p. 24.

and sets out the grounds upon which the recognition or enforcement of an arbitral award may be refused.

Chapter V: Recourse Against Award

Contains provisions governing the grounds upon which an arbitral award may be set aside.

Chapter VI: Conciliation and Mediation

Permits the parties to combine mediation within the context of an arbitration proceedings, and provides that a mediated agreement has the same effect as an arbitral award (subject to an execution order by the court).

Chapter VII: Foreign Arbitral Award

Defines what is a “foreign arbitral award”, the procedure for enforcing such an award within Taiwan, the grounds for refusing recognition and enforcement of a foreign arbitral award, and the grounds for setting aside a foreign arbitral award.

Chapter VIII: Miscellaneous

Provisions governing issues such as the scale of arbitration fees and the date of effect of the legislation.

Important Reforms Introduced in the New Arbitration Act

Although ambiguous and insufficient in some respects, the new Arbitration Act is a vast improvement from the previous Commercial Arbitration Act.¹⁴¹ The old Act only permitted commercial disputes to be submitted to arbitration, while the new Act expands the application of the legislation to allow other types of disputes to be resolved by arbitration (e.g. construction, labour, and consumer disputes), providing that such disputes are capable of “being settled by arbitration according to law”.¹⁴² The Act also contains a broad definition of an arbitration agreement following the provisions of Article II(2) of the New York Convention and Article 7(2) of the UNCITRAL Model Law. Articles 1.2 and 1.3 provide that an “arbitration agreement” must be in writing – an agreement is in writing if it is contained in a document signed by the parties or securities, or in an exchange of letters, telex, telegrams or other means of telecommunications which provide a record of the agreement. However, unlike the recent amendments to the HKSAR Arbitration Ordinance which contemplate advances in electronic technology and do not necessarily

¹⁴¹ See further discussion below.

¹⁴² See Article 1.1. Certain types of disputes such as those concerning marriage and inheritance are not arbitrable under Taiwanese law. The expansion of the application of the legislation is indicated by the title of the Arbitration Act, rather than the previous title of “Commercial Arbitration Act”. See discussion in Yu Hong-lin, above note 134, at pp. 107-108.

require the arbitration agreement to be “signed” by the parties, the new Act still requires that the arbitration agreement be signed by the parties. Article 3 of the new Act is a welcome addition since it expressly endorses the separability of the arbitration clause and provides that the arbitration tribunal has power to rule on questions relating to its own jurisdiction and the validity of the arbitration agreement. In accordance with Article 22 such a ruling on the arbitration tribunals’ jurisdiction is not subject to appeal.¹⁴³

In accordance with the party autonomy principle, the new Act provides that the parties are free to determine the number of arbitrators (failing agreement, the number of arbitrators is three) and can appoint arbitrators of their choice subject to those arbitrators having the necessary qualifications set out in the Act. Unlike the HKSAR Arbitration Ordinance, Articles 6 and 7 of the new Act contain detailed provisions concerning the qualities arbitrators must possess and the circumstances which may disqualify the arbitrators chose by the parties.¹⁴⁴ Furthermore, in an effort to ensure the continuing quality of Taiwanese arbitrators, Article 8 requires that arbitrators must attend training or seminars organized by the Ministry of Justice (although little details are provided about the frequency or nature of such training). Article 16.1 sets out the grounds upon which an arbitrator may be challenged, and includes factors such as: (a) a pre-existing or existing agency or employment relationship between the arbitrator and the parties (or their agents); (b) lack of qualifications as set out in Articles 6 and 7 and as agreed between the parties; and (c) circumstances likely to give rise to justifiable doubts about their impartiality or independence.¹⁴⁵

¹⁴³ In addition, under Article 22 an argument that the arbitration tribunal does not have jurisdiction will be denied if it is raised after submission of the statement of defence.

¹⁴⁴ Article 6 provides that arbitrators can be:

- (1) individuals who worked as judges, district attorneys or prosecutors;
- (2) lawyers, accountants, architects, engineers, or other professions relevant to commerce with more than five years’ experience;
- (3) the individuals having experience as arbitrators;
- (4) academics working in academic institutions recognized by the department of education with more than five years’ experience; or
- (5) other professionals with more than five years’ experience.

Under Article 7 individuals cannot be appointed as arbitrators if they have been convicted of corruption, “deprived of civil rights”, or declared bankrupt.

¹⁴⁵ The new Arbitration Act also adopts the policy underlying Article 13 of the Model Law by providing in Articles 14, 16 and 17 that the arbitrator must disclose any circumstances which would require judicial withdrawal under the Taiwanese Code of Civil Procedure, any prior or existing employment or agency relationship with either party, or any other circumstances likely to give rise to “justifiable doubts” about the arbitrator’s impartiality or independence from the parties.

Several provisions of the new Arbitration Act uphold the party autonomy principle. For example, Article 19 of the new Act provides that the parties are free to choose the procedural law governing the arbitration. In the absence of the procedural law agreed between the parties, the Arbitration Act will be applied to govern the proceedings (and will be supplemented by the Taiwanese Code of Civil Procedure and other relevant procedural laws).¹⁴⁶ The party autonomy principle has also been applied in Article 20 of the Act which grants the parties freedom to determine the place of arbitration (failing such agreement, the arbitration tribunal has jurisdiction to determine the place of arbitration).¹⁴⁷ In attempt to internationalize the arbitral regime in Taiwan, the new Act in Article 25.1 also allows the parties complete freedom to determine the language(s) of the arbitration proceedings. Article 22 of the new Act also expressly states that the arbitral tribunal shall provide the parties with “full opportunity of presentation” (the previous provision of the Commercial Arbitration Act was silent on this issue).¹⁴⁸ Article 31 of the Act was the subject of much debate during the reform process among those for and against allowing the application of *lex mercatoria*, *amiable compositeur* and *ex aequo et bono* as valid choices of proper law. The provisions of Article 31 are a compromise between these two groups and state that with the parties’ agreement, the arbitration tribunal can decide the cases as *amiable compositeur* or *ex aequo et bono*. Surprisingly, there is no mention made of the application of *lex mercatoria* within the section.¹⁴⁹

Recognition and Enforcement of Foreign Arbitral Awards

Unlike the HKSAR and the PRC, Taiwan is not a party to the New York Convention due to its uncertain international status. Prior to the legislative amendments in 1982, the previous Commercial Arbitration Act did not deal with the enforceability of foreign arbitration awards. As a result, foreign arbitral awards, with the exception of arbitral awards from the United States, were

¹⁴⁶ These provisions are similar to Articles 16 and 19 of the UNCITRAL Model Law.

¹⁴⁷ Article 20 is modeled after Article 20(1) of the UNCITRAL Model Law but surprisingly it does not contain any provision similar to Article 20(2) of the Model Law (enabling the arbitration tribunal to meet at any other place for purposes of consultation, hearing witnesses etc.). See discussion of this point in Yu Hong-lin, above note 134, at p.111.

¹⁴⁸ Article 13 of the Commercial Arbitration Act provided: “...the arbitrator(s) shall, before rendering an award, conduct inquiries, hear the contentions of both parties, and conduct whatever investigations may be deemed necessary for the determination of the controversy or dispute before him or them.” Article 22 of the new Arbitration Act embodies the spirit of Article 18 of the Model Law by providing: “The arbitral tribunal shall provide the parties with full opportunity of presentation and shall conduct all necessary investigation.”

¹⁴⁹ See discussion in Yu Hong-lin, above note 134, at p. 112.

not capable of being enforced in Taiwan.¹⁵⁰ However, it was possible for a party to an arbitration to submit an arbitral award to the Taiwanese courts as important evidence in a case, provided that it could be established that the award was based on principles of fairness and was not incompatible with public order, good morals or the mandatory laws of Taiwan.¹⁵¹

In June 1982 the Commercial Arbitration Act was amended to include several articles dealing with the recognition and enforcement of foreign arbitral awards. Under Article 30 all arbitration awards made outside Taiwan were considered to be “foreign arbitral awards”, regardless of the nationalities of the parties, the arbitrators, and the law in accordance with which the arbitration was conducted. A foreign arbitral award had to be submitted to a Taiwan court for recognition before it could be enforced. The Commercial Arbitration Act then contained a lengthy list of grounds upon which recognition and enforcement of arbitral awards could be refused, including¹⁵²:

- reciprocity (Taiwan’s courts would refuse to recognize an foreign arbitral award if the courts of the place of arbitration did not recognize arbitration awards rendered in Taiwan);
- if the award contravenes the “compulsory” or “prohibitive” provisions of the laws of Taiwan, or is contrary to public order or good morals of Taiwan;
- non-arbitrability;
- failure by the arbitration tribunal to follow arbitration rules;
- the arbitration award is not yet binding on the parties under the laws of the state where it was rendered,
- invalidity of the arbitration agreement;
- lack of due process;
- partiality or corruption by the arbitrators; or
- corruption, fraud or undue means exercised by either of the parties.

¹⁵⁰ US arbitration awards are enforceable in Taiwan based on Article VI(4) of the *Treaty of Friendship, Commerce and Navigation between the ROC and the USA* entered into on November 30, 1948. See also the 1974 decision of the Taiwanese Supreme Court, 63 Tai Shang Tze No. 426.

¹⁵¹ See discussion in Fan, above note 135, at p. 7 citing the decision by the Taiwanese Supreme Court in Wei Chieh Shipping Co., Ltd. v Hai Long Company, (1973) 62 Tai Shang Tze (codified in *Supreme Court Judgments on International Trade and Maritime*, Vol. 2, 9.925).

¹⁵² See Articles 32 and 33, Commercial Arbitration Act and further discussion in Fan, above note 135, at pp. 8 – 11.

The new Arbitration Act substantially changes the approach to the recognition and enforcement of foreign arbitral awards in Taiwan in two main ways: firstly, the grounds for refusing the recognition and enforcement of foreign arbitral awards have been reduced and now mirror the grounds contained in Article V of the New York Convention; and secondly, the definition of what constitutes a “foreign arbitral award” has been amended. Under Articles 49 and 50 of the new Arbitration Act a foreign arbitral award can only be refused enforcement on the grounds of: incapacity of the parties, invalidity of the arbitration agreement, irregularities in the arbitration procedure, that the decision of the arbitral tribunal exceeded the scope of the submission to arbitration, irregularities in the composition of the arbitral tribunal, that the award is not yet binding, non-arbitrability, or public policy. Thus, the new Act deletes the violation of compulsory or prohibitive provisions of Taiwanese laws as a ground for denial of enforcement. However, Article 49.2 of the new Act preserves the reciprocity ground and provides that a Taiwanese court may refuse recognition and enforcement of an arbitral award “if the court of the country where the arbitration took place or the applicable law of the country refuses to recognize or enforce arbitral awards made in Taiwan”.¹⁵³

A subject of intense debate among Taiwanese jurists and practitioners concerned the definition of “foreign arbitral award” and resulted in one of the most controversial changes introduced in the new Arbitration Act.¹⁵⁴ Article 47 defines an arbitral award as “foreign” if: (a) it is made outside the territory of Taiwan; and (b) it is made within the territory of Taiwan in accordance with foreign law.¹⁵⁵ Causing most concern was the use of the applicable law as a determinate factor in considering whether an arbitration award rendered in Taiwan was a domestic or foreign arbitral award. Many question whether an award made within Taiwan should be characterized as “foreign” simply because of the application of foreign laws. A potential problem arises in the ambiguity of this provision. An arbitration award rendered within the territory of Taiwan but in accordance with a foreign law (e.g. French law) would be characterized under the new Arbitration Act as a “foreign

¹⁵³ Article 48 of the new Arbitration act provides that an application for recognition and enforcement of a foreign arbitral award must be accompanied by: (a) the duly authenticated original award or a duly certified copy; (b) the original arbitration agreement or duly certified copy; and (c) the full texts of the foreign arbitration law, the arbitration rules of the foreign arbitration institution or the arbitration rules of international organization. If the documents are written in a foreign language, a duly certified translation into Chinese must be provided.

¹⁵⁴ See discussion of this debate in Yu Hong-lin, above note 134, at pp. 113 – 114.

¹⁵⁵ Article 30 of the previous Commercial Arbitration Act provided that foreign arbitral awards were awards rendered by any arbitral tribunal sitting outside Taiwan.

arbitral award". However, if that same award were taken to the courts of the foreign state (e.g. French courts) for enforcement, would the French courts characterize the award as a domestic or foreign arbitration award? Most jurisdictions adopt the territorial principle as contained in Article I of the New York Convention which provides that the Convention applies to the recognition and enforcement of arbitral awards "made in the territory of a State other than the State where the recognition and enforcement of such awards are sought". Thus, the French courts may apply the territorial criteria and determine that the nationality of the award is Taiwanese and decline the jurisdiction to recognize or enforce the award. Unfortunately, the reaction of legal practitioners to this Article has been overwhelmingly negative with many suggesting that they will avoid arbitrating in Taiwan due to the ambiguity of the provision.¹⁵⁶

Another concern is over the ambiguous nature of the term "foreign law" in Article 47 – does it refer to the substantive law or procedural law of a state other than Taiwan, or both? It is unclear from the legislation what is intended by this phrase and further clarification is warranted. The previous drafts of the new Arbitration Act suggest that the reference to "foreign law" is to procedural law only, although officials of the Taiwanese Commercial Arbitration Association have apparently stated that the phrase is intended to cover both substantive, as well as procedural law of state other than Taiwan.¹⁵⁷

PROBLEMS WITH THE CROSS-BORDER RECOGNITION AND ENFORCEMENT OF ARBITRAL AWARDS IN THE HKSAR AND THE PRC

The availability of a reliable, effective and fair method of recognizing and enforcing arbitral awards is imperative to the continued use and development of arbitration as a means of resolving commercial disputes within the HKSAR and the PRC.¹⁵⁸ However, since the resumption of sovereignty over Hong Kong by the PRC the mechanism for reciprocal recognition and enforcement of arbitral awards between

¹⁵⁶ See Yu Hong-lin, above note 134, at p. 113.

¹⁵⁷ A draft of the Arbitration Act in July 1997 defined a foreign arbitral award as follows: "An arbitral award is a foreign award if it is made outside the territory of the Republic of China, Taiwan, or if it is made within the territory of the Republic of China, Taiwan in accordance with (i) the foreign arbitration act, (ii) the rules of the foreign arbitration institution, or (iii) the arbitration rules enacted by the international organization." See Yu Hong-lin, above note 134, at p. 114 and Fan, above note 135, at pp. 14 – 15.

¹⁵⁸ Of course, it is also important for Taiwan although this portion of the paper deals mainly with the problems associated with the cross-border enforcement of arbitral awards in the HKSAR and the PRC.

the HKSAR and the PRC under the New York Convention has lapsed.¹⁵⁹ As discussed above, the result of a declaration by the Chinese Ambassador to the United Nations just prior to the hand-over is that the New York Convention ceased to be the law governing the recognition and enforcement of arbitral awards between HKSAR and the PRC as of July 1, 1997.¹⁶⁰

Courts in both the HKSAR and the PRC have refused to apply the Convention to enforce arbitral awards from the PRC or Hong Kong. In January 1998 the Court of First Instance in NG Fung Hong Ltd. v ABC,¹⁶¹ refused to enforce in the HKSAR an arbitral award rendered by CIETAC either under the New York Convention nor pursuant to the Arbitration Ordinance.¹⁶² Similarly, in July 1998 the PRC the Taiyuan Intermediate People's Court in RAAB KarcherKokle GmbH v Shanxi Sanjia Coal-Chemistry Co. Ltd. held that the enforcement of an arbitral award made by the HKIAC in Hong Kong should be suspended indefinitely because of the lack of clear basis in support of enforcement of HKSAR arbitral awards in the PRC and vice versa.¹⁶³ This legal vacuum with respect to reciprocal enforcement urgently requires a resolution, as it has resulted in damage to the HKSAR's reputation as centre for international trade and an attractive forum for arbitration.¹⁶⁴

¹⁵⁹ For an exhaustive review of the problem concerning the recognition and enforcement of arbitral awards in the HKSAR and the PRC, see Morgan, above notes 32 and 127 and Wang Guiguo, above note 64.

¹⁶⁰ See the "Declarations and Reservations of the Chinese Government Concerning the Application of Multiple International Treaties to the HKSAR", June 20, 1997 discussed in Zhang, above note 56, at p 17.

¹⁶¹ A similar result was reached Heibei Import-Export Corp v Polytek Engineering Co Ltd. (No 2), supra, discussed above. For a more detailed discussion of the judgements in these two cases, see Zhang, above note 56, at pp. 18 – 22.

¹⁶² The result in the Ng Fung Hong decision has equal application to the enforcement of Taiwanese arbitration award in the HKSAR. The court's application of sections 2AD and 2GG of the Arbitration Ordinance can be applied to Taiwanese arbitration awards and thus the Court of First Instance lacks discretion to grant summary enforcement of such awards. As a result, unless separate arrangements are made for the enforcement of Taiwanese arbitration awards in the HKSAR, a legal vacuum will similarly result. See further discussion on this issue below at note 197 and Morgan, above note 32, at p. 37.

¹⁶³ Most Hong Kong practitioners and academics agree that the New York Convention may not be applied to the recognition and enforcement of "intra-China" arbitral awards. A similar problem will result when the sovereignty over Macau, which is party to the new York Convention by virtue of Portugal's accession to the Convention, is transferred to the PRC on December 20, 1999. See discussion in Wang Sheng Chang, above note 59, at p. 1, David Little, "International Legal Assistance Through the Transition", in Peter Wesley-Smith (ed), *Law Lectures for Practitioners 1997* (Hong Kong, HKLJ Ltd., 1997) 232, Lin, above note 77, at p. 57 and Zhang, above note 56, at p. 19.

¹⁶⁴ See Karen Cooper and Jane Moir, "Millions 'lost' as settlements go to Singapore", *South China Morning Post*, November 30, 1998.

It is most unfortunate that the matter not resolved before the transfer of sovereignty¹⁶⁵. although it is clear that the issue was raised on many different occasions as early as 1992.¹⁶⁶ One solution suggested was the conclusion of a written “Memorandum of Understanding” between the UK and PRC governments prior to the transfer of sovereignty to the effect that the principles of the New York Convention would apply to the HKSAR in relation to the enforcement of arbitral awards.¹⁶⁷ However, the issue was considered by the Chinese side to be a matter of its internal politics and as such, no action was taken on the matter until after 1996.¹⁶⁸ Various proposal were suggested as a means of creating a new mechanism for the mutual cross-border enforcement of arbitral awards, however each have their drawbacks due to the fundamental differences between the political and legal systems in both jurisdictions.¹⁶⁹

Adoption of Unilateral Legislation by both HKSAR and PRC Governments

Various commentators, including Robert Morgan and Wang Guiguo, suggested that the governments of both the HKSAR and the PRC could enact domestic legislation which provides that arbitral awards from the other jurisdiction is treated as is subject to the provisions of the New York Convention.¹⁷⁰ Thus, the PRC could legislate to declare that for the purpose of enforcement, arbitral awards rendered in the HKSAR will be regarded as Convention awards, with similar legislation enacted in the HKSAR with respect to PRC arbitral awards. However, as Morgan and Zhang note, this proposal appears to link mutual recognition and enforcement of arbitral awards to

¹⁶⁵ Prior to the hand-over, the Solicitor-General of Hong Kong, Daniel Fung, advised local practitioners to provide for arbitration at venues other than Hong Kong or the PRC in view of the pending legal vacuum. See Daniel R Fung, “Mutual Legal Assistance as Between Hong Kong and the Mainland in the Run-up To, and Beyond 1997”, (1996) 2 *Arbitration* at pp. 87 – 88.

¹⁶⁶ As early as 1992 the issue of arbitral award enforcement was raised by the British with the Chinese side in the Joint Liason Group. See *Report of the Working Party on Legal and Procedural Arrangements Between Hong Kong and China in Civil and Commercial Matters* (October 1992) and discussion in Wang Sheng Chang, above note 59, at p. 15, Morgan, above notes 32 and 127, at pp. 18 and 31 and Zhang, above note 56, at p 17.

¹⁶⁷ See elaboration of this proposal in Morgan, above note 32, at p. 20.

¹⁶⁸ Ibid.

¹⁶⁹ For a detailed discussion of these suggestions, see Morgan, above note 32 and Zhang, above note 56.

¹⁷⁰ See, for example, Morgan, above note 32 and Wang Guiguo, above note 64 (suggesting that through the PRC’s unilateral declaration, Hong Kong arbitral awards should be treated as containing foreign elements and thus subject to the New York Convention in accordance with the Arbitration Law and Civil Procedure Law), and Xu Hong of the PRC Ministry of Foreign Affairs, all discussed in detail in Zhang, above note 56, at pp. 22 – 23. See also Wang Sheng Chang, above note 59, at p 5. Note that the obiter comments of the Hong Kong Court of Appeal in Hebei Import-Export Corp. v Polytek Engineering Co. Ltd (No 2) support this approach: see [1998] 1 HKC 192 at p. 197.

the New York Convention even though the PRC government has clearly excluded its application to cross-border enforcement of arbitral awards between the HKSAR and the PRC.¹⁷¹ The reality of two separate legal and political systems in the HKSAR and the PRC may also prevent the implementation of unilateral declarations or enactment of legislation. More importantly, such a proposal does not give due consideration to Article 95 of the Basic Law which provides for the establishment of a judicial assistance regime between the HKSAR and the PRC facilitating the cross-border enforcement of arbitral awards following the principles of the New York Convention (see discussion below).

Reciprocal Legislation Enacted by the HKSAR and other Regions of the PRC

Another suggestion was the enactment of “sympathetic” reciprocal legislation based on the New York Convention in the HKSAR and the 31 provinces, autonomous regions and municipalities in the PRC. The difficulty with this multi-party proposal, however, is the potential conflicts of law problems that may result and the possibility that each province, region or municipality could amend or repeal its law without reference to the others.¹⁷²

The PRC Central Government Legislates Rules Applicable to both the HKSAR and the PRC

Alternatively, it was suggested that formal directions could be issued centrally, either by the NPC or the Supreme People’s Court, to the effect that the principles of the New York Convention apply in relation to the enforcement of arbitral awards between the HKSAR and the PRC. This deceptively simple proposal, however, may raise problems based on the provisions of the Basic Law (Articles, 2, 17 and 18) which limit the interference of the PRC central government in the HKSAR to matters such as national defence and diplomacy and moreover, guarantee a high degree of autonomy and legislative power to the HKSAR.¹⁷³

Establishment of a Judicial Assistance Regime (Article 95, Basic Law)

Each of the above proposals – whether the passage of unilateral legislation or the enactment of reciprocal legislation – all have drawbacks given the fundamental differences between the legal and political systems of the HKSAR and the PRC, as well as the principles of governance enshrined in the Basic

¹⁷¹ See further elaboration of this point in Morgan, above note 32, at p. 20 and Zhang, above note 56, at p. 23.

¹⁷² See further discussion of this proposal in Morgan, above note 32, at p. 21 and Zhang, above note 56, at p. 24.

¹⁷³ The recent decision of the Court of Final Appeal in Ng Ka Ling, above note 6, makes it clear that the high degree of autonomy in the HKSAR is of central importance and indicates the willingness of the court to strike down PRC legislation adverse to the provisions in the Basic Law. See also discussion in Zhang, above note 56, at p. 24.

Law. A preferable solution is the conclusion of a mutual judicial assistance agreement between the HKSAR and the PRC governments for the mutual cross-border recognition and enforcement of arbitral awards.¹⁷⁴ It is encouraging to note that this approach has been adopted by the HKSAR government. On November 11, 1998 the HKSAR Secretary of Justice announced that the Department of Justice had entered into discussions with its counterparts in the Supreme People's Court, CIETAC and the Legislative Affairs Commission of the NPC (with the assistance of the Hong Kong and Macau Affairs Office) in attempt to reach an agreement on mutual judicial assistance in enforcing arbitral awards based on the provisions of the New York Convention.¹⁷⁵ Negotiations are currently underway for a cross-border judicial assistance agreement that will attempt to preserve the pre-1997 enforcement practice as far as possible by adopting the following principles:¹⁷⁶

Continuity:

The practice under the New York Convention prior to the transfer of sovereignty will be preserved. New provisions will be enacted in the HKSAR based on sections 42 and 44 of the Arbitration Ordinance to enable PRC arbitration awards to be enforced in the HKSAR, with the HKSAR courts continuing their pro-enforcement bias.¹⁷⁷ In the PRC a new notice will probably be issued by the Supreme People's Court making it mandatory for an Intermediate People's Court to enforce a HKSAR arbitral award in the absence of grounds for refusing enforcement specified in the notice (most likely those grounds set out in Article V of the New York Convention discussed above).¹⁷⁸

Enforcement Procedure:

The procedure for enforcement of arbitral awards will follow the law of the place where enforcement is sought. Thus, in the HKSAR Order 73 of the Rules of the High Court (with minor amendments) will

¹⁷⁴ See Little, above note 162 and discussion of issue in Zhang, above note 56, at pp. 24 – 27.

¹⁷⁵ See remarks made by the Secretary of Justice, Mrs. Elsie Leung Oi-sie on November 11, 1998 at the 1998 International Dispute Resolution Conference, Hong Kong. In a speech on January 11, 1999 at the ceremony signifying the Opening of the 1999 Legal Year, the Secretary of Justice stated that the parties hoped to reach some consensus on the matter in the near future. See May Sin-mi Ho, "Deal Struck on Cross-Border Cases", South China Morning Post, December 18, 1998 and Zhang, above note 56, at p. 27.

¹⁷⁶ For a detailed review of the proposed mutual judicial assistance agreement, see Morgan, above note 127 and Margaret Ng, "Reciprocal Enforcement Between the Mainland and the HKSAR", (Feb 1999) Hong Kong Lawyer 17. In January 1999 the HKSAR government also announced that an agreement between the HKSAR and the PRC had been signed for the mutual service of court documents: see Zhang Xian Chu, "The Extraterritorial Service of Judicial Documents from Hong Kong", (1998) Vol. 28:3 Hong Kong Law Journal 356.

¹⁷⁷ See previous discussion above.

¹⁷⁸ See the 1987 Supreme People's Court Notice concerning the implementation of the New York Convention discussed above. See further discussion in Morgan, above note 127.

govern the enforcement procedure.¹⁷⁹ In the PRC the provisions of the Civil Procedure Law will govern the enforcement procedure, along with those set out in the 1987 Supreme People's Court Notice concerning the implementation of the New York Convention (as well as the 1995 Supreme People's Court Notice establishing the pre-reporting mechanism).¹⁸⁰ As for the grounds for refusal of enforcement of awards, the provisions of Article V of the New York Convention will apply to both the HKSAR and the PRC.¹⁸¹

Minimum Alteration of Law

Under the agreement there is to be minimum alteration to the respective arbitration legislation. In the HKSAR the Arbitration Ordinance will be amended to provide for the enforcement of PRC arbitral awards in accordance with the New York Convention.¹⁸² It is unlikely that there will be any amendments to the PRC Arbitration Law, with notices issued by the Supreme People's Court used to implement the necessary changes.

Retrospectivity

Once a formal agreement is reached, it will have retrospective effect as follows:¹⁸³

- HKSAR arbitration awards made during the period July 1, 1997 to the commencement of the agreement will be enforced in the PRC if the application is submitted within six months of the agreement's commencement date;
- For those cases where PRC arbitral awards have been refused enforcement in the HKSAR, applications can be re-submitted within a certain time period to be decided¹⁸⁴;
- For arbitral awards made after the commencement of the agreement, the usual time limitations will govern enforcement applications. For the enforcement of HKSAR awards in the PRC, applications must be brought within 6 months for personal claims (or 1 year for a company and/or legal entity). By contrast, there is no such time limit imposed under the

¹⁷⁹ See discussion of Order 73 above.

¹⁸⁰ See above note 130.

¹⁸¹ Although each jurisdiction will utilize its own legislative phrases, e.g. with "public policy" used in the HKSAR and "public social benefit" used in the PRC. See Ng, above note 176.

¹⁸² With slight amendments made to Order 73 of the Rules of the High Court.

¹⁸³ See Ng, above note 176.

¹⁸⁴ As Morgan notes this provision presupposes that the issue of enforcement has not been determined in the meantime by an action on the award. It is interesting to note that no equivalent provision has been proposed for HKSAR awards that have been refused enforcement in the PRC. See Morgan, above note 127, at p. 35.

Despite this agreement over certain principles, the extent of the coverage of the reciprocal judicial assistance between the two sides remains a difficult problem. Under the current proposal only awards made by CIETAC and CMAC will be recognised and enforced in the HKSAR under the principles of the New York Convention. It does not contemplate the enforcement of arbitration awards rendered by other PRC arbitration commissions, including domestic arbitration commissions.¹⁸⁶ Another unresolved issue concerns the “commercial” reservation adopted by the PRC in connection with the New York Convention.¹⁸⁷ It is unclear whether the PRC will continue to limit the recognition and enforcement of HKSAR awards to those made in “commercial” disputes as happens in connection with Convention awards.¹⁸⁸ These and other problems are likely to be contentious points of discussion in the on-going negotiations between the HKSAR and PRC authorities.¹⁸⁹

CONCLUSION

The divergent political, economic and legal regimes governing international commercial arbitration in the HKSAR, the PRC and Taiwan illustrate the difficulties associated with the implementation of the “one country, two systems” within the proposed reunification of Greater China.¹⁹⁰ Reunification will transform the PRC from a unitary and hierarchical socialist legal system into a pluralist legal system with multiple legal regions (which will include elements of socialist law, common law and civil law all of which are quite different in nature, form and content). The different legal systems of the HKSAR (dominated by the English common law legal system), Taiwan (heavily influenced by Japanese and

¹⁸⁵ See Article 219, Civil Procedure Law and the 1987 Supreme People’s Court Notice discussed above. Under section 4(1)(c) of the Limitation Ordinance (Cap 347) there is a 6 year limitation period for commencement of a common law action on the arbitration award.

¹⁸⁶ However, the HKIAC want any PRC arbitration award, whether rendered by CIETAC or CMAC or by any other PRC arbitral commission (including domestic arbitration commissions), to be recognised and enforced in HKSAR in the same way as Convention awards. This point appears to have been a contentious point in the negotiations. See Morgan, above note 127, at pp. 34 – 35.

¹⁸⁷ See discussion above.

¹⁸⁸ See further discussion in Morgan, above note 127, at p. 36.

¹⁸⁹ Another issue of concern is the “quality” of arbitral awards issued by PRC arbitral commissions. It will probably be at least mid-1999 before any legislative changes are introduced in the HKSAR. See discussion of this issue in Morgan, above note 127, at p. 36 and Ng, above note 176.

¹⁹⁰ Although such inter-regional conflicts of law are an inevitable result of the PRC’s quest for reunification of Hong Kong, Macau and Taiwan. See extensive discussion of these inter-regional conflicts of law in Huang and Xuefeng, above note 7.

European civil law systems), the MSAR (heavily influenced by Portuguese civil law) and the PRC (with its socialist civil tradition), will inevitably create complex issues as to which regional law should be applied and whether the courts in different regions will recognize and enforce the judgments and arbitral awards of the courts and arbitral tribunals of the other regions.¹⁹¹

One way of dealing with the emerging inter-regional conflicts of law resulting from the potential reunification of Greater China, is to attempt to harmonize and unify the substantive law in the various regions and to develop rules governing the inter-regional conflicts.¹⁹² Unifying the substantive law governing international commercial arbitration will be a challenge given the substantial differences between the arbitral regimes of the HKSAR, Taiwan and the PRC. This reflects not only the diversity in the underlying economic, legal and political systems of these jurisdictions, but also the separate historical evolution of the different arbitral regimes. The enactment of the PRC Arbitration Law in 1995¹⁹³ and the new Taiwanese Arbitration Act in 1998 have resulted in the adoption of some fundamental principles of international commercial arbitration (eg. a limited recognition of the party autonomy principle and the finality of arbitration). However, neither of these two jurisdictions has fully adopted the principles inherent in the UNCITRAL Model Law as the HKSAR has endeavoured to do. Some of the main areas of divergence between the arbitral regimes of the HKSAR, Taiwan and PRC include:

- the PRC Arbitration Law only provides for institutional arbitration and does not expressly contemplate ad hoc arbitrations, while both ad hoc and institutional arbitrations may be conducted in the HKSAR. The emphasis in the PRC is placed on institutional arbitration, whereas ad hoc arbitration is much more prevalent in the HKSAR. Reflective of the emphasis on institutional arbitration, there are more formal requirements governing the commencement and conduct of arbitrations in the PRC than in the HKSAR;
- the HKSAR Arbitration Ordinance has a broader provision concerning the requirement for an arbitration “to be in writing” (as does the Taiwanese Arbitration Act) and thus both incorporate the parties’ intention to arbitrate more so than in the PRC Arbitration Law;
- in HKSAR and Taiwanese arbitrations, the parties are free to choose the arbitrator of their choice. However, parties involved in arbitrations in the PRC lack freedom to choose arbitrators and must select from the arbitration commission’s panel of arbitrators. As such

¹⁹¹ See discussion of these issues in Huang and Xuefeng, above note 7.

¹⁹² Ibid. As suggested above with respect to the cross-border recognition and enforcement of arbitral awards in the HKSAR and the PRC.

¹⁹³ As well as the recent revisions to the CIETAC Arbitration Rules.

there is no full implementation of the party autonomy principle in the PRC:

- the PRC Arbitration Law does not expressly allow arbitrators to decide their own jurisdiction (instead CIETAC or the competent People's Court decide on the existence and validity of the arbitration agreement and the jurisdiction of the arbitration commission over a case), whereas the HKSAR Arbitration Ordinance and the Taiwanese Arbitration Act expressly vest this power in the arbitrators;
- unlike arbitrators in Taiwan and the PRC, arbitrators in the HKSAR are vested with extensive powers to make orders or give directions under the 1996-97 reforms of the Arbitration Ordinance¹⁹⁴; and
- arbitrators in the HKSAR may now limit the amount of recoverable costs awarded in favour of the successful party, subject to the common law principle that costs follow the event. By contrast, the CIETAC Arbitration Rules provide that an arbitrator has power to award costs in favour of the winning party but such compensation must not exceed 10% of the total amount awarded.¹⁹⁵

While the Arbitration Law has dramatically reformed the system of domestic arbitration in the PRC (particularly by the establishment of the China Arbitration Association and independent and autonomous domestic arbitration commissions), its effect on the system of international arbitration is much less dramatic. More significant changes are required to bring the arbitration system in the PRC in greater conformity with international arbitration law and practice, including: allowing the parties freedom to choose arbitrators and removing the restrictive panel system for selection of arbitrators; vesting greater discretion and decision-making power and control over the arbitration proceedings in arbitration tribunals rather than in the domestic arbitration commissions and CIETAC and CMAC; and removing the virtual monopoly of CIETAC and CMAC by expressly allowing ad hoc foreign-related arbitrations to be held in the PRC, under whatever arbitration rules.¹⁹⁶ The Taiwanese Arbitration Act also warrants further reform to fully embrace the principle of party autonomy, to grant the arbitrators greater powers

¹⁹⁴ See discussion above and note 54.

¹⁹⁵ Another difference is that in the PRC there is a 6 or 12 month time limit imposed on the enforcement of arbitral awards (depending upon whether the parties are natural persons or companies and legal entities), whereas in the HKSAR an arbitration awards remains enforceable for 6 year. See above note 184.

¹⁹⁶ Chen Min suggests that this could be achieved by clarifying the nature of Article 16 of the PRC Arbitration Law through an amendment making "arbitration commission chosen" a separate clause and revising it as follows: "The parties may choose the arbitration institution in their agreement". See Chen Min, above note 116, at p. 103.

over the arbitration proceedings, and to rectify the ambiguity in the legislation concerning the recognition and enforcement of foreign arbitral awards. Finally, it is obvious that it is in the best interests of both the governments of the HKSAR and the PRC to quickly resolve the difficulties associated with the cross-border recognition and enforcement of arbitral awards.¹⁹⁷ In view of (a) the PRC's drive to modernize its economy and its attempts to become a member of the WTO¹⁹⁸, and (b) the HKSAR's desire to maintain itself as an important financial center in Asia and an attractive forum for the conduct of arbitrations, it is imperative that an effective mechanism for the mutual cross-border enforcement of HKSAR and PRC arbitral awards be formalized and implemented as soon as possible.

¹⁹⁷ As discussed above, it is also important for the HKSAR to conclude a separate arrangement with Taiwan for the mutual recognition and enforcement of arbitral awards (discussed above at note 161). However, this will prove difficult given the existing political relationship between the PRC and Taiwan. Although Taiwan is considered as part of the PRC in accordance with HKSAR law, Taiwan considers itself a sovereign nation independent from the PRC. As a result, it will protest vociferously against any attempt by the PRC to negotiate with the HKSAR on its behalf for arrangements concerning the mutual enforcement of arbitral awards between Taiwan and the HKSAR. See further discussion of this issue in Morgan, above note 32, at p. 37.

¹⁹⁸ See Ian Johnson, "China Displays Renewed Desire to Join WTO", (March 6 – 9, 1999) Vol. XXIII, No. 129 Asian Wall Street Journal 1.

Non-Judicial Settlement Of Financial Dispute in Russia

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Conference
Non-Judicial Dispute Settlement in International Financial Transactions

Law Centre for European and International Cooperation (R.I.Z.)

Cologne, March 22-23, 1999

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Non-Judicial Settlement Of Financial Disputes In Russia

Dr. Timothy Kautz

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Non-Judicial Dispute Settlement in International Financial Transactions

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Cologne, March 22-23, 1999

Non-Judicial Settlement Of Financial Disputes In Russia

March 22, 1999

Dr. Timothy Kautz
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Non-Judicial Settlement Of Financial Disputes In Russia

March 22, 1999¹

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I. Arbitration And Its Options

Non-performance of contracts by Russian banks and businesses is one of the most worrisome problems at the moment in the world economy in general and for many European, Japanese and American banks and corporations specifically. This renders the enforceability of contracts with Russia entities and the means of dispute settlement perhaps the paramount issue in East European - Western commercial relations.

The state of the Russian courts and the lack of reciprocity agreements for the enforcement of foreign court judgments makes arbitration the favored form of settling financial disputes for capital-exporting ("Western") business in Russia.² Without a treaty for reciprocal enforcement, Russia will not enforce foreign judgments, but only recognize them on the principle of comity.³

Russian entities favor arbitration in Russia over foreign court or arbitral proceedings that would increase their hard currency exposure and liability in the form of court fees or institutional fees.⁴

¹ Russian laws and regulations and the Russian economy are changing rapidly. This draft article is current through March 1, 1999.

² Dmitri Kurochkin, "Enforcement of Judgments in Russia-In Theory and Practice" East/West Executive Guide January 1998 <<http://www.wtexec.com/ew0198.html>>; Geoffrey Mitchell, "Legal & Regulatory Issues" in Russia: Grappling the Bear June 4, 1998 <<http://www.wtci.org/russiapro.htm>>; Volker Viechtbauer, "Arbitration in Russia" 29 Stanford J. Int'l L. 355, 456 (1993) (view in 1993 that "[g]iven Russia's inadequate civil an economic courts systems, resolution of foreign disputes without resort to international commercial arbitration is unimaginable"); Glenn P. Hendrix, "Business Litigation and Arbitration in Russia" 31 Int'l Lawyer 1075, 1079 (1997): one assessment as of early 1996 was more than 40 foreign arbitral awards had been recognized in Russia, and only one awards was refused for enforcement in the first instance and was recognized on appeal. Actual enforcement of arbitral awards faces substantial problems because of the Russian court system, but those problems exist equally for foreign judgments, Russian arbitral awards, and Russian court judgments.

³ Newton Davis, "Commercial Litigation in Russia: Getting a Fair Deal" 3 Parker School J. E. Eur. L. 625, 630 (1996).

⁴ Viechtbauer, id. at 368; Hendrix, id. at 1079-80; Davis, id. at 631.

A further reason Western creditors (and perhaps Russian borrowers) may prefer arbitration to litigation is the rapid change in complex financial regulations (i.e., chaos) in Russia. An arbitral tribunal would be likely to interpret any applicable Russian financial laws and regulations in a way that is consistent with established principles of international financial law.⁵ Parties may not have the same confidence in how Russian, or even Western, courts would apply Russian financial laws and regulations.

A. The Option of Foreign Courts: No Enforcement

A judgment of a Western court is unlikely to be recognized or enforced in Russia. Foreign judgments are recognized and enforced in Russia if there is a reciprocity agreement with the foreign country. Russia has over 20 such agreements, but almost exclusively with former “East Block” allies. Russia has almost no such bilateral or multilateral agreements with Western countries.⁶

B. The Option of Russian Courts: No Confidence

Although there have been bright spots of quick, quality decisions (mostly at the appeals level),⁷ Western observers and businesses are generally dissatisfied with the quality and efficiency of the Russian courts.⁸ This is not surprising in light of the enormous changes in

⁵ Viechtbauer, *id.* at 369 (arbitration favored because likely to produce a reasonable result in “uncharted legal territory”).

⁶ Kurochkin, *id.*; Alla Naglis, “The Status of Foreign Judgments and Arbitration in Russia” *CIS Law Notes* September 1997 <[http://www.pbwt.ru/issue 27/issue27-4.htm](http://www.pbwt.ru/issue%2027/issue27-4.htm)> (noting bilateral treaties with Spain and Italy regarding court judgments); Davis, *id.* at 630.

⁷ Davis, *id.* at 633, reports of successes of Westerners in matters involving the Smirnov vodka name and vis-a-vis tax authorities; Hendrix, *id.* at 1102-03, noting that one U.S. company has won nine of ten disputes with the tax authorities.

⁸ Jan H. Kalicki, Counselor to the U.S. Department of Commerce and U.S. Ombudsman for Energy and Commercial Cooperation with the New Independent States, Remarks before the U.S.-Russian Investment Symposium, Harvard University, January 15, 1998 in Daily Washington File <<http://www.usis.it/wirelesswf990119/99011919.htm>>; Ilya Nikiforov, “Legal Research in Russian Law: Outline for the tutorial taught at Case Western Reserve University, Spring 1995” in *Russian Legal Server* <<http://solar.rtd.utk.edu/~sanorresearch/tutorial.htm>>; *Economist Intelligence Unit*, “Russia: Order in the court” November 12, 1997 <<http://www.eiu.com/35aXY20a/latest/3469393f.html>> (noting “a Byzantine preference for form over substance”); Paul Tatum, “Don’t Get Caught in a Contract Dispute in Russia” in *Wall St. J. Eur.* September 26, 1996 <http://www.squarepegpress.com/pages/new_russia_pages/pt_contract_dispute.html>; Nadia Y. Rendak, “Russian Joint Stock Companies: A Picture of Current Regulation” 2 *Parker School J. E. Eur. L.* 382, 396 (1995) (judges of the ordinary courts, especially in rural areas, are often hostile to foreign investments and have little or no experience in commercial matters).

thinking required of Russian jurists to transform a legal system in place for over 70 years.⁹ The court system also has had organizational problems of overlapping jurisdictions as a result of trying to salvage the former "Arbitration Courts" of the USSR as a separate institution, as it, and not the ordinary courts, holds the commercial legal experience of the justice system.¹⁰

Reports are ubiquitous that the bribery of judges and officials is commonplace.¹¹ Russia ranked 76th out of 85 countries in the 1998 Corruption Perceptions Index.¹² Threats of violence against judges are also likely in the view of Russia's Procurator General.¹³

The sole advantage of the Russian courts over an arbitral award is the longer period of execution before a "suspension" of the enforcement proceedings becomes necessary (to be resumed when, if ever, the debtor has assets permitting further execution). Writs of enforcement are valid for a period of three years for domestic and foreign judgments, but only for six months for arbitral awards.¹⁴

⁹ Evelyne Bernasconi-Mamie and Stefanie Solotych, "Law Transfer in Eastern Europe - systems in transition from the viewpoint of practitioners" in Swiss Reports Presented at the XVth International Congress of Comparative Law 55 (Schulthess Polygraphischer Verlag Zürich 1998). The authors lament the inability of Russian jurists to apply newly-passed laws and regulations in a way other than envisioned by Lenin that "everything is public law by nature." For example, Russian judges will give much greater weight to government documents than to private documents, particularly government documents that are "formalistically flawless." Id. at 56, 60. See also Burke McDavid, "Arbitration Alternatives with a Russian Party" 32 Int'l Law 199, at note 116 (1998) (Russian arbitrators may have reservations about the virtues of capitalism).

¹⁰ Viechtbauer, id. at 442-49; Hendrix, id. at 1086 (taking the view that the state commercial courts have exclusive jurisdiction over foreign investors); Davis, id. at 626 (taking the view of shared jurisdiction with the ordinary courts); Simon G. Zinger, "Navigating the Russian Shipping Industry: Making the Most of International and Russian Law for Successful Arbitration Against Russian Parties" 8 U.S.F. Mar. L.J. 141, at note 173 (1995).

¹¹ Nikiforov, id.; Economist, id.; Hendrix, id. at 1076; McDavid, id. at notes 68-80; Zinger, id. at notes 232-34; Karen Halverson, "Resolving Economic Disputes In Russia's Market Economy" 18 Mich. J. Int'l L. 59 (1996).

¹² 1998 Corruption Perceptions Index of Transparency International in CNN Financial Network online <<http://www.europe.cnnfn.com/hotstories/economy/9809/22/corruption/>>.

¹³ Hendrix, id. at 1101 (statement made in an interview 1995).

¹⁴ Kurochkin, id.; I.S. Zykin, "Commercial Arbitration in the CIS" in Guide to Int'l ADR (1997) G-4.

C. Other Options in the Russian Economy 1999?

1. The State of Financial Transactions

a. Before The Fall

Until August 1998, the Russian stock market was outperforming all others in the world.¹⁵ Its consumer goods market grew at double or triple-digit percentage rates.¹⁶

The shaky financial system¹⁷ was a both the key to and the lock on economic growth. Russian companies generally required advance partial payment to finance production, and Russian buyers also required credit to finance imports. Westerners found Russian financial laws inadequate generally.¹⁸

(1) Russian Banks

Russian banks started out quite small with minimum authorized capital of only 100 million Rubles in 1993, raised to 2 billion Rubles (then about US\$ 1 million) in 1994, and by 1999 banks are supposed to have (back in 1996 were scheduled to have by 1999) ECU 5 Million (now about US\$ 5.5 million).¹⁹

Russian banks usually do not provide trade finance against an L/C or contract.²⁰ Standby

¹⁵ 8/20/98 Wall St. J. A1, 1998 WL-WSJ 350621; Peter Gordon, "Attracting Investment to Russia (Again): How Russian firms and organisations can deal with the changed international situation" in Russia At Your Fingertips: Russian Business Online <<http://www.publications-etc.com/russia/papers/pg4.html>>.

¹⁶ Gordon, "Attracting Investment."

¹⁷ In 1997 there were 2500 banks operating in Russia; in 1998 it was only 1500, and only around 150 banks with more than US\$ 5 million in equity. Robert Koran (Vice President, Central & Eastern Europe, Creditanstalt Corporate Finance, Inc.) "Financing in Russia" in Russia: Grappling the Bear June 4, 1998 <<http://www.wtci.org/russiapro.htm>>.

¹⁸ Kalicki, Remarks.

¹⁹ Peter J. Pettibone and Juliette M. Passer-Muslin, "Russian Banking and Currency Regulations: Overview of the Russian Banking System" 1 Parker School J. E. Eur. L. 709, 710 (1994).

²⁰ Peter Gordon (Executive Director, Russian Trade Association), Business Briefing on Russia Summary of Speeches before the Federation of Hong Kong Industries and the Hong Kong Trade Development Council, January and February 1999, Russia At Your Fingertips: Russian Business Online <<http://www.publications-etc.com/russia/papers/pg5.html>>.

letters of credit gave rise to collection problems.²¹ Thus, Russian businesses generally had to find foreign banks to get approval from the Western trading partner.²² Western banks considered Russian banks unreliable entirely apart from any hard-currency problems they might have.²³

Russian banks do little commercial lending.²⁴ Instead, until a Ruble "band" was imposed in mid-1995, Russian banks made enormous amounts betting against the Ruble, buying Dollars one week and selling them for Ruble the next week after the Ruble had declined.²⁵

After the Ruble band stopped currency speculation in 1995, the Russian domestic capital markets have primarily consisted of trading Treasury Bills GKO's ("Geckos"--Gosudarstvennye Kratkosrochnie Obligatsii), OFZs (Obligatsii Federalnovo Zaima), and OVV's (Obligatsii Vnutrenovo Valutnovo Zaima).²⁶ The annualized return on these bills exceeded 100% for most of 1995.²⁷

(2) Foreign Banks

Foreign banks were issued licenses under the Central Bank Regulations on the Conditions for Opening Banks with the Participation of Foreign Investments on the Territory of the Russian Federation ("Conditions"), and by June 1994 at least 12 foreign banks had been licensed.²⁸ In November 1993, however, a presidential decree froze all operations of foreign banks with Russian residents until January, 1996. A further decree in 1994 returned operating rights to all banks granted licenses before November 15 1993 under a grandfather clause, and permitted foreign banks to operate if licensed after that date, a bilateral investment treaty exists with Russia and the bank's home country and Russian banks enjoy reciprocal rights in the bank's home country.²⁹

Foreign banks must contend with complicated currency and capital market regulations

²¹ Todd Rosenthal, "Company Case Study" in Russia: Grappling the Bear (June 4, 1998) <<http://www.wtci.org/russiapro.htm>>; Koran, id. (around ten percent of Russian L/Cs are not accepted).

²² Gordon, Briefing; ; Koran, id. (financing purchasers "usually not possible due to the uncertainty of Russian banks).

²³ For example, a bank might not make the ordered payment transaction even though the Russian customer has sufficient funds in the bank. Gordon, Briefing.

²⁴ Bruce Bean, "Russian Capital Markets: 1996 and Beyond" 3 Parker School J. E. Eur. L. 65 (1996).

²⁵ Bean, id. at 65.

²⁶ Bean, id. at 66.

²⁷ Bean, id. at 66-67.

²⁸ Pettibone and Passer-Muslin, id. at 711 (those banks included major Western banks).

²⁹ Pettibone and Passer-Muslin, id. at 712.

discussed in greater detail below in Section IV.C. For example, foreign purchasers of GKO's are limited to ten percent of any issue and must be purchased through an "current account" that does not allow conversion into hard currency or repatriation.³⁰ OFZs, in contrast, can be purchased by foreigners through an "investment account" and profits repatriated.³¹

Russian laws set high minimum capital requirements for foreign banks and provided that the aggregate assets of all banks with more than 50% of foreign participation (including branches of foreign banks) may not exceed 12% of the aggregate capital of all banks in Russia.³²

b. After The Fall

The Ruble was devalued in August 1998, and lost 70% of its value in relation to the U.S. Dollars by the end of the year.³³ The total value of imports have decreased by about half since the devaluation.³⁴ Russia's GDP shrank by five percent in 1998; its foreign investment fell by 50%, its global trade volume fell by 13 %.³⁵ Inflation hit 84.4% for 1998.³⁶

Russia stopped payments Aug. 17 on some US\$ 40 billion in Ruble-denominated debt with the devaluation in August 1998.³⁷ Foreigners hold nearly a third of the frozen debt and have balked at a restructuring deal that they say values their holdings at about five cents on the

³⁰ Bean, id. at 66.

³¹ Bean, id. at 66.

³² Pettibone and Passer-Muslin, id. at 712 (in 1996 the aggregate foreign share was at about seven percent).

³³ Gordon, Briefing; the Ruble varied between seven and sixteen to the Dollar in September and October 1998, and now is in the low 20s to the Dollar.

³⁴ Gordon, Briefing; Kalicki, Remarks (imports decreased by 45%).

³⁵ Kalicki, Remarks.

³⁶ Ren Molnar, "Russian inflation near 85 per cent, Ruble loses 70 per cent of value" <<http://interactive.cfra.com/1998/12/31/84246.html>>.

³⁷ Gordon, "Attracting Investment." Russia has effectively defaulted on much of its Soviet-era debt, including US\$ 20 billion to the London Club of commercial creditors and US\$ 40 billion to the Paris Club of government creditors. It has so far remained current on post-Soviet debts, such as Eurobonds and loans from the International Monetary Fund. Russia must pay about US\$300 million to the IMF each month in 1999 except in July, when the payment jumps to more than US\$ 1 billion. In March 1999, it must also make \$US 177 million in interest payments on Eurobonds. 2/23/99 Wall St. J. A19, 1999 WL-WSJ 5441615. In November 1996, Russia placed US\$1 billion of Eurobonds in a milestone first international debt offering since before the 1917 Revolution. 1/15/97 Wall St. J. A12, 1997 WL-WSJ 2405789.

Dollar.³⁸ Some foreign bondholders have considered suing the Russian Government.³⁹

Russia's debt stock obligations reach almost US\$ 150 billion. Over US\$ 17 billion in debt service is due in 1999.⁴⁰ Access to additional financial in the short and medium term will be limited.⁴¹ Moscow alone faces more than US\$150 million in payments to service its foreign debt in 1999.⁴²

The Russian banking system is in bad shape. On August 17, 1998, the Russian Government imposed a 90 moratorium on repayment of loans received from non-residents and on other payment due under financial transactions⁴³. On February 1, 1999, Russia's largest commercial bank, Uneximbank, missed a US\$ 12.3 million payment on a US\$ 250 million Eurobond, becoming the first Russian institution to default on a Eurobond.⁴⁴

The Moscow Arbitration Court has declared Tokobank bankrupt and ordered its assets of US\$ 165 million distributed among its creditors with claims of US\$ 365 million. Tokobank was once one of the 20 largest banks in Russia.⁴⁵ Most of the major private sector banks are technically insolvent.⁴⁶ Foreign banks are facing large losses in Russia.⁴⁷

In response to covert capital flight, the Central Bank has reintroduced repatriation obligations for exporters and upped the percentage to 75% of their hard-currency revenues.

³⁸ 2/16/99 Wall St. J. A19, 1999 WL-WSJ 5440740.

³⁹ 2/16/99 Wall St. J. A19, 1999 WL-WSJ 5440740.

⁴⁰ Kalicki, Remarks.

⁴¹ Kalicki, Remarks.

⁴² 2/26/99 Wall St. J., 1999 WL WSJ 5442378. Moscow's toughest month is May, when the city must make three payments totaling more than US\$ 42 million.

⁴³ "Statement of the Government of the Russian Federation and the Central Bank of Russia" reprinted in 9 Survey of East European Law No. 8 (September 1998).

⁴⁴ 2/3/99 Wall St. J. A15, 1999 WL-WSJ 5439224; 2/10/99 Dow Jones Int'l News Service 04:45:00, 2/10/99 DJINS 04:45:00. Uneximbank is said to owe as much as US\$ 2 billion, much of it to foreign creditors who had purchased forward-currency contracts through the bank such as investment bank Lehman Brothers Holdings Inc., which has frozen some of Uneximbank's offshore bank accounts in a legal battle.

⁴⁵ Molnar, id.

⁴⁶ Gordon, Briefing; Molnar, id.

⁴⁷ For example, a Swiss-U.S. multinational bank may have generated roughly US\$ 1 billion in profits in Russia during the 1990s, but when Russia devalued its currency and defaulted on its debts last August, it was left with net exposures topping US\$ 2 billion and assets that shrank to a tiny fraction of their former value. 2/26/99 Wall St. J. C18, 1999 WL-WSJ 5442285).

Nevertheless, reserves keep falling despite a trade surplus that recently reached US\$ 3 billion a month.

"Capital flight...is one of our weak points ... The Central Bank is trying different ways to stop it, but our people's inventiveness has no limits, and each new regulation gives birth to a new invention."
[emphasis added]⁴⁸

There is no clear sign within Russia or abroad of the political will arising to change the economic policies, principally Russia's monetary policy, that have led to the collapse.⁴⁹

2. Bankruptcy

Bankruptcy is a very likely locus for dispute resolution currently. Thus, settlement of financial disputes in Russia may end of being judicial by necessity. AO Sidanko, a major Russian oil company, has been put into restructuring in Russia's biggest bankruptcy proceeding.⁵⁰ Sidanko sold a 10% stake to BP Amoco PLC for US\$ 571 million in 1997, and owes more than US\$ 150 million to a group of foreign creditors led by a large German bank and the investment banking arm of large British bank.⁵¹ A Sidanko official is quoted as saying:

"There is no funny business. . . . If you want the company to survive you have to put the company into bankruptcy."⁵²

Uneximbank holds a 46% stake in Sidanko.⁵³ As of March 1, 1999, Russian financial markets are in rapid meltdown. The Central Bank estimates that only 200-300 Russian banks will

⁴⁸ Central Bank Deputy Chairman Oleg Mozhaiskov quoted in 2/23/99 Wall St. J. A19, 1999 WL-WSJ 5441615. One reported scheme is banks using fake import contracts to send hard currency abroad.

⁴⁹ Commentators observed sadly that at the February 1999 G-7 conference, "[t]he G-7 could also have provided valuable advice to Russia by urging it to legalize the use of foreign currencies within its borders. For years, the G-7 and the International Monetary Fund have abetted a monetary policy for Russia that forced the Ruble to lose 99.99% of its value while leaving intact the Russian government's monopoly on money." 2/23/99 Wall St. J. A22, 1999 WL-WSJ 5441698.

⁵⁰ 2/1/99 Wall St. J. A17, 1999 WL-WSJ 5438930. Bankruptcy petitions have also been filed against AO Kondpetroleum and AO Udmurtneft, two Sidanko oil-producing subsidiaries.

⁵¹ 2/1/99 Wall St. J. A17, 1999 WL-WSJ 5438930.

⁵² 2/1/99 Wall St. J. A17, 1999 WL-WSJ 5438930.

⁵³ 2/1/99 Wall St. J. A17, 1999 WL-WSJ 5438930.

survive 1999; there were 1500 Russian banks in 1998.⁵⁴

3. Negotiations, Re-Negotiations, and Offers You Can't Refuse

The familiar adage "When you owe a bank a thousand Dollars, you have problem. When you owe it a million Dollars, the bank has a problem" would seem to fit the current situation in Russia. Banks have problems, and their choice is to write off the loans or negotiate, re-negotiate, and re-re-negotiate terms until money turns up to pay off the debts.⁵⁵

You may not have a problem if you are Russian bank, however. Then you just transfer your assets to a bank with a new name, Rosbank, and leave the debts to the Russian State (the solution favored by U.S. Savings & Loans in the 1980s).⁵⁶

Seventy years of Soviet rule and the lack of a strong commercial tradition before 1917⁵⁷ have also ingrained expectations in the Russian psyche as to what a contract can or should do that differ from Western expectations. Contracts may not be fulfilled in Russia, but they also do not go away easily.⁵⁸ A contract is a "current understanding" and the Russian expectation is that problems should occasion consultation and re-negotiation, not demands and litigation.⁵⁹

Finally, organized crime is reputed to offer its services for non-judicial "Alternative Dispute Resolution" (ADR) of various kinds.⁶⁰ Amazingly, these services sometimes resemble mediation more closely than warfare. There exists an informal institution called a "Sorting Out"

⁵⁴ 2/22/99 Business Eastern Europe (Economist Intelligence Unit Ltd.), 1999 WL 2503025.

⁵⁵ The Russian government owes US\$ 20 billion to the London Club of commercial creditors and US\$ 40 billion to the government lenders of the Paris Club. Negotiations with both Clubs are ongoing. 2/23/99 Wall St. J. A19, 1999 WL - WSJ 5441615.

⁵⁶ "New Names But Same Old Bankers," 2/20/99 The Moscow Times 10, 1999 WL 6806128.

⁵⁷ Pre-revolution Russia had a commercial tradition, but not a strong one. In 1917, Russia had four commercial courts, one each in Moscow, St. Petersburg, Odessa, and Warsaw. Halverson, *id.* at note 40. For a discussion of Russia's commercial history, see generally Halverson, *id.*

⁵⁸ Bernasconi-Mamie and Solotych, *id.* at 57 (material breach does not give a party the right to rescind the contract except through a court action to declare the contract rescinded).

⁵⁹ Bean, *id.* at 68; Halverson, *id.* at notes 3-4 ("tendency of Russian business culture to attribute greater value to the maintenance of a business contact than to the sanctity of a legally enforceable contract").

⁶⁰ Nikiforov, *id.*; Economist, *id.*; Halverson, *id.* at notes 191-95.

(*razborka*), that, on one report, even Russian bankers may make use of.⁶¹ It may consist in appointing an experienced, retired career criminal to lead a discussion with both parties, asking them questions as to the substance of the dispute and inquiring into what result "honor among thieves" and Russian substantive law would require.⁶²

The ADR services of organized crime may more usually consist in debt collection through violence.⁶³ In 1996, Alexander Shokhin, the First Vice Chair of the Duma, stated in any case:

"It is much easier to send a group of armed people to collect debts than to appeal to an *arbitrazh* court and expect its rulings to be carried out promptly."⁶⁴

It is not clear whether the statement was intended descriptively or prescriptively.

II. Russian Arbitration Law: An Effective International Dispute Resolution Framework

A. Adoption of the UNCITRAL Model Law

In the Law of July 7, 1993, Russian adopted the UNCITRAL Model Law ("Model Law") for international arbitration ("Russian International Arbitration Law," RILA).⁶⁵

1. Agreements to Arbitrate Outside Russia Are Enforceable

As follows from the adoption of the New York Convention, the Model Law and the nature of financial disputes as commercial, Russian entities are free to agree to international

⁶¹ Halverson, *id.* at notes 191-95.

⁶² Halverson, *id.* at notes 191-95.

⁶³ Nikiforov, *id.*; *Economist*, *id.*

⁶⁴ Hendrix, *id.* at 1098.

⁶⁵ V.V. Veeder, "The ICAC [International Commercial Arbitration Court] at the Chamber of Commerce and Industry of the Russian Federation in Moscow at the Chamber of Commerce and Industry of the Russian Federation" 11 *Arb. Int'l* 197 (1995); Hermann Schmitt and Myriam Ahmad, "Russische Föderation: Neue Verfahrensordnung des Schiedsgerichts bei der Industrie- und Handelskammer Moskau" 1996 *Recht der Internationalen Wirtschaft* (RIW) 809; Alexander S. Komarov (President of the International Arbitration Court at the Chamber of Commerce and Industry of the Russian Federation, Moscow) "International Commercial Arbitration in the Russian Federation," paper presented at the Seminar under the auspices of the Deutsche Stiftung für Internationale Rechtliche Zusammenarbeit (I.R.Z.) "Aktuelle Rechtslage und -praxis auf dem Gebiet der internationalen Schiedsgerichtsbarkeit" June 10-12 1996, Bremen.

arbitration of financial disputes at a location outside of Russia.⁶⁶

The Stockholm Chamber of Commerce continues to be a popular choice for the situs and governing rules of arbitration as it was in the days of the USSR.⁶⁷ Russian entities likewise can participate in institutional arbitrations administered by Western institutions. The ICC, LCIA and the Stockholm Chamber of Commerce have published their rules in Russian and administrate arbitrations in Russia.⁶⁸

2. Modifications of the Model Law

RILA adopted the Model Law from the official Russian-language version with only minor changes.⁶⁹ The changes enhance the position of arbitration, if anything. The adoption was also done conveniently, keeping the same order of provisions and article numbers as in the Model Law.

a. Expansion of the Definition of “International”

As discussed below in Section II.B.1.a., RILA expands the scope of what constitutes an “international” arbitration in Art. 1 (2). Russian companies with more than 30% equity ownership by foreign investors qualify as a foreign company for the purposes of RILA and enforcement of an arbitral award.

b. Maintains Existing Arbitration Treaties

Art. 1 (5) RILA sets out explicitly that it does not derogate from the provisions concerning arbitration in any previously concluded international treaties.

c. President of the Chamber of Commerce and Industry as Appointing Authority

Art. 6 RILA bifurcates the responsibilities of the appointing authority from the responsibilities of the state courts in support of arbitration. The President of the Chamber of Commerce and Industry of the Russian Federation is the appointing authority for the default appointment of arbitrators (Art. 11 (3) and (4)), for challenges of arbitrators (Art. 13(3)), and

⁶⁶ Naglis, *id.*

⁶⁷ Viechtbauer, *id.* at 450 (Stockholm preferred foreign situs since the 1970's); Kaj Hober, “Enforcing Arbitral Awards Against Russian Entities” 10 *Arb. Int'l* 17 (1994) (Stockholm Chamber of Commerce caseload with Russian entities increasing since dissolution of the USSR). Stockholm caseload is reportedly around 50 to 100 cases per year, whereas the ICAC caseload has risen to around 450 to 500 cases per year. Hendrix, *id.* at 1080.

⁶⁸ V.V. Veeder, *id.* Even after the dissolution of the USSR, the former CMEA countries continued to their reluctance to agree to ICC arbitration, which had been considered a “bourgeois” institution and had no CMEA state members. Viechtbauer, *id.* At 453.

⁶⁹ Schmitt and Ahmad, *id.* at 809.

concerning the impossibility of an arbitrator performing his functions (Art. 14).

The state courts become involved in the arbitration only for decisions on the jurisdiction of the arbitral tribunal (Art. 16(3)) and on set aside actions against awards (Art. 34(2)). Thus, RILA reduces state court involvement to an absolute minimum.⁷⁰

The state courts with jurisdiction over arbitral jurisdiction and set aside actions are the ordinary courts, not the state commercial ("Arbitration") courts.⁷¹ This is by historical accident more than design. The state commercial courts have far greater experience with international commercial matters than do the ordinary courts, and in 1995 the state commercial courts became competent for handling disputes involving foreign parties generally.⁷²

d. Omission Of Party Agreement to Decision *Ex Aequo Et Bono*

Art. 28 RILA omits Art. 28 (3) Model Law permitting an award *ex aequo et bono* only if the parties have so agreed. While the omission of a prohibition of such awards might seem to permit awards *ex aequo et bono* even without party agreement, the remaining text of Art. 28 RILA / Model Law does not support that inference. Instead, the remaining text makes abundantly clear that the arbitrators shall decide only in accordance with the rules of law and the terms of the contract as consistent with trade usage.

e. Addition of Mandatory Contents For Award

Art. 31(2) RILA mandates that the arbitral awards contains not only "reasons upon which it is based," but additionally statements as to whether the requested relief is granted or rejected, the costs of the proceedings and the liability of the parties as to such costs. The same provision also omits the possibility contained in the Model Law of an award being rendered without reasons on the agreement of the parties. The thrust of RILA is therefore towards a complete and clear statement of the views of the tribunal.

3. Maintaining Key Model Law Principles

a. Primacy of the Party Agreement

Except where changes have been noted above, RILA follows the wording of the Model Law exactly, including the Model Law's litany of rules that apply only subject to there being no party agreement otherwise. Stated conversely, RILA establishes the principle of party autonomy and party primacy in arbitration.

⁷⁰ The ICAC Rules (Art. 1 (6)) aim at the same result by empowering the President of the ICAC to grant a request for security even before the arbitral tribunal is constituted. This is time when parties are most likely to call on state courts for quick temporary relief.

⁷¹ Hendrix, *id.* at 1086.

⁷² Hendrix, *id.* at 1084-86.

The points on which the parties's agreement takes precedence over the "default rules" of RILA are numerous, including rules, *inter alia*, on the following

- When a writing is deemed received (Art. 3 RILA);
- The number of arbitrators (Art. 10 RILA);
- The manner in which the arbitrators are appointed (Art. 11 RILA);
- The procedure for challenging an arbitrator (Art. 13 RILA);
- Whether provisional relief is available from the arbitral tribunal (Art. 17 RILA);
- The procedure for the arbitration "before the tribunal" (Art. 19 RILA);
- The place of arbitration and the location of hearings (Art. 20 RILA);
- When the arbitration is deemed to begin (Art. 21 RILA);
- The language of the proceedings (Art. 22 RILA);
- The time periods in which to submit pleadings (Art. 23 RILA);
- Whether there will be an oral hearing (Art. 24 RILA);
- When a party is in default in the proceedings (Art. 25 RILA);
- The role of expert witnesses appointed by the tribunal (Art. 26 RILA);
- How the arbitral tribunal must reach decisions (Art. 29 RILA);
- Deadlines for applications to correct or alter an award (Art. 33 RILA).

In most cases, the parties will reach agreements on these points by incorporating a set of arbitration rules. Where a party has a particular concern, however, an agreement on that point in the arbitration agreement will be enforceable. U.S. parties, for example, may want to provide in the arbitration agreement for rights concerning discovery, if discovery is expected to be beneficial to their case in a dispute.

b. Choice of Law

The choice of law applicable to the dispute is also under party primacy. Art. 28 RILA provides, in the wording of the Model Law, that the arbitral tribunal shall apply the law chosen by the parties to the dispute. Prudent parties can attempt to exclude any application of Russian law, for example based on tort or statutory delict related to the contract or on currency regulations, by specifying very clearly that the arbitrators are to apply a certain (other) law to the dispute. A choice of law that states it governs the contract and its interpretation might not achieve the same result.

c. Limited Court Involvement

RILA has limited the role of the courts in arbitration even further than the Model Law by making the President of the Russian Chamber of Commerce and Industry the appointing authority. Courts are involved only for rulings on jurisdiction and set aside actions. A decision by a Moscow court illustrates that the courts may take a very reserved posture even in these matters remaining in their jurisdiction.

In a decision dated December 13, 1994, the Moscow City Court confirmed an arbitral tribunal's negative ruling on its own jurisdiction. In doing so, the Moscow court appears to have given the factual findings by the arbitral tribunal practically conclusive weight.⁷³ The Russian

⁷³ Decision of the Moscow City Court dated December 13, 1994, reported in XXII Yearbook Comm. Arb. 294 (1997).

courts may therefore favor a strong version of Kompetenz-Kompetenz.

d. Narrow Grounds to Set Aside Awards

RILA and the Model law track the narrow grounds for refusing enforcement under the New York Convention as the same sole grounds for setting aside an arbitral award rendered in Russia. Russian courts have also demonstrated that they will interpret those grounds for setting aside an award restrictively.

For example, the Moscow City Court refused to set aside an arbitral award on the grounds that the arbitral tribunal ruled that the defendant had no liability even if the defendant had admitted partial liability. This did not constitute a procedural defect since the arbitral tribunal was not bound by any admission by a party. The court also rejected the notion that the procedural issue could constitute a public policy grounds for setting aside an award.⁷⁴

An interesting decision for financial disputes was the one made by the Moscow City Court dated September 18, 1995.⁷⁵ The award-debtor sought to have the award set aside for a violation of Russian public policy. The arbitral tribunal had ordered the debtor to pay a sum in hard currency, but the debtor did not have a requisite foreign currency account to make the payment. The court rejected the argument that the award violated Russian public policy.

The case report ends cryptically, however, reading "[i]n this connection, the court noted that, in the enforcement of the award, the competent court had the option of modifying the arrangements and procedures for enforcement."⁷⁶ The terse report of the decision also leaves it unclear whether the award-debtor could have established the needed foreign currency account.

Thus, the exact import of the decision is not clear. Russian courts clearly do not grasp at every opportunity to set aside awards, however, and regulatory obstacles to obtaining currency to fulfill payments obligations are not *per se* public policy matters.

⁷⁴ Decision of the Moscow City Court dated November 10, 1994, reported in XXII Yearbook Comm. Arb. 293 (1997). The ruling by the Moscow City Court is noteworthy, because the Swiss Federal Tribunal has expanded the concept of public policy in principle to some undefined procedural defects that constitute a violation of "procedural public policy." That extension by the Swiss Federal Tribunal has been criticized as opening an empty category.

⁷⁵ Reported in XXII Yearbook Comm. Arb. 295 (1997).

⁷⁶ XXII Yearbook Comm. Arb. at 296.

B. Arbitrability

1. Definition of International Commercial Arbitration

a. International

A financial dispute qualifies as international if the place of business of at least one of the parties is situated outside Russia.⁷⁷ Additionally, “[e]nterprises with foreign investment, international associations and organizations established in the territory of the Russian Federation”⁷⁸ will be treated as having their place of business outside of Russia in order to give them the advantages of international arbitration.⁷⁹

b. Commercial

Finance disputes are clearly arbitrable as commercial disputes under Russian law.⁸⁰ Art. 1 (2) RILA explicitly names of long list of commercial transactions and includes finance among them. Non-contractual relationships may qualify as commercial.⁸¹

2. Excluded Subject Matters

Financial disputes are unlikely to overlap with non-arbitral subject matters. As of 1993, the only subject matters that were non-arbitrable invention and copyright rights, railroad freight, air communications, and certain maritime transactions, water and land use rights, labor disputes and family law relationships.⁸² Disputes with the Russian Government, in particular with the tax authorities, are not arbitrable.⁸³ There are practically no laws private law statues that prohibit arbitration, and, indeed, the new Civil Code permits arbitration even to redress violations of civil rights.⁸⁴

⁷⁷ Zykin, *id.* at G-6.

⁷⁸ Zykin, *id.* at G-6, citing Article 1.2 RILA.

⁷⁹ Zykin, *id.* at G-6; the main advantage is not being subject to the 1992 Temporary Act governing domestic arbitration which makes awards subject to a review on the merits by the state courts. Hendrix, *id.* at 1081 (the definition of “international” opens the door for many purely Russian matters to be arbitrated before the ICAC).

⁸⁰ Zykin, *id.* at G-6.

⁸¹ Komarov, *id.* at 2.

⁸² Viechtbauer, *id.* At 396 f.

⁸³ Hendrix, *id.* at 1084.

⁸⁴ Komarov, *id.* at 3.

3. Validity of the Arbitration Clause

Just as U.S. judges strongly prefer to apply U.S. law when examining the validity of an arbitration clause, Russian state court judges are very likely to apply will apply Russian law.⁸⁵ This occurs despite Art. 34 (2) No. 1 RILA providing that Russian law is to be applied only if the parties have not chosen the law to govern the arbitration agreement. In Western Europe, the law selected to govern the contract will normally be found to apply to the arbitration clause absent unless the arbitration agreement itself states otherwise. Russian law does not present any particular hazards to drafting a valid arbitration clause, however, so the net effect in minimal.⁸⁶

C. Arbitration Conventions

1. New York Convention

The Soviet Union acceded to the 1958 New York Convention⁸⁷ with the reciprocity reservation of Article I(3). The Russian Federation succeeded the USSR to the New York Convention under Article 12 of the Agreement on the Creation of the Commonwealth of Independent States done December 8, 1991.

On January 23, 1992, the Second Moscow District Court rejected the attempt of a Russian award-debtor to avoid enforcement of a foreign arbitral awards on the grounds that the Russian Federation had not ratified the New York Convention.⁸⁸ Subsequent court decisions under the New York Convention have properly refused to examine the treatment of the merits of the dispute in the award⁸⁹ and rejected a defense that the award-debtor was unable to settle accounts independently of the Russian Government.⁹⁰

Furthermore, the standard for establishing a violation of Russian public policy so as to defeat recognition and enforcement is high. The misapplication of Russian law by the arbitral tribunal to the merits of the dispute does not constitute a violation of Russian public policy.⁹¹ In dicta, the Eighth Moscow District Court (Civil Department) defined "public policy" under Art.

⁸⁵ McDavid, id. at notes 113-14.

⁸⁶ McDavid, id. at notes 113-14.

⁸⁷ Convention on the Recognition and Enforcement of Foreign Arbitral Awards, June 10, 1958 in New York, 21 U.S.T. 2717, 330 U.N.T.S. 38.

⁸⁸ Excerpt of Decision by the 2nd Moscow District Court (Civil Department) dated January 23, 1992, reported in XIX Yearbook Comm. Arb. 710 (1994).

⁸⁹ Decision of the Third Moscow District Court (Civil Department) dated October 12, 1992, reported in XXI Yearbook Comm. Arb. 666 (1996).

⁹⁰ Decision of the Supreme Court of the Russian Federation, dated April 28, 1993, reported in XXI Yearbook Comm. Arb. 668 (1996).

⁹¹ Decision of the Fifth District Court of Moscow (Civil Department), dated October 31, 1995, reported in XXIII Yearbook Comm. Arb. 735 (1998).

V(1)(e) New York Convention to be a matter that "contradict the sovereignty of the Russian Federation" or "contradict the basic principles of Russian legislation."⁹²

2. European Convention

Russia is a member of the European Convention on International Commercial Arbitration⁹³ done April 21, 1961 through the Soviet Union's accession. There are no reported cases of the European Convention being applied to an arbitration in the USSR, Russia, or in an arbitration involving a Soviet or Russian party.⁹⁴

One practical consequence of the application of the European Convention to an arbitration in Russia would be the continued enforceability of the award in member states even if set aside for public policy reasons in Russia.⁹⁵ For example, were a Russian court to set aside an arbitral award made in Russia because it violated Russian public policy in the form of currency regulations, the other member states would still be obligated to recognize and enforce the arbitral award under Art. IX(2) European Convention.

3. Other Conventions

a. Moscow Convention

Russia remains a member of the 1972 Moscow Convention.⁹⁶ Article I of the Moscow Convention extended the competence of the arbitration courts attached to the respective chambers of commerce of the countries in the Council of Mutual Economic Assistance (CMEA) to all contractual and other civil law disputes arising from economic, scientific, and technical co-

⁹² Decision of the Eighth District Court of Moscow (Civil Department), dated April 21, 1997, reported in XXIII Yearbook Comm. Arb. 745 (1998).

⁹³ 484 U.N.T.S. 364.

⁹⁴ "List of European Convention Court Decisions and Arbitral Awards" XX Yearbook Comm. Arb. 1042 ff. (1995); "Court Decisions on the European Convention 1961" XXIII Yearbook Comm. Arb. 1113 ff. (1998).

⁹⁵ Art. IX(2) European Convention limits the application of Article V(1)(e) New York Convention (for refusing recognition and enforcement of an arbitral award) to the grounds enumerated in Art. IX(1) European Convention. Those grounds do not include public policy. Thus, member states can refuse enforcement of a Russian arbitral award that has been set aside by the Russian courts only if the award was set aside on grounds corresponding to Art. V(1)(a) through (d) New York Convention, namely, an invalid arbitration agreement, lack of notice, ultra vires, or an improper appointment of the arbitrator(s).

⁹⁶ Convention on Settlement by Arbitration of Civil Law Disputes Resulting From Economic, Scientific and Technical Cooperation, May 26, 1972 13 ILL.M. 5 (1974) signed by Bulgaria, Czechoslovakia, the German Democratic Republic, Hungary, Mongolia, Poland, Romania, and the Soviet Union. Viechtbauer, id. At 391. Poland has repudiated the Convention.

operation between economic organizations of those countries and excluded the jurisdiction of the ordinary courts.⁹⁷ The CMEA dissolved in 1991,⁹⁸ and the role of the Moscow Convention is decreasing.⁹⁹ It is unlikely to be of interest for large financial disputes, since the former CMEA countries are all capital importers, and indeed, of Western (or Far Eastern) capital.

b. BITs/ICSID/MIGA

Russia has signed Bilateral Investment Treaties (BITs) with Western Capital exporting countries such as Germany (1989) and the USA (1992). The U.S.-Russian BIT provides for ICSID arbitration at the option of the U.S. investor to redress losses resulting from violations of the BITs investment protection provisions.¹⁰⁰ These investment protection provisions include the free convertibility of currency and the repatriation of profits.

A loan by a U.S. lender to a Russian entity qualifies as a protected investment under BIT. As of March 1, 1999, Russia has not yet ratified the U.S.-Russian BIT.

Russia signed the ICSID Convention on June 16, 1992, but likewise has not yet ratified it.¹⁰¹

c. Other Trade Agreements

The Soviet Union concluded more than 40 bilateral trade agreements that provide for arbitration in some form, and many such agreements provide for reciprocal recognition and enforcement of arbitral awards.¹⁰² Agreements providing for reciprocal enforcement include those with Germany, Switzerland, Austria, Italy, and Japan, among others, and are based on the nationality of the arbitral parties, not the situs of the arbitration (accordingly, however, some bilateral agreements apply only to Soviet foreign trade organizations).¹⁰³

⁹⁷ Viechtbauer, *id.* at 391 f.

⁹⁸ Viechtbauer, *id.* at 393.

⁹⁹ Zykin, *id.*

¹⁰⁰ Zinger, *id.* at note 246-73; for a discussion of the U.S.-Russian BIT, see Kenneth J. Vandeveld, "U.S. Bilateral Investments Treaties: The Second Wave" 15 *Mich. J. Int'l L.* 622 (1993).

¹⁰¹ "Washington Convention of 1965: List of Contracting States and Signatories" XXIII *Yearbook Comm. Arb.* 1119, 1112 (1998).

¹⁰² Viechtbauer, *id.* at 428; Naglis, *id.* (noting additionally Spain).

¹⁰³ Viechtbauer, *id.* at 428 (other countries are Afghanistan, Cyprus, Iraq, Laos and Syria).

III. Arbitrating Financial Disputes in Russia

A. Multiple Dangers of Confusion Getting To Arbitration

1. State "Arbitration" Courts v. Private Arbitration

There is a confusing similarity between the names of the state commercial courts and the major arbitral institution in Russia. The state commercial courts are called arbitration courts, and, indeed, at each level of courts.¹⁰⁴ Bankruptcy falls within the exclusive jurisdiction of these state "arbitration" courts, and any court-appointed interim manager such as the bankruptcy trustee is termed an "Arbitration Manager."¹⁰⁵

The courts of first instance are regional arbitration courts, 82 in number.¹⁰⁶ Above them are ten circuit arbitration courts. The highest commercial court of Russia is called the Supreme Arbitration Court of the Russian Federation.

These courts use procedural rules entitled confusingly enough "The Arbitration Procedural Code of the Russian Federation of 1995."¹⁰⁷ These state courts conduct commercial litigation and bankruptcy proceedings, not arbitration as it is commonly known elsewhere, namely, as a contractually-agreed, private, binding dispute resolution on the merits to the exclusion of the state courts.¹⁰⁸ Arbitration in the usual sense is sometimes called "tretejskyi" (third-party) arbitration to distinguish it from such state commercial courts.¹⁰⁹

As one can imagine, there are cases where parties dispute the jurisdiction of the state commercial courts or an arbitral tribunal based on an alleged confusion between various state

¹⁰⁴ Zykin, *id.* at G-2; Viechtbauer, *id.* at 363, 442-49 (the name "Arbitration Court" has its roots in the *arbitrazh* courts established in the former Soviet Union for dispute resolution between state-owned enterprises in proceedings that combined administrative and civil procedure to the exclusion of the traditional ordinary courts; in 1991, a new law opened these "Arbitration Courts," which still carry the name *arbitrazh*, to all commercial disputes, even those of individuals, making them essentially commercial courts); *see also* Hendrix, *id.* at 1086 ff.

¹⁰⁵ Mark Borhesani *et al.*, "Russian Bankruptcy Law: The Rights of Creditors" East/West Executive Guide October 1998 <<http://www.wtexec.com/ew1098.html>>, at notes 2 and 16.

¹⁰⁶ "The Supreme Arbitration Court of the Russian Federation" <<http://www.arbitr.ru/english.htm>>.

¹⁰⁷ Zykin, *id.* at G-2; "The Supreme Arbitration Court of the Russian Federation" <online <http://www.arbitr.ru/english.htm>>.

¹⁰⁸ Zykin, *id.* at G-2.

¹⁰⁹ Davis, *id.* at 626; Zykin, *id.* at G-2; Halverson, *id.* at note 89.

courts and arbitral institutions.¹¹⁰

2. Domestic vs. International Arbitral Institutions

There are different laws in Russia governing domestic versus international arbitration. Domestic commercial arbitration in Russia is governed by the June 24, 1992 Temporary Act On Third-Party Tribunals Resolving Economic Disputes (1992 Temporary Act).¹¹¹ The 1992 Temporary Act permits the state courts to review the arbitral award on the merits *sua sponte* and remand the matter to the arbitral tribunal for corrections of errors of law or fact.¹¹²

International arbitration is governed RILA and by the recognition and enforcement of foreign arbitral awards in the Decrees of the Supreme Soviet of the USSR On the Recognition and Enforcement of Decisions of Foreign Courts and Arbitral Tribunals in the USSR from June 21, 1988.¹¹³ That Decree was, *inter alia*, the implementing legislation for the New York Convention in the USSR.¹¹⁴

There is a small difference in the enforcement of a domestic arbitration award versus the enforcement of an international arbitration award. The domestic award is enforced by the State Arbitration Courts, *i.e.*, the commercial courts.¹¹⁵ An international arbitration award is enforced by the ordinary courts.¹¹⁶

a. The Arbitration Court for Settlement of Economic Disputes at the Chamber of Commerce and Industry of the Russian Federation

This court came into existence after the collapse of the Soviet Union and was created to hear disputes between companies within the CIS. Its Rules apply the 1992 Temporary Act on Third-Party Tribunals Resolving Economic Disputes, *i.e.*, the domestic arbitration law. That legislation provides that it does not apply *automatically* if one party is the a resident of another country or an organization involved in foreign investment. The parties can agree that 1992 Temporary Act shall apply, however. Thus, a party agreement to arbitrate under the rules of the Arbitration Court for Settlement of Economic Disputes at the Chamber of Commerce and Industry of the Russian Federation constitutes an agreement, by incorporation, that the 1992

¹¹⁰ Zykin, *id.* at G-2.

¹¹¹ Halverson, *id.* at note 108; Zykin, *id.* at G-2.

¹¹² Article 26 Temporary Act even allows the State commercial ("Arbitration ") court to transfer the matter to its own jurisdiction if a remand to the arbitral tribunal is "not feasible." Halverson, *id.* at note 115. See also Zykin, *id.* at G-3.

¹¹³ Zykin, *id.* at G-2.

¹¹⁴ Zinger, *id.* at notes 199-200.

¹¹⁵ Davis, *id.* at 633; Halverson, *id.* at note 113.

¹¹⁶ Davis, *id.* at 633.

Temporary Act shall apply.¹¹⁷

b. The *International Commercial Arbitration Court (ICAC) at the Chamber of Commerce and Industry of the Russian Federation in Moscow*

(1) History

The institution was previously called the Foreign Trade Arbitration Commission and has existed since 1932.¹¹⁸ Its current Rules took effect on May 1, 1995.¹¹⁹ Its statute is contained as Appendix I to RILA.¹²⁰

Section 4 of the ICAC statute provides that the ICAC is the successor to the Arbitration Court of the Chamber of Commerce and Industry of the USSR, and both arbitral awards and RILA have confirmed this succession.¹²¹ In 1994, the Austrian Supreme Court (*Oberster Gerichtshof*) upheld enforcement of an arbitral award rendered by ICAC based on an arbitration clause from 1988 designating the Arbitration Court of the Chamber of Commerce and Industry of the USSR as arbitral institution.¹²² The Austrian Supreme Court stated that there was no question that the Russian Chamber of Commerce and Industry succeeded to “all functions” of the former USSR Chamber.¹²³

(2) The Leading Russian International Institution

The ICAC is by far the Russian arbitral institution with the largest number of international cases.¹²⁴ In 1996, the ICAC heard 542 cases with parties coming from around 70 countries, including many Western countries.¹²⁵ The 1995 revision of its Rules has been very

¹¹⁷ Zykin, *id.* at G-3.

¹¹⁸ Olga Zimenkova and Alla Kazakina, "New Rules of Procedure of the International Commercial Arbitration Court at the Chamber of Commerce and Industry of the Russian Federation" 6 *Am. Rev. Int'l Arb.* 385, 386 (1995); McDavid, *id.* at note 84.

¹¹⁹ Zimenkova and Kazakina, *id.* at 386; Zykin, *id.* at G-3, G-4.

¹²⁰ Zimenkova and Kazakina, *id.* at 386; Zykin, *id.* at G-2.

¹²¹ Zykin, *id.* at G-4.

¹²² Austrian Supreme Court Decision dated November 30, 1994 - 3 Ob 164, 165/94 (*Österreichischer Oberster Gerichtshof, Beschluß vom 30.11.1994*) in 1995 *Recht der International Wirtschaft* 773.

¹²³ Austrian Supreme Court Decision dated November 30, 1994, *id.*

¹²⁴ Hendrix, *id.* at 1080; Zykin, *id.* at G-4.

¹²⁵ Zimenkova and Kazakina, *id.* at 386; Zykin, *id.* at G-4.

well received by the Western business and legal community.¹²⁶ By 1997, it has "secured grudging respect for Western Jurists as a generally unbiased tribunal."¹²⁷ A U.S. court has referred parties to the ICAC in Moscow even the basis of a "pathological" arbitration clause, opining that the arbitration would be fair and impartial.¹²⁸

(3) The Standard ICAC Arbitration Clause

The ICAC recommended arbitration clause reads:

"Any dispute, controversy or claim which may arise out of or in connection with the present contract or the execution, breach, termination or invalidity thereof, shall be settled by the International Commercial Arbitration Court at the Chamber of Commerce and Industry of the Russian Federation in accordance with its Rules."

B. Where To Arbitrate In Russia

1. ICAC

a. Jurisdiction

An ICAC tribunal will not assert jurisdiction over a matter if the arbitration clause does not specifically name ICAC. A reference to "the arbitration court in Moscow" will not be found sufficient to designate ICAC.¹²⁹

Art. 1 (2) ICAC Rules tracks the language of Art. 1 (2) RILA, however, setting out the wide definition of "international" to include Russian companies with foreign equity ownership. Thus, even two Russian companies could arbitrate before ICAC if both have substantial foreign ownership.¹³⁰

b. Situs

The place of arbitration and the location of hearings is Moscow. Art. 7 (1) ICAC Rules. On agreement of the parties, hearings may be held elsewhere in Russia, but the parties may have

¹²⁶ As early as 1996, U.S. businessman Paul Tatum, later murdered in Moscow, had praise for the ICAC as the "fairest and quickest" dispute resolution available in Russia and "run according to the standards of the International Chamber of Commerce." Tatum, *id.*

¹²⁷ Hendrix, *id.* at 1080.

¹²⁸ Filanto, S.p.A. v. Chilewich Int'l Corp., 789 F. Supp. 1229, 1242 (S.D.N.Y. 1992), appeal dismissed, 984 F.2d 58 (2d Cir. 1993).

¹²⁹ Komarov, *id.* at 4.

¹³⁰ Zimenkova and Kazakina, *id.* at 387.

to pay additional fees to cover the excess costs. Art. 7 (2) ICAC Rules. Unlike many other institutional rules, the ICAC Rules do not expressly permit conducting hearings outside of Russia, and, in fact, seem to limit the possible situs for an ICAC arbitration to the territory of the Russian Federation. Art. 7 (3) ICAC Rules.

c. Language

The language of ICAC proceedings is Russian unless the parties agree otherwise. Art. 10 ICAC Rules. Pleadings may be submitted the language of the contract in dispute, or in the language of the correspondence between the parties, or in Russian. Art. 9 (2) ICAC Rules.

Art. 28 (1) ICAC Rules expressly provides that foreigners and foreign organizations may represent parties in ICAC proceedings. Foreign attorneys have been able to argue in the ICAC proceedings as a matter of fact.¹³¹

d. Selection of Arbitrators

(1) Party Autonomy

Parties are free to select their party-arbitrators on a three-person tribunal and to agree on any person as sole arbitrator. Art. 19, 20 ICAC Rules. The chairman of any three-person tribunal must come from the ICAC List of Arbitrators, however. Art. 20 (3) ICAC Rules. The List contains over 100 individuals, not all of whom are Russian.¹³² Before 1995, the parties had to select arbitrators from the ICAC list, and all of the arbitrators were Russian.¹³³ Under Art. 2 (1) ICAC Rules, party-appointed arbitrators are not to be considered representatives of the parties.¹³⁴

(2) Substitute Arbitrators

Art. 19, 20 ICAC Rules also require the parties to appoint substitute arbitrators along with any primary arbitrator so there will be no delay if the primary arbitrator(s) cannot participate in proceedings.¹³⁵ Likewise, ICAC will appoint a substitute chairman, substitute sole arbitrator, and substitute default arbitrators (if a party fails to appoint a primary or substitute arbitrator).

(3) The ICAC List of Arbitrators

The ICAC list of arbitrators has 109 persons, over half of whom report that they speak

¹³¹ Tatum, *id.*

¹³² McDavid, *id.* at note 97; Zykin, *id.* at G-4.

¹³³ Hendrix, *id.* at 1082.

¹³⁴ Komarov, *id.* at 6.

¹³⁵ Zimenkova and Kazakina, *id.* at 388; Zykin, *id.* at G-4.

English.¹³⁶ Since 1995, the ICAC list of arbitrators may contain non-Russians, and as of October 1996, there were 34 non-Russian arbitrators with 17 nationalities on the list.¹³⁷ The ICAC list of arbitrators was made for a five-year term in 1995.¹³⁸

e. Procedure

(1) Preliminary Relief

Art. 1 (6) ICAC Rules permits the President of ICAC to decide on a security for a claim at the request of a party.¹³⁹ The security measures include attachment of assets, injunctive relief, and the mandatory posting of a bond.¹⁴⁰ Art. 30 ICAC Rules as well as Art. 17 RILA also permit the arbitral tribunal to grant preliminary relief. The rule empowering the ICAC President therefore seems intended to permit temporary relief even before the arbitral tribunal is constituted. This, in turn, addresses a concern Western businesses have had about the inability to obtain quick preliminary relief in the Russian state courts.¹⁴¹

(2) Witnesses

An ICAC tribunal can invite third party witnesses to testify only if the parties so agree.¹⁴² It does not have subpoena power.¹⁴³

f. Counterclaims

Art. 33 ICAC Rules permits counterclaims and offsets only if these are based on the same agreement as the principal claim. They also must be raised in the first responsive pleading, otherwise the tribunal has discretion to reject them as untimely.

¹³⁶ Hendrix, *id.* at 1082.

¹³⁷ Hendrix, *id.* 1082; Halverson, *id.*, note 106.

¹³⁸ Art. 2 (2) ICAC Rules; Zykin, *id.* at G-4.

¹³⁹ Zimenkova and Kazakina, *id.* at 387; Zykin, *id.* at G-4.

¹⁴⁰ Zimenkova and Kazakina, *id.* at 387.

¹⁴¹ Russian courts tend to reject requests for interim relief made by parties to an arbitration agreement on the confused belief that the Civil Code prohibits courts from granting such relief. The Civil Code provides that only the court making the decision the merits can provide interim relief. Komarov, *id.* at 12. Art. 9 RILA expressly permits state courts to grant preliminary relief to parties in an arbitration.

¹⁴² Davis, *id.* at 631.

¹⁴³ Davis, *id.* at 631.

g. Application of Law

Foreign law. ICAC tribunals will respect the parties' choice of foreign law, as they are required to do by the ICAC Rules and RILA. As a matter of practice, however, the tribunals have a mixed history in applying foreign law accurately. Tribunals are unwilling to hire foreign law experts to help them analyze the disputes, and are unable to access foreign law in Russia because there are no private or public libraries on foreign law.¹⁴⁴

Law versus equity. ICAC tribunals (and Russian tribunals generally) tend to apply the law strictly and formally, without the close factual argumentation and consideration of (submerged) appeals to equity more common in Western (particularly U.S.) disputes.¹⁴⁵

Conflict of laws. If the parties failed to specify the applicable laws, ICAC tribunals usually apply Russian conflicts of laws rules, which in turn usually leads to the application of Russian substantive law.¹⁴⁶

h. Arbitration Fees

The ICAC arbitration fees are modest in comparison to Western arbitration institutions. For example, as of 1997, a claim of US\$ 10 million would create fees of about US\$ 40,000, inclusive of the arbitrators' and reporter's fees.¹⁴⁷ This would be reduced by 30% if the matter is decided by a sole arbitrator.¹⁴⁸ The plaintiff may request to pay the fees in any currency, not just Rubles.¹⁴⁹

i. Enforcement

It is commonly believed that ICAC awards will be readily enforced in the Russian courts; one commentator is aware of only one award that was not enforced in the first instance, and it was enforced on appeal.¹⁵⁰

2. St. Petersburg

St. Petersburg has established a Chamber of Commerce and Industry more or less

¹⁴⁴ McDavid, id. at notes 125-32.

¹⁴⁵ Neil F. O'Donnell and Kirill Y. Ratnikov, "Dispute Resolution in the Commercial Law Tribunals of the Russian Federation: Law and Practice" 22 N.C. J. Int'l L. & Com. Reg. 795, at note 42 (1997); McDavid, id. at notes 144-45.

¹⁴⁶ O'Donnell and Ratnikov, id. at note 39.

¹⁴⁷ Hendrix, id. at 1081.

¹⁴⁸ Hendrix, id. at 1081.

¹⁴⁹ Zimenkova and Kazakina, id. at 393.

¹⁵⁰ Hendrix, id. at 1082.

modeled after the Russian Chamber of Commerce and Industry in Moscow with the intent of administrating arbitrations in St. Petersburg and adopting the same international standards as ICAC.¹⁵¹

The St. Petersburg International Commercial Arbitration Court applies the UNCITRAL Rules of Arbitration. It also maintains a list of arbitrators that include lawyers from many countries, including Austria, Germany, the U.K., and the U.S., among others, in addition to Russians.¹⁵² As yet, the St. Petersburg International Commercial Arbitration Court does not appear to have become a serious rival of ICAC for large commercial cases.

3. Others

There are numerous other arbitral institutions in Russia, usually but they are generally without any significance for international arbitration (except the Russian Maritime Arbitration Institution). In many cases they are attached to local chambers of commerce and also to commodity and stock exchanges; nevertheless, they handle almost exclusively domestic disputes, and only in a few instances do they have a significant caseload.¹⁵³

a. Maritime Arbitration Commission (MAC) at the Chamber of Commerce and Industry of the Russian Federation

The MAC resembles ICAC in that it has existed since 1930 and was re-established by RILA in 1993.¹⁵⁴ Its proceedings are likewise governed by RILA, its Rules also generally follow the Model Law, and it has a similarly solid reputation as ICAC as to quality.¹⁵⁵ While primarily for maritime disputes, financial disputes in the context of shipbuilding have been settled by MAC.¹⁵⁶

b. Arbitration Court of the Union of Jurists

In 1990, the USSR Union of Jurists drafted a statute for an Arbitration Court to handle international arbitrations, trying to "westernize" the then-current Arbitration Rules of ICAC.¹⁵⁷

¹⁵¹ "International Commercial Arbitration Court Established in St. Petersburg" 9 World Arb. Mediation Report 127 (May 1998).

¹⁵² "International Commercial Arbitration Court Established in St. Petersburg, id.

¹⁵³ Komarov, id. at 3; Hendrix, id. at 1079; Halverson, id. at notes 158-59.

¹⁵⁴ Zinger, id. at notes 140-44.

¹⁵⁵ Zinger, id. at notes 140-44; Halverson, id. at notes 105-06.

¹⁵⁶ "English Court Enforces \$7 Million Award After Conversion to Judgment" 10 Mealey's Int'l Arb. Rep. 7 (1995) (reporting on enforcement of a MAC award in the matter Far Eastern Shipping Co. v. AKP Sovcomflot).

¹⁵⁷ Viechtbauer, id. At 433-36.

The organization changed its name to Union of Jurists after the disintegration of the Soviet Union.¹⁵⁸

The Union of Jurists also maintains and uses a list of arbitrators, which, although including some of the most highly-respected jurists in Russia (eight of whom in 1996 are also on the ICAC list), are only 32 in number.¹⁵⁹ The Union of Jurist Arbitration has been little used, even in domestic Russian matters.¹⁶⁰

Mediation. Unlike ICAC, the Union of Jurists arbitration rules contain detailed provisions adopted in 1993 for optional mediation under the guidance of the tribunal chairman.¹⁶¹ This does not seem to have made its proceedings more popular.

c. Arbitral Tribunal at the Moscow Interbank Currency Exchange (MICEX)

MICEX is Russia's largest currency exchange established in 1992 and its membership is restricted to banks.¹⁶² The MICEX Rules provide for preliminary relief from the tribunal if the plaintiff shows that without such measures an enforcement of an award would be difficult or impossible.¹⁶³ As a domestic arbitration forum, it is subject to review and enforcement by the state commercial courts.¹⁶⁴

Mediation. MICEX also has a mediation procedure since 1995, which was instituted upon the request by member banks.¹⁶⁵

d. Arbitration under the Auspices of the Association of Russian Banks

The Association of Russian Banks has established an arbitral tribunal to settle disputes arising out of banking transactions. Its awards are apparently heeded because the Association is powerful and expulsion from it (for failure to comply with an award) would be a serious sanction.¹⁶⁶

¹⁵⁸ Halverson, *id.*, note 122.

¹⁵⁹ Halverson, *id.* at note 124.

¹⁶⁰ Halverson, *id.* at note 124.

¹⁶¹ Halverson, *id.* at note 125.

¹⁶² Halverson, *id.* at note 135.

¹⁶³ Halverson, *id.*, note 151.

¹⁶⁴ Halverson, *id.* at notes 113-14.

¹⁶⁵ Halverson, *id.* at note 125.

¹⁶⁶ Halverson, *id.* at note 155, note 137.

e. **Arbitration Commission of the Moscow Commodities Exchange (MCE)**

MCE was established in 1990, handled a large number of cases, published awards, obtained compliance with awards on the basis of market reputation, developed recommended language for an arbitration clause and went defunct.¹⁶⁷

Mediation. MCE had no mediation provisions.¹⁶⁸

4. *Ad Hoc*

Although strongly disfavored in the USSR,¹⁶⁹ *ad hoc* arbitration has been available at the latest since the adoption of the Model Law in 1993. The European Convention will permit *ad hoc* arbitrations to proceed without having to take recourse to courts of law.¹⁷⁰ RILA permits *ad hoc* arbitration without recourse to the Russian courts as well by making the President of the Russian Chamber of Commerce and Industry the appointing authority in its adoption of the Model Law.

IV. **Special Issues In Arbitration Of Financial Transactions**

A. **Traditional Objections To Arbitration To Resolve Financial Disputes**

What issues does the arbitration of financial disputes in Russia raise? Traditional objections to the arbitration of financial disputes have been the following, and are easily answered:¹⁷¹

- Simplicity: the dispute is expected to be simple, based on the unwillingness or inability of the debtor to pay. Thus, the added expertise arbitration offers is unneeded.¹⁷²

Answer: There are regularly significant legal issues of in financial disputes, for example, the interpretation of language in L/Cs, loans, etc. and in dealing with the possible application of currency regulations. Certainly, the evolving Russian regulatory framework and the convolutions it may add to financial transactions will be likely to

¹⁶⁷ Halverson, *id.* at notes 135-57.

¹⁶⁸ Halverson, *id.*, note 125.

¹⁶⁹ Viechtbauer, *id.* at 436 f.

¹⁷⁰ Viechtbauer, *id.* At 438 (members include, besides the USSR and other former CMEA countries, Austria, Belgium, Denmark, Germany, France, Italy, Luxembourg, and Spain).

¹⁷¹ Otto Sandrock, "Internationale Kredite und die Internationale Schiedsgerichtsbarkeit, Teil I" 1994 Wertpapier-Mitteilungen, ("WM") 405, 406-407.

¹⁷² Sandrock, WM at 406-407.

require more, not less, expertise from a tribunal. This favors arbitration.

- Strict law: creditors disfavor arbitration in the belief that it might result in a more equity-based award than the strict application of law in the state courts.¹⁷³

Answer: The parties can always include a provision that the arbitrators may decide a dispute based only on the strict application of law if they are concerned that arbitrators might fail to observe strict law as they are obligated to in most legal systems absent an agreement of the parties otherwise.¹⁷⁴ Neither the RILA nor the ICAC Rules provide for the option of *ex aequo et bono* decisions. RILA (Art. 28(3)) and the ICAC Rules (Art. 13) both follow the Model Law in requiring that the arbitral tribunal “decide in accordance with the terms of the contract and shall take into account the usages of the trade ...” On the contrary, Russian tribunals are unlikely to consider equitable aspects at all.¹⁷⁵

- Publicity: creditors favor the additional pressure public put on debtors by a public court proceeding that is absent from arbitral proceedings.¹⁷⁶

Answer: The lender should have the negotiating strength to include a mutual waiver of confidentiality in the arbitration agreement, if it thinks publicity makes a significant difference debtor compliance.¹⁷⁷ Besides, it seems there would be little bad news that could shock the financial community in Russia.

- Summary proceedings: state courts have summary proceedings that creditors can use, whereas arbitration does not.¹⁷⁸

Answer: Most countries (the USA being a possible exception in some jurisdictions) permit arbitration parties to obtain temporary relief in the courts.¹⁷⁹ Art. 31 ICAC Rules provides for an award on documents alone, if the parties so agree.

- Limited forums: arbitration limits the forums in which the creditor can bring suit,

¹⁷³ Sandrock, WM at 406-407.

¹⁷⁴ Otto Sandrock, "Is International Arbitration Inept to Solve Disputes Arising Out of International Loan Agreements?" 11 *J. Int'l Arb.* 33, 52 (1994).

¹⁷⁵ O'Donnell and. Ratnikov, *id.* at note 42; McDavid, *id.* at notes 144-45.

¹⁷⁶ Sandrock, WM at 406-407. Relatively few arbitration statutes, such as those of Japan, Spain, and many Latin American countries, allow arbitrators to decide on equitable considerations unless the parties expressly exclude that. Sandrock, *J. Int'l Arb.* 50-51.

¹⁷⁷ Sandrock, *J. Int'l Arb.* at 53.

¹⁷⁸ Sandrock, WM at 406-407.

¹⁷⁹ Sandrock, *J. Int'l Arb.* at 55, citing, *inter alia*, K.P. Berger, *Internationale Wirtschaftsschiedsgerichtsbarkeit* (Berlin 1992).

whereas a choice of forum clause can be non-exclusive, allowing the creditor to pursue the debtor wherever the money is.¹⁸⁰

Answer: Obviously, the New York Convention allows enforcement of an arbitral award in over 100 jurisdictions, and only foreign Western arbitral awards have the hope of enforcement in Russia.¹⁸¹

A further point in favor of arbitration of financial disputes (in the view of lenders) is the lowered risks of lender liability under U.S. law.¹⁸² Arbitration eliminates juries and goes far to ensure the selection of a commercially sophisticated adjudicatory body.¹⁸³

B. Mandatory Law and IMF Regulations

The prime suspect for controversy in financial disputes in Russia is the effect, if any, of Russian currency regulations on financial obligations. Currency regulations could be considered mandatory national law to be observed regardless of the parties's choice of law.

Currency regulations are not the only candidates for mandatory national law, to be sure. The Russian combination of compulsion to legislate and to pass contradictory laws¹⁸⁴ may make it impossible to avoid violating "mandatory law" in a financial transaction. The Russian Ministry of the Interior reported that almost every privatization violated a Russian law or regulation.¹⁸⁵

Currency laws and regulations pose yet more serious dangers, however. They may rise to the level of international law under the Bretton Woods Agreement, which supersedes national law, or, alternatively, can be considered part of the applicable law, if the law of an IMF member country is chosen. Article VIII of the Bretton Woods Agreement obligates member countries to observe currency regulations of other member countries. Western courts have interpreted the scope and effect of foreign currency regulations on financial contracts in various ways¹⁸⁶ that

¹⁸⁰ Sandrock, WM at 406-407.

¹⁸¹ Sandrock, J. Int'l Arb. at 55-56.

¹⁸² Lender liability for excessive control of the debtor's operation even if within contractual provisions or for disappointing debtor expectations is unknown in Europe or Japan. Sandrock, WM at 412.

¹⁸³ William W. Park, "Arbitration in Banking and Finance" 17 Ann. Rev. Banking L. 213, at note 36 (1998).

¹⁸⁴ Halverson, id. at note 167-77.

¹⁸⁵ Halverson, id., note 235.

¹⁸⁶ German courts have interpreted Art. VIII Bretton Woods, contrary to U.S. and English courts, very widely. An "exchange contract" is basically one that has any affect on the currency reserves of a member state of the IMF. One appellate court has decided differently as of 1994, however. OLG Hamburg, Decision dated October 9, 1992, WM 1992, 1941. Another appellate court did not feel competent to decide the

contradict one another,¹⁸⁷ even within the same legal system.¹⁸⁸

Article VIII, Section 2(b) of the Bretton Woods Agreement from July 1944 reads:

Exchange contracts which involve the currency of any member and which are contrary to the exchange control regulations of that member maintained or imposed consistently with the Agreement shall be unenforceable in the territories of any member.¹⁸⁹

Moratoriums on payment, reductions in interests rates and fixed exchange rates can constitute such “exchange control regulations” that make “exchange contracts” unenforceable under Article VIII Bretton Woods.¹⁹⁰ If a financial transaction qualifies as an exchange contract and violates valid currency regulations, it is unenforceable.¹⁹¹ On the view of one distinguished commentator, the application of IMF regulations might make the arbitration agreement itself unenforceable as “not capable of settlement by arbitration” under the New York Convention Articles II (1) and V (2) (a).¹⁹²

issue without obtaining the opinion of an international law institute. German conflict of laws rules would usually result in the currency-related acts of foreign states being given effect, even though there is no “Act of State” doctrine under German law. Sandrock, WM at 413.

¹⁸⁷ English law is also less than certain concerning Art. VIII Bretton Woods and the Act of State Doctrine. Sandrock, WM at 412-13.

¹⁸⁸ New York courts have rejected the contention that international credit contracts constitute “exchange contracts” within the meaning of Art. VIII Bretton Woods. See I. Zeevi & Sons Ltd. V. Grindlays Bank (Uganda) Ltd., 333 N.E.2d 168, 169 (C.A.N.Y. 1975); Libra Bank Ltd. V. Banco Nacional de Costa Rica, 570 F. Supp. 870, 899 (S.D.N.Y. 1983). They have admitted that currency-related moratoriums on loan repayment may be justified under the common-law Act of State Doctrine, however. Allied Bank International v. Banco Creditro Agricola de Cartago, 566 F. Supp. 1440 (S.D.N.Y. 1983), reversed on other grounds on rehearing, 757 F.2d 516 (2d Cir. 1985)(Act of State Doctrine not applicable because the place of payment was New York, not Costa Rica); see also Wells Fargo Asia Ltd. V. Citibank, 695 F. Supp. 1450 (S.D.N.Y. 1988), 852 F. 2d 657 (2d Cr), 495 U.S. 660 (1990), 936 F.2d 723 (2d Cir. 1991) (place of payment decisive whether Act of State Doctrine applies). See Sandrock, WM at 409-10.

¹⁸⁹ Sandrock, WM at 409.

¹⁹⁰ Sandrock, WM at 409; Park, id. at notes 155-161.

¹⁹¹ Park, id. at note 156.

¹⁹² Park, id. at note 160. This would seem to violate the separability principle, however.

However, only currency exchange controls valid under the Bretton Woods agreement could have such force.¹⁹³

Russia joined the International Monetary Fund (IMF) in 1992.¹⁹⁴ In May 1996, President Yeltsin issued Edict 721 instructing the Central Bank to “strengthen the system of control over operations connected with the movement of capital” and “to adopt decisions which are necessary to ensure that the Russian federation meets the requirements of Article VIII of the Foundation Agreement (Charter) of the International Monetary Fund.”¹⁹⁵

Clearly, there is great potential for the settlement of financial disputes in Russia to depend on the answers to complex questions regarding the nature and state of Russian currency laws, the relationship between national and international law, and the exact meaning of provisions in multiple international treaties.

C. Russian Currency Laws

The Russian Central Bank was established in 1990.¹⁹⁶ The Ruble is not a freely convertible and cannot be transferred outside of Russia.¹⁹⁷

Russian currency regulation since 1991 can be summarized as labyrinthine, riddled with exceptions, and subject to ever-new re-issuing and reinterpretation. Russian currency regulations stubbornly contradict the fundamental premise of capitalist markets, namely, that money is the universal medium of exchange.

Currency operations associated with the movement of capital require a license from the Central Bank.¹⁹⁸ Of particular interest for financial transactions are the Russian Central Bank regulations putting restrictions on the movement of capital.¹⁹⁹ A loan with a tender of over 180 days is considered a movement of capital and requires a Central Bank license.²⁰⁰ If the loan is not from a licensed bank, Value Added Tax at a rate of 20% is payable in addition to the loan.²⁰¹

¹⁹³ Park, id. at notes 155-161.

¹⁹⁴ Viechtbauer, id. at 455.

¹⁹⁵ William R. Henry and Vladimir Zheltonogov, “Russian Federation Currency Policy Changes Create Foreign Currency Payment Problems” East/West Executive Guide (February 1998) <<http://222.wtexec.com/ew0298.html>>.

¹⁹⁶ Pettibone and Passer-Muslin, id. at 710.

¹⁹⁷ Henry and Zheltonogov, id.

¹⁹⁸ Henry and Zheltonogov, id.

¹⁹⁹ Bean, id. at 65.

²⁰⁰ Bean, id. at 65.

²⁰¹ Bean, id. at 65.

1. Currency Regulations Regarding Russian Residents

Russia's laws and regulations have continuously moved away from permitting the use of foreign currency within Russia, starting with a ban on use of foreign currency between Russian residents.²⁰² The Letter of the Central Bank on the Procedure for the Circulation of Foreign Currency Cash in the Territory of Russia issued on September 2, 1994 restricted the transfer of foreign currency cash to accounts of non-resident individuals.²⁰³

Hard currency payment flows to Russian residents must be credited to the resident's account with a Russian bank in Russia licensed by the Central Bank for foreign currency operations.²⁰⁴ This includes disbursements to and payments due to Russian residents under loans, and does not allow the lender to withhold fees and expenses from the disbursement.²⁰⁵ As usual, an exception is possible if a specific license is obtained from the Central Bank, which would allow the currency proceeds to be deposited in an account abroad.²⁰⁶

Russian entities must deposit payment in hard currency received for exports in authorized Russian banks.²⁰⁷ These accounts have been subject to a 50% mandatory conversion into Rubles.²⁰⁸

2. Currency Regulations Regarding Non-Residents

There have been complex regulations for non-residents Ruble accounts in Russia.²⁰⁹ Non-residents include, *inter alia*, organizations organized under laws other than Russia and their branches in Russia.²¹⁰ There have been two types of Ruble accounts for non-residents, a current

²⁰² Pettibone and Passer-Muslin, *id.* at 712.

²⁰³ Pettibone and Passer-Muslin, *id.* at 713.

²⁰⁴ Liza Ivanova, "Strict Compliance Required for Hard Currency Loans to Russian Residents" *East/West Executive Guide* (March 1998) <<http://www.wtexec.com/ew0398.html>>.

²⁰⁵ Ivanova, *id.*, citing Central Bank Instruction No. 7 and Central Bank Letter No. 12-562 dated August 13, 1996.

²⁰⁶ Ivanova, *id.*

²⁰⁷ Pettibone and Passer-Muslin, *id.* at 715, citing the State Customs Committee and the Ministry of Foreign Economic Relations Instruction No. 19 on the Procedures for Implementing Currency Control of the Receipt of Foreign Currency Revenues from the Export of commodities dated October 12, 1993.

²⁰⁸ Pettibone and Passer-Muslin, *id.* at 715-16.

²⁰⁹ Pettibone and Passer-Muslin, *id.* at 712.

²¹⁰ Pettibone and Passer-Muslin, *id.* at 713; Henry and Zheltonogov, *id.* (Term "non-resident" is defined by the Currency Law (of 1992) to include any entity formed under laws of a jurisdiction other than the Russian Federation and includes any Russian

account (Type "T") and an investment account (Type "I"). Each kind of account has had restrictions on its uses, on the sources from which it can be funded, and its conversion into hard currency.²¹¹ Moreover, the restrictions on each of these areas have differed depending on whether the account is a current account or an investment account.²¹²

In particular, Rubles accumulated in current accounts (Type "T") cannot be converted into hard currency and repatriated and cannot be transferred into an investment account.²¹³ Rubles earned in a transaction with a Russian company must be deposited into a current account, thus prohibiting conversion and repatriation (except through reinvestment in the purchase and export of commodities).²¹⁴

A further examples of currency restrictions of non-residents as of 1996 was the rule that non-residents could purchase GKO treasury bills only through current ("T") accounts, thereby prohibiting conversion into hard currency and repatriation of profits²¹⁵. Foreigners could purchase OFZ treasury bills through an investment ("I") account which permits conversion and repatriation.²¹⁶

Some restrictions on Ruble transaction by non-residents were lifted in 1996.²¹⁷

Foreign banks also cannot process payment orders in any other currency than Rubles for work or services provided (by the bank) in Russia.²¹⁸ It appears that most services performed by

branches or Russian representative offices of such foreign entities, without regard to the location, extent or nature of the activities of the entity).

²¹¹ Pettibone and Passer-Muslin, *id.* at 713-14.

²¹² Pettibone and Passer-Muslin, *id.* at 713-14.

²¹³ Pettibone and Passer-Muslin, *id.* at 714.

²¹⁴ Pettibone and Passer-Muslin, *id.* at 715-16.

²¹⁵ Bean, *id.* at 66.

²¹⁶ Bean, *id.* at 66.

²¹⁷ Henry and Zheltonogov, *id.*: "Restrictions on a foreign legal entity's ability to convert Rubles into foreign currency for the purpose of repatriation ... were abolished in 1996 and currently there are no restrictions imposed upon a properly registered foreign entity which limit the conversion of Rubles from a Russian bank account into foreign currency and repatriation of that foreign currency."

²¹⁸ Henry and Zheltonogov, *id.* This is a result of a reinterpretation of what constitutes a "imported" service by the Central Bank; a service licensed in Russia, e.g., that of a foreign bank, is not imported and thus must be paid for in Rubles as a transaction associated with capital movement, unless the purchaser of the service obtains a license from the Central Bank for settlement in foreign currency. *Id.* Transactions between Russian individuals and/or entities in Russia must be settled in Rubles under Art. 2.1, Law No. 3615-1 of the Russian Federation of October 9, 1992 on Currency

non-residents in Russia will likewise be considered not to be imported and thus subject to settlement solely in Rubles (requiring the service provider to open a current Ruble account).²¹⁹ Some Russian banks consider the Central Bank interpretation of currency regulations to exceed its authority, however, and continue to process foreign currency payments for services provide by non-residents to residents.²²⁰ The sanction for violating Russian currency law is confiscation of everything received in the forbidden transaction, i.e., a 100% loss.²²¹

Some of the problems can be avoided if the non-resident obtains special permission from the Central Bank to make all payments to other non-residents from its Russian business in hard currency.²²²

Non-resident accounts have been subject to mandatory conversion into Rubles by the Central Bank.²²³ The mandatory conversion can be lifted by special government enactment however.²²⁴ For example, presidential decrees exempted hard currency funds from mandatory conversion to enable one Russian company to pay off loans from an Italian bank that financed the company's modernization, and another Russian company was used to repay money to the Japanese Export-Import bank.²²⁵

3. Recent Developments

On October 7, 1998, the Central Bank announced that it will recommend four changes to currency regulation policies to the Duma for amendment of the Law On Hard Currency Regulation and Control. The new law should contain a clear-cut definition of "hard currency valuables," including the Russian national currency as a valuable hard currency when used in settlements between residents and non-residents in the territory of Russia. Second, the new law will divide powers between a body for hard currency regulation and one for hard currency control, i.e., Central Bank and the Government. Third, the new law will specify the rights and obligations of Russian commercial banks as hard currency control agents. Fourth, the amended law will have a streamlined system of liabilities for the violation of hard currency legislation.²²⁶

On January 10, 1999, currency regulations were introduced that force Russian exporters to sell 25 percent of their hard currency earnings directly to the Central Bank on top of an

Regulation and Currency Control.

²¹⁹ Henry and Zheltonogov, *id.*

²²⁰ Henry and Zheltonogov, *id.*

²²¹ Henry and Zheltonogov, *id.* (Article 14 Currency Law).

²²² Pettibone and Passer-Muslin, *id.* at 713-14.

²²³ Pettibone and Passer-Muslin, *id.* at 715-16.

²²⁴ Pettibone and Passer-Muslin, *id.* at 716.

²²⁵ Pettibone and Passer-Muslin, *id.* at 715-16.

²²⁶ 10/29/98 Russian Daily Business Digest Segodnya, 1998 WL 17713710.

existing requirement for exporters to sell 50 percent of their profits at a special morning trading session on the Moscow Interbank Currency Exchange.²²⁷

We may see the introduction of a Currency Board to undertake the “herculean task” of reinventing a Russian currency.²²⁸ Or we may see new laws and regulations tying the Ruble to gold.²²⁹ In any scenario, we can reasonably expect changes to Russian currency laws and regulations in the future.

D. Other Financial Regulations

Other laws impact on financial transactions and, accordingly, could play a role in a financial dispute where mandatory Russian law is found to apply. They will obviously play a role in a dispute governed by Russian law. Western businesses and advisors are generally unhappy with the quality of Russian legislation in these finance-related fields.²³⁰

1. Accounting Regulations

Even accounting is the subject of regulations and laws which perpetuate Soviet standards and goals, which are to stop people from stealing by keeping tabs on inventories.²³¹ Russia's Chart of Accounts, the framework for corporate bookkeeping, dates from November 1991, and has been supplemented by laws, decrees and instructions in a twice-monthly journal without changing the basic premise.²³²

Russian use the outmoded bookkeeping practices to play shell games with their bad loans. The Central Bank is trying to pressure the banks to disclose the true state of their finances. The IMF has endorsed a requirement that all financial institutions report consolidated results.²³³

²²⁷ 1/11/99 *Agence France-Presse*, 1999 WL 2527095. The government also reduced the time exporters have to sell their foreign currency earnings from 14 to seven days.

²²⁸ Steve H. Hanke, “Reinventing the Ruble How to Create a Currency Law for Russia” 9/7/98 *Wall St. J. Eur.* 8, 1998 WL-WSJE 12730994.

²²⁹ Jude Wanniski, “Reinventing the Ruble ...Or Make the Ruble As Good As Gold” 9/7/98 *Wall St. J. Eur.* 8, 1998 WL-WSJE 12730971.

²³⁰ See, e.g., “Summary Recommendations of the Capital Markets Forum following the Tenth Meeting of the U.S.-Russian Commission on Economic and Technological Cooperation” (also known as the Gore-Chernomyrdin Commission), dated March 9, 1998, <<http://www.usis-it/wireless/wf980313/98031312.htm>>.

²³¹ 8/20/98 *Wall St. J. A1*, 1998 WL-WSJ 3506211. For example, instead of allowing accountants to set depreciation rates according to real lifespans, the state published schedules dictating the lifespan of everything from wooden chairs to machine tools.

²³² 8/20/98 *Wall St. J. A1*, 1998 WL-WSJ 3506211.

²³³ 8/20/98 *Wall St. J. A1*, 1998 WL-WSJ 3506211.

2. Securities Laws

Russian securities laws are "patchwork" and many important areas have no legislation at all.²³⁴ A presidential decree established the Russian Federal Committee for Securities and Capital Market.²³⁵ The Securities Committee has the authority to stop any non-licensed entities from trading and to suspend the license of a trading entity if it violates securities legislation.²³⁶ Given the patchwork nature of the law and the broad powers of the Securities Committee, capital market participants must expect the unexpected.

3. Corporations Laws

The Russian federal law on corporations ("stock associations") took effect on January 1, 1996.²³⁷ Previously, corporate issues had been regulated by presidential and agency decrees and not statutes. This raised problems of determining the hierarchy of applicable laws and how to handle contradictory rules.²³⁸

The new corporations law regulates financial and capital transactions involving a corporation, such as the contribution of charter capital, the payment of dividends, conditions for transactions with "interested" parties and for "large" transactions.²³⁹ It also regulates securities, for example, by requiring that initial stock issuance and subscription be at nominal (par) value.²⁴⁰ There can also be no initial public offering (IPO) in the usual Western sense because stock must be issued to the founding shareholder.²⁴¹ Finally, the corporations law also prohibits the repurchase of stock by the corporation in certain situations, including if the corporation is insolvent.²⁴²

²³⁴ Natasha Alexeeva, "Russia Establishes a Federal Securities Committee" 1 Parker School J. E. Eur. L. 717, 719 (1995).

²³⁵ Alexeeva, id. at 717.

²³⁶ Alexeeva, id. at 718.

²³⁷ William G. Frenkel, "Overview of the New Russian Corporation Law" 3 Parker School J. E. Eur. L. 101 (1996).

²³⁸ Rendak, id. at 383.

²³⁹ Frenkel, id. at 103-07.

²⁴⁰ Frenkel, id. at 112.

²⁴¹ Frenkel, id. at 112.

²⁴² Frenkel, id. at 112.

E. Cases

1. Novokuznetsk Aluminum Plant: Swiss Federal Tribunal, July 9, 1997

Novokuznetsk Aluminum Plant (NKAP) v. Soinco S.A.C.I., decision of the Swiss Federal Tribunal dated July 9, 1997,²⁴³ is a case where the arbitral situs was outside Russia and the parties had chosen law other than Russian law to govern the contracts in dispute. A Russian supplier sought setting aside of Swiss arbitral award in which arbitrators had ruled that Russian exchange control laws, if relevant at all, did not override the applicable Hungarian and Argentine law to share purchase contracts between the Russian supplier and Hungarian and Argentine purchasers. Those share purchase agreements provided that the Russian supplier purchase a minority interest in each of these purchasers. In a Russian court decision (rendered after the conclusion of the arbitration), a Russian court declared the share purchase contracts to be void because they violated Russian public policy in the form of Russian currency laws.

The Swiss Federal Tribunal ruled that the arbitrators had considered the issues of law and that there was no violation of international public policy necessary to set aside an award in Switzerland. The non-application of Russian currency laws did not constitute a violation of international public policy. Moreover, it appeared that the analysis as to applicable law and the application of those laws by the arbitral tribunal was correct. (Strictly speaking, that was irrelevant.)

2. Russian Court Decisions Under the New York Convention

The Russian courts have properly ignored attempts by Russian award-debtors to stave off enforcement by invoking currency and payment-related issues. One award-debtor attempted to reopen the merits of a Stockholm Chamber arbitral award by claiming that because the contract in question required funding through hard-currency held only by the Russian government, the Russian Government was solely liable for satisfaction of the award. The Third Moscow District Court found this argument irrelevant.²⁴⁴

Similarly, a Russian State organization claimed that the Russian government was the true award-debtor because the State organization had no means to settle accounts and was ordered by the Russian government to enter into the contract. The Supreme Court of the Russian Federation rejected this defense as a question of the merits that was under the sole jurisdiction of the Stockholm Chamber arbitral tribunal.²⁴⁵

The misapplication of Russian law in a foreign arbitral award has been found not to

²⁴³ Reported in Mealey's Int'l Arb. Rep. October 1997, at 4 f. and C-1 ff.

²⁴⁴ Decision of the Third Moscow District Court (Civil Department) dated October 12, 1992, reported in XXI Yearbook Comm. Arb. 666 (1996).

²⁴⁵ Decision of the Supreme Court of the Russian Federation, dated April 28, 1993, reported in XXI Yearbook Comm. Arb. 668 (1996).

violate Russian public policy;²⁴⁶ this sound principle should also apply to Russian currency laws. To rule otherwise, a Russian court would have to find that the currency laws constitute "basic principles of Russian legislation."²⁴⁷ As noted above, the decision of the Moscow City Court dated September 18, 1995 refusing to set aside an award requiring payment in hard currency would seem to put currency laws at a lower level than "basic principles of Russian legislation."²⁴⁸

3. Decision of the State Arbitration Court

Although a judicial (not non-judicial) settlement of a financial dispute, the decision of a State Arbitration Court may illustrate that Russian jurists disfavor avoiding financial obligations through use of the formalism of Russian legal practice. (Query: why keep formalism?). For example, a foreign bank affiliate, as lender, entered into loan and security agreement before it officially became a legal entity. When repayment time came, the debtor argued that the agreement was invalid and therefore no interest was due. The bank affiliate lost at every instance except the Supreme Arbitration Court., which found that the foreign bank had authorized its affiliate to conclude the loan and security agreement. This authorization of the contract was held to be a substitute for the affiliate being a legal entity at the time of the agreement, making the loan a binding obligation.²⁴⁹

V. Practical Enforcement Issues

A. Enforcement of Finance-Related Non-Russian Awards: Soinco S.A.C.I v. Novokuznetsk Aluminum Plant (NKAP)

The US\$ 19.6 million award against Novokuznetsk Aluminum Plant (NKAP) in the Swiss arbitration discussed above (Section IV.E.1.) was recognized by the English courts and enforcement proceedings were initiated.²⁵⁰ The courts granted the request by the award-creditor to garnish funds amounting to over US\$ 10 million held by Base Metal Trading Ltd. (BMTG) in a London bank account on the grounds that BMTG was indebted NKAP in that amount.

BMTG opposed the garnishment on the grounds that a Russian court might not recognize the garnishment as satisfying BMTG's debt to NKAP. BMTG was being subjected to the risk of having to pay the debt twice, if a Russian court issued a judgment against it. That risk was real, BMTG argued, because a Russian court had declared the share purchase contracts between NKAP and Soinco void for violation of Russian currency laws

²⁴⁶ Decision of the Fifth District Court (Civil Department), dated October 31, 1995, reported in XXIII Yearbook Comm. Arb. 735 (1998).

²⁴⁷ Decision of the Eighth District Court of Moscow (Civil Department), dated April 21, 1997 reported in XXIII Yearbook Comm. Arb. 745 (1998).

²⁴⁸ Reported in XXII Yearbook Comm. Arb. 295 (1997).

²⁴⁹ Reported in Davis, id. at 634.

²⁵⁰ Enforcement proceedings reported in "Double Jeopardy Argument Fails; Award to Soinco Paid" 13 Mealey's Int'l Arb. Rep. No. 3, at 9 (1998).

The English courts rejected BMTG's arguments. There was no Russian judgment against BMTG for its debt to NKAP and there was no Russian judgment in which a Russian court refused to recognize the arbitral award against NKAP.

But if there had been one or both such Russian judgments?

B. Enforcement of Russian Awards Abroad: Far Eastern Shipping Co. v. AKP Sovcomflot

The English courts have enforced a Russian arbitral award rendered by the MAC (at the Chamber of Commerce and Industry of the Russian Federation) against the Russian party AKP Sovcomflot ("AKP") and in favor of Far Eastern Shipping Co. ("Far Eastern").²⁵¹ Far Eastern had loaned money to AKP under a loan agreement in the context of a ship purchase and chartering transaction. Under the loan agreement, Far Eastern paid off AKP's debts to some Japanese banks, but AKP (apparently) did not repay Far Eastern.

A MAC arbitral tribunal issued an award in favor of Far Eastern in the amount of US\$ 7 million. AKP challenged the award before a Russian court, which rejected the challenge on January 18, 1994. AKP then tried again to have the award set aside by the Russian Supreme Court, which rejected the challenge on July 29, 1994.

Far Eastern was "unsuccessful" in having the award enforced in Russia. It then sought enforcement in the U.K. The English courts granted Far Eastern's motion to have the award recognized, converted into an English judgment and enforced. AKP assets amounting to US\$ 7.55 million in the U.K were then attached.

C. Enforcement of Awards in Russia

At the stage of attaching assets, domestic and foreign arbitral awards in Russia fare no better than domestic Russian judgments, namely, abysmally. Less than 50 percent of Russian court judgments are actually enforced and resulted in any recovery of money.²⁵² If enforced, the procedure takes so long that assets have dissipated.²⁵³

In 1997, the Duma enacted two laws to improve judgment (and arbitral award)

²⁵¹ Enforcement proceedings reported in "English Court Enforces \$7 Million Award After Conversion to Judgment" 10 *Mealey's Int'l Arb. Rep.* No. 1, at 7 (1995).

²⁵² Kurochkin, *id.* (citing the Russian Ministry of Justice); *Economist*, *id.*; Tatum, *id.* (enforcement actions hindered by poorly paid and trained bailiffs under old law); Hendrix, *id.* at 1099, citing the Russian Ministry of Justice for the year 1995.

²⁵³ Hendrix, *id.* at 1083-84 (still no money collected three years' after court enforcement proceedings had begun for an ICAC award). To enforce an arbitral award in Russia, an "executory list" must be obtained from the state court of general jurisdiction and presented for enforcement within six months. If the judgment or award cannot be executed because the debtor lacks sufficient assets, the executory period is stayed Davis, *id.* at 630.

collections, a Law On Bailiffs and a Law On Enforcement Proceedings.²⁵⁴ A new office of Bailiff-Executor was created to carry out executions and the militia is empowered to assist bailiffs.²⁵⁵ The law on enforcement proceedings also permits the judgment- or award-creditor to send the writ of enforcement (*ispolnitelnyi list*) directly to a bank where the debtor has assets. The bank must turn over funds or declare that it has insufficient funds within three days. If the bank fails to do so, it faces a fine of 50% of the judgment amount.²⁵⁶

The effect of the 1997 Law On Enforcement Proceedings remains to be seen. The new office of Bailiff-Executor was scheduled to be fully staffed only in 1999.²⁵⁷

²⁵⁴ Kurochkin, id.

²⁵⁵ Kurochkin, id.

²⁵⁶ Kurochkin, id.; Davis, id. at 630.

²⁵⁷ Hendrix, id. at 1099.

Non-Judicial Settlement of Financial Disputes in Middle East

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Cairo

Conference

Non-Judicial Dispute Settlement in International Financial Transactions

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Dr. Sarie-Eldin joined the Cairo Regional Center for International Commercial Arbitration (CRCICA) in 1990 as a legal advisor and assistant to the Director of Cairo Regional Center for International Commercial Arbitration. Dr. Sarie-Eldin participated in drafting the recent amendments made to the CRCICA Rules of Arbitration.

Dr. Sarie-Eldin was appointed as a Research Fellow of Banking Law at the Center for Commercial Law Studies, London University for the years 1993-1995

Special Missions:

Dr. Sarie-Eldin is also acting as a legal advisor to the Ministry of Foreign Affairs on issues related to International Business Law and was delegated to represent the Ministry in all its affairs at the United Nations Commissions for International Trade Law (UNCITRAL). In this capacity, he represented Egypt in the following works: Electronic Commerce Model Law; Model Law on Financing Receivables; BOT Legal Guide.

Dr. Sarie-Eldin is currently a member in the Legislative Committee relevant to the Egyptian Ministry of Justice responsible for amending and developing the following laws: the Law of Fonds de Commerce, the Law of Commercial Books, the Law of Commercial Registry and the Law of Chambers of Commerce.

In addition, the Ministry of Housing and New Urban Communities has assigned to Dr. Sarie-Eldin the preparation of new laws related to Drainage and Restructuring of the Water Sector. This Assignment was finalized in December 1998.

PART ONE

**DEVELOPMENT OF ARBITRATION
AND OTHER ALTERNATIVE DISPUTE RESOLUTION MECHANISMS
IN THE ARAB WORLD**

General

International commercial arbitration in the Arab World until quite recently has been a critical issue. Adoption thereof was controversial, favoured by some but opposed by many. The result was that legislative policy in most Arab countries tended to avoid the application of arbitration for the resolution of disputes¹.

This has now changed. Arbitration and other dispute resolution mechanisms are being regulated by relatively sophisticated and progressive legislation, and have received much practical support. This is due to two main reasons. The first is the fact that arbitration has proved to be extremely effective in the resolution of different types of disputes, like civil, commercial or administrative ones. The second is that most businesspersons and lawyers have acquired sufficient experience and self-confidence to benefit of the system and to reduce any potential disadvantages².

Support of Arbitration

Legal, technical and practical support given to arbitration and other dispute resolution mechanisms in the Arab world may be demonstrated from the following:

¹ Dr. Abdel Hamid EL-AHDAB, Historical Development of Arab Legislation, Arbitration in the Arab Countries, Part Two, 1990, Nouvel.

² Counselor Dr. Mohammed ABUL-ENEIN, The Trends in Field of Dispute Resolution in the Middle East, working paper presented to the Conference for the Settlement of Disputes, The Trends in the Field of Dispute Resolution in the Middle East, Washington, 2-4 April 1998.

First, many new laws that encourage the adoption of arbitration have been enacted. Most of such laws contain progressive principles of arbitration and which undoubtedly will support it as an effective mechanism for resolution of national and international disputes.

Second, during the last decade, a relatively large number of international commercial arbitration centres have been established in most of Arab capitals. This happened in order to introduce arbitration and offer legal, technical and administrative support to all parties concerned with arbitration.

Third, most Arab countries have adhered to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (The New York Convention). This Convention encourages resort to arbitration as it regulates and facilitates the enforcement of awards among member states, a matter that of course does not exist for court judgements.

Fourth, most Arab states have been very keen to provide members of the judiciary with extensive training and practical experience to deal effectively with arbitration. The most obvious impact of this was allowing arbitration and enforcement of awards to take place quite effectively and thus fulfilling its purpose.

Fifth, arbitration as a mechanism for dispute resolution and especially international commercial arbitration is being taught in most law schools, not only on a postgraduate level, but also as a compulsory subject at the graduate level.

The impact or the result of all of the above mentioned can be summarised as follows:

First: As to Modern Arab Legislation.

It is in fact the Model Law prepared by the United Nations Committee on International Trade Law (UNCITRAL) the main driving force which led to the adoption of many new arbitration laws in the Arab world³.

In Egypt for instance, the Arbitration Law was enacted by Law No. 27 of 1994 (The Egyptian Arbitration Law). It is in fact based upon the Model Law. However there are a few remarkable differences. For instance, Egyptian Arbitration Law applies to both domestic and international arbitration. This was determined in order to give these two types equal force and effectiveness. Also, the term international commercial arbitration under the Egyptian Arbitration Law is interpreted quite broadly. Another difference with the Model Law is an express prohibition to apply for the recusation of arbitrator more than once by the same party. This was quite controversial. Many jurists have called for the amendment of this rule. For in spite of the fact that it avoids causing undue delays, it does in fact violate a fundamental principle of litigation, especially where new reasons justifying recusation arise after the first denied application.

Another major difference is that an award is rendered null and void if the Arbitral Tribunal disregards the application of substantive applicable law chosen by the parties. The reason for this express rule is simply that it is believed in the past, the Arab world has suffered a lot of prejudice from the unjust application of laws that were not chosen by the parties, and were not even the most relevant ones.

³ The effect of The Model Law was not limited to the Arab World alone, but many African and Asian countries have adopted it as a basis for regulating their international commercial arbitration laws, for more see: Betger, K. International Economic Arbitration, Kluwer International, (1993), pp. 1-6.

A controversial issue raised before the courts is whether the rules of enforcement of foreign awards found in the Code of Civil and Commercial Procedures, are still applicable as to foreign awards that are not strictly speaking subject to the definition of international awards found in the Arbitration Law. The Cairo Court of Appeal when deciding this issue determined that such awards are in fact subject to the Arbitration Law⁴. This is because the Law contains flexible rules to the extent that where the New York Convention applies, and according thereto, national and international awards must be treated equally.

Several other examples concerning the impact of the Model Law can be seen in Tunisia, Bahrain and Oman. Tunisia and Bahrain each enacted an arbitration law quite recently⁵. Both laws are similar in the fact that they apply to international arbitration and do not to domestic ones, a major difference with the Egyptian law. As for Oman, it has also enacted quite recently an arbitration law that is quite similar to the Egyptian one, and has even adopted most of Egypt's modification to the Model Law.

It should be noted here that most Arab countries have adopted most of the fundamental principles of arbitration, in order to avoid deficiencies found in arbitration in the Arab world until quite recently, some of which are as follows:

- 1- **The Freedom of Choice.** Most laws adopted in the Arab world have given parties to arbitration the freedom to regulate its procedures. And most regulative provisions found therein are mainly complementary and apply in the absence of agreement as to any important and particular issue. For instance, the parties are free to determine the number of arbitrators, the place where arbitration is to be held, the language of

⁴ Cairo Court of Appeal, Case 76 of

⁵ Tunisia enacted its arbitration law in 1993, and Bahrain in 1994.

proceedings, and are also free to select the law applicable to the substance of the dispute⁶.

- 2- **The Autonomy of Arbitration Clause.** Most modern Arab arbitration laws have expressly confirmed this vital principle which validates an arbitration clause found in an agreement even if the contract contained therein is invalid. This is provided of course that the arbitration clause is itself valid⁷.
- 3- **The Principle of Competence de Competence.** This is also valid in most Arab laws. Accordingly, the arbitral tribunal is entitled to determine the validity of its own jurisdiction without resort to the ordinary national courts⁸.
- 4- **The Finality of Award.** In brief, this principle renders an award final, binding and may not be challenged except in very particular cases, which are all in accordance with internationally recognised causes for nullity of awards. It should be noted that challenging an award in most Arab countries is not a second degree of litigation, but an exceptional procedure for applying nullity thereof, and inadmissible except in the exclusive express cases provided for and which are not subject to wide interpretation⁹.

⁶ See for instance Articles: 5, 17, 28 and 29 of the Egyptian Arbitration Act, Law No. 27 of 1994.

⁷ See Article 23 of the Egyptian Arbitration Act.

⁸ See Article 22 of the Egyptian Arbitration Act

⁹ Dr. Prof. Fathy Wali, Legal Action for Nullity of Awards according to the Egyptian Arbitration Law No. 27 of 1994, unpublished article, in Arabic.

Second: The Establishment of Arbitration Centres

One of the first and most important centres in the Arab Middle East region is of course the Cairo Regional Centre for International Commercial Arbitration (CRCICA). The importance of this very particular centre is mainly due to the fact that it is a pioneer in the field of arbitration in the Arab world.

The CRCICA is non-profit international organization. It came into existence as a result of a resolution issued by the Afro-Asian Group of non-allied states of the United Nations. In general this resolution aimed to establish several regional centres for arbitration in Africa and Asia, in order to promote arbitration and strike a balance in the field of international commercial disputes.

It is interesting to note that in 1979 an agreement was concluded between the Afro-Asian Group and the Egyptian Government, selecting Cairo as a venue for the first such centre. In 1987 the Egyptian Government and the Afro-Asian Group concluded another agreement whereby the CRCICA was awarded immunity usually determined exclusively for international organisations, and thereby, all of its personnel enjoy the status of international employees. It should be noted here that no other similar arbitration centre enjoys a similar legal status.

The CRCICA adopts the UNCITRAL Rules with some slight modifications that could be described as interpretative modifications¹⁰. This was done for the sole purpose of expediting proceedings and avoiding any and all undue delays. The CRCICA has also provided for many additional rules that provide solutions for situations that remain unregulated, like for instance setting special rules for multiparty arbitration. It has also made its rules available on the internet, it also holds a comprehensive panel of arbitrators covering most fields of specialisation and a quite recent report shows that that over 120 international commercial

¹⁰ Dore, I. Arbitration and Conciliation under the UNCITRAL Rules, A Textual Analysis, 1986.

arbitration have been held under its auspices. This is a considerable number as the concept of arbitration is relatively new in Egypt. At least, 20% of this number involved financing disputes.

The most important role the CRCICA undertook upon itself to achieve is the development and promotion of arbitration, not only in Egypt but also in the entire Arab world. This can be seen from the vast number of seminars, international conferences and training courses it held. This has contributed in the provision of training to members of the judiciary, lawyers and even business people concerned with arbitration. It has also prepared rules on conciliation, technical expertise and other alternative dispute resolution mechanisms. It has also assisted in establishing an arbitration centre in the State of Djibouti.

However the most valuable contribution it provided was assisting the Egyptian Government in preparing a new arbitration law. The result was the enactment of Egypt's Arbitration Law No. 27 of 1994. It should be noted that since this law is mainly concerned with international commercial arbitration, the CRCICA has in fact contributed in the promotion of international trade and investment in Egypt, by providing regulations and a venue for the resolution of related disputes.

After the establishment of the CRCICA many other Arab countries followed the same example. To state just a few examples: The Chamber of Maritime Arbitration in Morocco was established in 1983, The Bahrain Arbitration Centre in 1993, the Tunisian Arbitration Association in 1996 and the Yemeni Conciliation and Arbitration Centre in 1996 also. Also, in 1995 the Commercial Arbitration Centre for the Gulf States Council comprising Saudi Arabia, Kuwait, the United Arab Emirates, Bahrain and Qatar, was established. It should be noted in this context that these centres apply the UNCITRAL Rules suitable for both domestic and international arbitration.

And even though a relatively small numbers of arbitration have been held at the above mentioned centres, they have in fact helped promoting the concept of arbitration and development of arbitration laws in the country where they function.

Third: The New York Convention.

One of the most important concepts of arbitration is the facilitation of enforcement of awards¹¹. This is why then the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards is so important¹². For according to this Convention it is not permissible to deny the enforcement of foreign awards except in the exclusive cases provided for in Article 5¹³.

It should be noted here that many Arab countries are in fact parties to this Convention. For instance, Egypt and Syria adhered in 1959, Tunisia in 1967, Kuwait in 1978, Jordan in 1979, Algiers in 1989 and quite recently Saudi Arabia in 1993.

Fourth: New Judicial Trends in Dealing with Arbitration.

The traditional judicial approach tended to view arbitration as an exceptional method of dispute resolution, which limited the power of the judiciary. This approach has started to change for many reasons. Probably the most important are the following: the courts have been facing a large number of cases that are

¹¹ Cronston, M., Yohiel, E., Arbitration and Dispute Resolution in the International Construction Industry, 2 ICLR, 1995, pp. 231-257.

¹² Van Den Berg, A., The New Arbitration Convention of 1958: Towards a Uniform Judicial Interpretation, 1981.

¹³ Like for instance where the arbitration agreement is null and void as a result of a party's legal incapacity in accordance with his own personal law. Or where the award violates public order in the state where recognition and enforcement is sought. Or where the formation of the arbitral tribunal is not in accordance with the parties' agreement.

too many to decide in adequate time, there has been a sudden widespread use of arbitration, and the acquisition of sufficient knowledge of arbitration by everyone concerned.

And because Egyptian courts have acquired a higher level of understanding of the concept of arbitration, its advantages and most important how to deal with it, there is a remarkable change in attitude which tends to support rather than hinder. This change has appeared in quite a large number of cases where awards were challenged for no obvious valid legal reasons. The courts as a result allowed enforcement thereof. This can be demonstrated by an example where the Egyptian Court of Cassation held that the New York Convention has become an integral part of Egyptian law, and thus supersedes any civil or commercial provision of national law where any contradiction exists¹⁴. In another decision the same court held in 1990 that Egyptian courts are precluded from reviewing the subject matter of a dispute which was subject to arbitral proceedings. This is because the court with jurisdiction to allow enforcement of awards is not an appellate court. Furthermore, the Court of Cassation prior to the enactment of the Egyptian Arbitration Law in 1994, had repeatedly confirmed in many of its judgements the concept of finality of awards and that they possess the same force of final decisions rendered by the ordinary courts, that is unless of course the award is null and void. The Court of Cassation had also quite correctly confirmed the fact that there are no restrictions as to the arbitrators' nationality or place of where an arbitration can be held¹⁵.

Another interesting point to mention is the one concerning allowing arbitration in administrative contracts. This issue was controversial both before and after the enactment of the Arbitration Law of 1994. For even though according to this Law

¹⁴ Court of Cassation Decision Number 547 of 1991.

it is permissible, the General Assembly of the Conseil d'Etat issued a legal opinion in 1997 denying the application of the arbitration law to contracts subject to the jurisdiction of administrative courts. At the same time, the ordinary courts adopted an extremely flexible approach and held that the new arbitration law is applicable to administrative civil and commercial contracts¹⁶. The Cairo Court of Appeal, in this judgement, confirmed that the Arbitration Law No. 27 of 1994 is applicable to administrative and civil and commercial contracts alike. It determined that the application raised for nullity of arbitration agreement in the relevant administrative contract is not justified and has no legal basis. It contradicts the requirement that obligations to be respected and performed with good faith, a principle which applies to all types of agreements, including administrative contracts. The Court also found that the application contradicts a well settled principle in international commercial arbitration jurisprudence and doctrine which does not allow states or public entities to deny the application of arbitration clauses it has included in its contracts, on the basis of existence of legal restrictions found in some law, even if valid and applicable. This is because otherwise, the state or the public party could dissolve itself from any arbitration agreement it has voluntarily concluded and would affect and harm the credibility of the system and the purpose of investment and development projects. It should be noted here that this particular issue has been completely resolved. An amendment was entered to the Arbitration Law, by Law No. 4 of 1997, which reconfirmed by express provision for arbitration in administrative contracts. This, simply, means that an arbitration will be binding on Governmental entities entering into loan agreements and other credit facilities.

¹⁵ Court of Cassation Decision Number 4032 of 1992.

¹⁶ See the judgment rendered by the Cairo Court of Appeal, Circuit 63 – Commercial, Decision Number 64, on 19 of March 1997.

Another example to show the friendly attitude of Egyptian Courts towards arbitration can be illustrated. Law No. 27 of 1994 in Egypt is applicable to international arbitration if s carried out in Egypt, or if it is carried out abroad and the parties have agreed to apply the Egyptian Arbitration Law. Thus, the enforcement of foreign arbitration awards, which are not subject to Law No. 27 would be subject to the provisions of procedures law on civil and commercial matters. These procedures are more complicated than those provided in Arbitration Law. This has led to the fact that the enforcement of foreign awards are more difficult to be enforced from local and international arbitration awards that are governed by Arbitration Law. The Court of Appeal has intervened again to cure this unbalance by deciding that the enforcement of the arbitral award must be governed by the rules of Arbitration Law. The Court has acknowledged that a foreign award, under New York Convention, which is an integral part of Egyptian Law, must not be treated in less favourably from local and international arbitration, and all these arbitral awards must be subject to the same rules in connection with enforcement of arbitral awards.

Fifth: Academic Aspects.

Academics have realised more and more the importance of creating a generation of lawyers, judges and arbitrators specialised in international arbitration. Accordingly many universities and academic institutions have prepared courses on international commercial arbitration in particular. For instance such subject is compulsory at the graduate level at the Faculty of Law of the University of Cairo. This same university has also set up a postgraduate diploma dealing mainly with the topic of arbitration. It is hoped that other universities in the Arab world follow the same example.

Final Remarks:

Even though arbitration in the Arab world has been developing as seen in this Section, and even though the advantages of arbitration are quite clear to everyone concerned in this part of the world, arbitration has encountered many practical problems. For instance some of the most apparent ones are related to the choice of arbitrators and to the conductance of proceedings. It has been noticed that arbitrators, in many instances, are not chosen on the basis of efficiency, but because they are on good terms with one of the parties, or the very least because an arbitrator adopts an opinion which concurs with that of a party. This undoubtedly affects the entire concept upon which arbitration is established, namely, absolute neutrality, for arbitrators undertake the same identical role of a judge. Also, it has been noticed that delay in making awards has become quite common. In order to avoid any of these two problems, amendment of legislation is not recommended, rather providing more training and expertise in case management could be the best solution.

PART TWO

**ARBITRATION AS A MECHANISM FOR THE RESOLUTION
OF DISPUTES ARISING FROM FINANCING AGREEMENTS AND
BANKING TRANSACTIONS IN THE
ARAB WORLD**

General

The traditional approach in the banking field and financing related disputes in the Arab world, as in every where else, has always tended to avoid arbitration and resort to the courts instead. This is in fact a general tendency common in all countries and not restricted to Egypt alone. It also covers all types of disputes where a bank or a financing institution is concerned.

As shall be seen later on, this approach is not established upon practical reasons but it is rather a common practice influenced by general trends prevailing in the Arab world. Notwithstanding that financial institutions, particularly, in Egypt, have fundamentally started to change their views by avoiding arbitration clauses.

There were many reasons given to explain why banks and financing organisations tended to avoid arbitration¹⁷. Some of the most important arguments against resort to arbitration are as follows:

¹⁷ Sandrock, O., International Arbitration Inept to Solve Disputes Arising Out of International Loan Agreement, II Journal of International Arbitration (1994) pp. 30-60; & Park, W., Arbitration in Banking and Finance. Paper presented to the Conference on the Financing Sector in Latin America, held in Spain, 27-29 of May, 1998.

Reasons Given Against Arbitration in Financial Disputes:

The First based upon a concept called the Simplicity Theory. The simplicity of claims related to banking operations and financing agreements, and non-existence of complicated technicalities makes resort to arbitration unnecessary. Thus one of its advantages like high specialisation and expertise is not really needed. For after all the subject matter of claim is payment of capital and interest.

The Second Argument was based upon the concept of the Strict Law Theory or Fear of Equitable Arbitration. For resort to arbitration might lead to the application of the principles of equity and thus avoid the application of the law chosen by the parties. And this sometimes happens because arbitrators usually tend to reconcile conflicting interests. Thus non-application of the strict rules of law could jeopardise the creditors' rights.

The Third Argument was based on the Publicity Theory. The argument raised is that judgements are always public and this represents a deterrent to borrowers. On the other hand, arbitration is in principle confidential unless otherwise agreed.

The Fourth Argument was non-existence of summary proceedings that exist in some jurisdictions. Some financing organisations tend to favour such proceedings as it provides for expeditious settlement of disputes. In arbitration this is not available.

The Fifth was the Flexibility Theory. According to this argument it is possible in litigation before the courts to select the most convenient forum. This would then allow the lender to select a forum where the borrower possesses assets to facilitate enforcement of judgements. In arbitration, this is usually not possible.

Finally, it has been stated in the past that in many Latin American and Middle Eastern jurisdictions, arbitration has been met with great hostility and was quite unpopular and thus it is preferable to avoid it.

New Trends in Financial Industry in the Middle East

It is quite clear that all these arguments are not founded and unreasonable. They are probably due to what could be referred to as inherited historical practices. For as financing organisations and especially international conduct a highly risky business they therefore tend to be conservative and not to change practices they are familiar with.

The above arguments could easily counter-argued as follows:

Concerning the Simplicity Theory:

This theory can be rejected based on the fact that most financing agreements raise legal and technical issues that are always highly complicated. This is most apparent in international financing agreements, where for instance issues like sovereign immunity and restrictions found in the Bretton Woods Agreement are concerned¹⁸. Also, these types of agreements raise another complicated issue like the concept of the Acts of State. Even more complicated issues are those related to the lender's liability for environmental hazards, and which are regulated for instance in the United States of America by the Comprehensive Environmental Response Compensation and Liability Act of 1980 which needs a high level of specialisation¹⁹.

¹⁸ See for instance Section 8(ii)(b) of the Bretton Woods Agreement which prohibits any member state to set domestic rules in contradiction therewith and concerning transactions in foreign currency.

¹⁹ There is quite a lot of case law concerning the issue of lender's liability in the United States of America in particular. The American courts have adopted a strict policy requiring banks to resort to arbitration. Accordingly, three major banks in the U.S.A. have recently declared acceptance to

Also, there are many banking transactions, which raise a lot of technical and highly sophisticated issues that the courts in many countries have not been able to deal with. As a consequence, this very matter has in many cases prejudiced the credit business. For instance Egyptian courts have not been able to this day to understand the legal nature of unconditional letter of guarantee. There are many cases where the courts suspended payment thereof in spite of non-existence of fraud²⁰. Situations like this have in fact rendered banks reluctant and withheld payment of letters of guarantee pursuant to their clients' instructions, a matter that is an express and clear violation of the legal nature and economical function of this form of credit. Also, the importance of arbitration would most obviously appear in the case of for instance performance bonds and where surveyors' certificates are concerned. Finally, arbitration has in fact been able to successfully resolve many disputes related to letters of guarantee²¹.

It should also be noted that there are other types of disputes that arise from documentary credits and the application of the UCP ICC 500 Rules, which require a high level of technical expertise and specialisation. Probably the best example to demonstrate the new tendency of Egyptian banks to resort to arbitration is the National Bank of Egypt's decision to refer a dispute with an international Bank to arbitration. This concerned a syndicated loan and a letter of guarantee worth about two hundred million U.S. dollars.

resort to arbitration to settle its disputes with clients. These banks are: The Bank of America NT&SA, Union Bank of California N.A. and Wells Fargo Bank N.A.

²⁰ See for instance the Judgment rendered by the Court of Expeditious Matter, the Seventh Circuit, Decision No. 3449 of 1986 rendered on 29 March 1987; and that rendered on 14 April 1984, Judgment No. 1149.

²¹ See ICC Case(s) Nos. 3896 of 1982, 3267 of 1979 and 1512 of 1971.

Also, another complicated issue requiring a high level of expertise and specialisation would be the ICC Documentary Credit Resolution Expertise Rules (DOCDEX Rules).

It should also be noted in this context that paragraph 4 of Article 1 provides that the expert's opinion is non-binding unless otherwise agreed by the parties.

Financial disputes are not limited to lending and traditional banking activities, but include also underwriting arrangement, private placement, and other securities transactions.

Also, the issue of project finance and its modern application in B.O.O.T. arrangements are also complicated. This appears for instance in such concepts as non-recourse finance, intervention in management, stepping in clause and bankability issues, and intercreditors agreements. In addition there are other newly introduced mechanisms in the Arab world like asset securitization and hedging agreements and underwriting of securities which have all become quite popular in Egypt.

All of these examples clearly demonstrate how in fact banking and financing claims are not simple and thus arbitration would be more effective in dealing with related disputes. For in fact the dispute is not restricted to claiming capital and interests but raise other issues which require high specialisation and expertise, matters which the courts would need much time to assimilate. Recently, local and international banks working in Egypt have started to utilise arbitration as standard clause in most of their activities. Such utilisation of arbitration does not affect the rights of financial institutions to enforce their security interests, or to take any conservatory measure.

As for the **Second Argument** concerning the fear that an arbitral tribunal may apply rules of equity instead of the applicable law the following may be stated. It

is extremely irregular in practice for an international loan agreement or any other similar type of financing agreement to be concluded without providing for an applicable substantive law. Also, both Egyptian and comparative law provide that resort to rules of equity must be pursuant to an express agreement between the parties²². In addition, Egyptian Law renders an award null and void if the arbitral tribunal applies a law other than the one agreed upon by the parties. This of course then applies to the rules of equity. And finally any risk in this context could easily be avoided by the express and adequate provision determining the applicable law.

As for the **Third Argument** concerning the Publicity Theory, in practice, it has appeared that this matter is one of least importance to most concerned parties, especially the borrower.

As for the **Fourth** concerning resort to summary proceedings, the following may be emphasised. According to Egyptian law, the parties to arbitration may authorise the arbitral tribunal to take interim and provisional measures²³. Also, resort to the courts for the same measures does not breach the arbitration agreement. And under Egyptian law and most Arab jurisdictions, the concept of summary proceedings is different than the one applicable in others like the United States of America. It should also be noted that the parties to arbitration can agree that the award be made within a short period of time and anyway, Egyptian law requires the award be made within a year from the commencement of proceedings. Further, a summary proceedings in arbitration is adopted by certain arbitration institutions, where the case can be settled within 3 months.

As for the argument concerning the Flexibility or Exclusivity Theory, it is also hardly valid. In international loan agreements, banks are perfectly capable to

²² See for instance Article 39(4) of the Egyptian Arbitration Act, Law No. 27 of 1994.

select the place of arbitration and all adequate rules to protect their interests. Also, and as previously stated Egyptian arbitration law does not prevent banks or financing institutions to take all necessary interim measures to protect their legal interests. And finally, the enforcement of foreign or international awards is much easier where the New York Convention applies, as there are about 110 states actually parties thereto. The same is not true for court judgements. Enforcement is subject to complicated legal proceedings and practical obstacles. Also, there are in fact very few international conventions allowing recognition and enforcement of judgements rendered in other states²⁴.

As for the **Last Argument** concerning scepticism arbitration has been met with in many jurisdictions, this has become a matter of the past. For the fact that about 110 states are parties to New York Convention is an obvious recognition of the vital role of arbitration. Also, many Latin American and Arab countries, as we have seen, participated in the preparation of the UNCITRAL Model Law, and then adopted it as a basis for their own national laws.

Another vital and valid argument that could be stated in favour of arbitration and its vital role concerns inter-bank disputes. These types of disputes require absolute confidentiality and high expertise to resolve, something which arbitration can easily provide. Further, in certain transactions, arbitration between syndicate banks provides a convenient form. In syndicated loans, the local bank insists on where the loan is divided into two parts: local and international, arbitration seems to be the best solution for the settlement of disputes under intercreditors agreements. Examples of these types of disputes are like for instance the application of the pari passu clause, or the liability of the agent bank, or electronic set off between banks in the same network etc...

²³ Section 24 of Egyptian Arbitration Act.

²⁴ Like for instance the Brussels Convention of 1968, Concerning the Recognition and Enforcement of Judgments Rendered in Civil and Commercial Matters.

In this context it could be useful to point out a very successful example which took place in Spain. During the late 1970s, the Association of Spanish Banks established a specialised centre for the resolution of inter-bank disputes. A recent report issued by this Centre shows that all inter-banks disputes have in fact been resolved thereby to the exclusion of the national courts. Most settlements have been quite satisfactory and its Rules of Conciliation have played an important role therefor. It should be noted here that the Association of Egyptian Banks has in fact started studying the possibility of establishing a similar centre.

Conclusion:

The conclusions that may be drawn here are as follows:

- 1- It is about time that banks and financing organisations start developing arbitration and other mechanism as a mean of resolving disputes they are a party to.
- 2- Special care and attention should be taken in resort to arbitration for it may not be the most convenient or adequate mean in certain cases. For there are in fact some relatively minor issues such as opening of saving or current small accounts, collection of drafts, etc... And it should be noted here that the reasons which led to the adoption of arbitration in disputes related to such relatively simple matters like in the United States of America, do not exist in the Arab world.
- 3- Success of arbitration requires a cautious approach during two particular stages. The first is when selecting convenient arbitration rules and venue. The second is during drafting the arbitration clause or agreement. This is in

order to reduce the chances of having an award nullified, and to avoid unnecessary delays. Thus it is important to refer the rules of a permanent arbitration centre, determine precisely the applicable law, expressly authorise the arbitrators to order interim or protective measures, provide adequate rules in multiparty arbitrations, select a suitable place for the arbitration to be held, and finally selecting an arbitrator on objective criteria is of extreme importance.

Non-Judicial Settlement of Financial Disputes in The United States

Joe Norton
Dallas/ London/ Hong Kong

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The Evolving U.S. Experience With ADR Respecting Financial Institution Disputes

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Bank of America NT & SA Arbitration Language

Union Bank of California, N.A. Arbitration Language

I. Introduction

The traditional U.S. approach to resolution of financial and financial institution disputes roughly parallels the scenario described by Dr. Walker in his paper on the English approach to such disputes: that is, financial-related disputes are best left to judicial determination. The conventional wisdom is that financial institutions lend funds of others (*i.e.*, of depositors) to third parties who legally obligate themselves to repay in full according to contractually specified terms. The resulting reality is that there effectively is nothing to arbitrate or to mediate: and, arbitration or mediation would tend to result in the ASolomon choice of Asplitting the baby.

Such a view is firmly ingrained in Anglo-American bankers and financiers because Anglo-American legal systems have been generally well-developed commercially and, in practice, have been commercially expedient (*e.g.*, use summary judicial proceedings). In fact, some Anglo-American jurisdictions (*e.g.*, Texas) even judicially uphold and support non-judicial foreclosure proceedings.

However, modern commercial practicalities are leading toward an increasing use of commercial alternative dispute resolution techniques (ADR) in the resolution of liability claims involving financial institutions, for a variety of reasons, such as, (i) the rise of structured financings; (ii) intercreditor issues; (iii) specialized, technical issues (*e.g.* environmental issues); and (iv) the advent of the North American Free Trade Agreement (NAFTA) and its inclusion of provisions on liberalization of cross-border financial services and investments.

In its simplest terms, commercial ADR is the resolution of disputes in a forum other than the traditional judicial system. It is an alternative to adverse publicity and costly and time-consuming litigation, and in the U.S. also to Arunaway juries. For these and numerous other practical reasons, discussed in Section II, many banks and other financial institutions in the U.S. (particularly in California and the Western States, but also elsewhere) are finding ADR a more attractive dispute resolution procedure than litigation.

In the U.S., especially in the context of lender liability claims made against banks and other financial institutions, ADR, most notably binding arbitration, has been viewed by many institutions as the appropriate avenue by which to avoid excessive damage awards made by relatively unsophisticated juries. Recent experience and empirical evidence has substantiated the benefits of arbitration both in decreasing the number of cases being filed and in lowering the size of the awards.

This paper provides an overview of ADR and its statutory and contractual underpinnings, as viewed from recent U.S. experiences. It also discusses the perceived benefits and detriments of ADR, particularly as they relate to financial institutions. While mediation is a major part of the ADR process, this paper will deal primarily with binding arbitration. Except in limited or specifically negotiated situations, mediation clauses are not normally found in loan documents and are not conducive to most commercial disputes involving financial institutions. Further, although consumer issues are often closely related to protective legislation not normally accorded to commercial transactions, this paper will deal with disputes relating to commercial/ business transactions rather than consumer financial transactions. This is not to say that arbitration is not increasingly being used and enforced in consumer transactions, quite to the contrary. It is anticipated that within the next five years, most U.S. major banks

and lending institutions will implement arbitration procedures for consumer transactions.

Toward II. Precipitating Factors For Move ADR Techniques

The U.S. trend toward a greater use of commercial ADR techniques results from a number of precipitating factors, beginning with the rise of lender liability claims in the 1980s.

A. Lender Liability Claims

For the U.S. financial industry, the expansion of various theories of lender liability, rising jury verdicts and increasing legal fees, all have resulted in the court system being prohibitively expensive and, in a jury context, often incapable of a predictable result. Plaintiff's development of viable theories of lender liability have come to embrace not only fundamental common law notions based on contract, tort, agency and partnership, but also a range of statutory liability theories. The practical effect has been that financial institutions' utilization of summary judicial proceedings often are frustrated, with the ultimate determinations left to the trier-of-fact (most often a jury). Even if a financial institution can ultimately prevail in a seriously contested lender liability case, it is usually only after a protracted and expensive appeals process. All this has resulted in a number of financial institutions, initially in the California banking industry, introducing private alternative dispute resolution processes as a standard requirement in most, if not all, of their loan documents. For example, some of these financial institutions, such as Bank of America, Union Bank of California and Wells Fargo Bank, have been expansive in the required use of binding arbitration clauses while other financial institutions only use arbitration clauses in selected types of transactions or with selected borrowers.

The experience of the California banking industry's introduction of private, binding arbitration appears to have been successful. A study by the Rand Institute for Civil Justice has provided the first empirical study concerning the success of arbitration in controlling excessive litigation expenses and jury verdicts in lender liability cases. Although the Rand study was based on early and preliminary information, its conclusion (with some qualifications) suggests that through the use of binding arbitration, there has been a decline in the number of cases filed, a decrease in liability exposure and a lowering of litigation costs and expenses. Rand's conclusion was based primarily on empirical data from one major banking institution (Bank of America) and anecdotal evidence of similar benefits from the other banks involved in the study. Further, the perception by the banks was that arbitration also limited their exposure by lessening the risk of punitive damages and by eliminating the unpredictability of juries. The reduction in the award factor lowered the incentives for plaintiffs' attorneys to take cases. The Rand study further concluded that the future appeared quite bright for the use of ADR in the banking industry and that it was expected that financial institutions would continue to expand its use into new areas of their banking business.

In the five years since the Rand study was released, California financial institutions have continued to have significant success in the use of arbitration. In interviews [by Mr. Berchild] with the legal departments of some of California's major financial institutions, they stated that they have generally experienced a significant decrease in litigation and the expenses relating thereto. Most significantly, however, was the surprising fact that

arbitrations were not found to have increased significantly. The experience has been that disputes tended to be worked out informally between the bank and its customer. If litigation was not available to the plaintiff bar, the alternative of arbitration seemed not to offer the leverage or possibility of significant recoveries often required to entice plaintiff's counsel to take on the more dubious claims of borrowers. Tempering this positive assessment, however, is the fact that with the continuing "boom" economy, litigation has generally decreased across the board for the banks. The real test concerning the success of arbitration for financial institutions will be when times are tougher and options for cooperative negotiations are fewer.

B. Rise of Structure Finance

Modern commercial financings increasingly are becoming highly structured arrangements, whether it be asset-based financing, infrastructure financing, construction financing, sale-leaseback arrangements, asset securitization, energy financings, etc. In each of these arrangements, material issues facing lenders often go beyond traditional questions of payment defaults. For example, complex issues such as interrelations to other key contracts and complicated performance standards may arise. Resolution of such disputes may lend themselves to non-judicial alternatives where technical experts may be better suited as dispute resolvers.

C. Intercreditor Issues

Most major commercial loans are in the form of syndicated or participated loan arrangements. What is often forgotten is that such arrangements entail a complex of contractual relationships beyond the lender-borrower relationship. For instance, there is the relationship among the Alead/agent bank and the other lenders and in the syndicated process there is a relationship among the lenders *inter se*. As such, disputes can arise among the lenders themselves in numerous situations (*e.g.*, pro-rata sharing, duties and responsibilities of lead/agent etc.). Contentious public litigation among commercial financial institutions may give rise to undesired adverse publicity and may lead to undesired adverse commercial/business fallout. In such situations, ADR may offer a more private and more expeditious dispute resolution forum.

D. Specialized Issues (E.g., Environment)

In modern financial arrangements, specialised issues may arise. This could involve complex accounting issues or regulatory issues. For example, in the United States, the matter of environmental law compliance can be difficult to evaluate. Yet, for a lender, assurance that a borrower is in compliance with such laws may be at the heart of key representations and warranties, covenants and reporting provisions in a loan agreement as critical for minimizing environmental liability risks for the borrower and lender. Disputes over environmental compliance may be better resolved by non-judicial experts.

Also, regulatory matters could arise from various Agross-up clauses in major international and domestic commercial loans, for example, as to capital adequacy costs incurred by a lender. Such issues, again, may be best dealt with by non-judicial experts and may ensue confidentially in highly sensitive institutional areas.

E. Cross-Border Arrangement (NAFTA and Beyond)

As will be elaborated upon by Professor Gordon in his presentation, one of the foundation stones of the NAFTA process is the presence of specific and general NAFTA treaty dispute resolution provisions, including special provisions on financial service-related dispute resolution. But, what is often forgotten is that the NAFTA process is generating greater user of private ADR in the financial services area. ADR might serve as a prototype model or reference point for the private resolution of NAFTA-related financial and commercial disputes.

F. Restructurings

A loan workout or rescheduling is essentially an alternative way to resolve disputes over a troubled financing arrangement. Consensually, through negotiations between lender and borrower and related third parties, the terms of the arrangement are restructured so that the lending relationship under modified terms can be maintained. Effectively, both the lender and the borrower give up something to gain something. More broadly, this consensual approach can be used to effect an overall non-judicial, non-bankruptcy reorganization of the debtor. The overall reorganization plan often will endeavor to coordinate and mesh a series of related, individual workouts.

III. Types of ADR

ADR is generally defined as a consensual, contractual procedure for resolving disputes outside of the judicial adversary process. ADR procedures fall into two broad categories, Arbitration and Mediation. Arbitration resembles litigation and while it can be non-binding, the binding form is the preferred method, especially when agreed to prior to the occurrence of a particular dispute. Mediation involves a negotiation process usually under the guidance of a trained mediator and is non-binding in nature.

A. Mediation

Mediation is by definition non-adjudicatory. It is a process by which parties submit their dispute to a neutral third party who assists them in reaching a settlement of their conflict. It is essentially an extension of the negotiation process. Mediators are facilitators whose primary role is to identify the issues and interests for each party in an effort to find a basis for resolving the dispute. While many lawyers erroneously view mediation as being akin to a settlement conference in which a judge pushes two parties toward the middle in an attempt to settle a matter, the mediation process should be viewed as performing much more of a psychological role, enabling the mediator to transcend the posturing of parties so that true concerns may be addressed. In mediation the focus is far more on the psychology of settlement than using a nonjudicial/litigation forum to impose a third party's will or decision on a specific issue. The primary benefits to mediation are confidentiality and a process in which parties are directly engaged in negotiating a settlement through a neutral third party who can view the dispute objectively and assist the parties in exploring alternatives that they might not have considered on their own. It is an especially useful process when the business relationship is more important than the dispute. Mediation offers an ideal format for the resolution of a matter that needs to be handled without the risk of destroying the bigger business relationship. To have a successful mediation, both parties are usually genuinely interested in resolving and settling a particular matter rather than trying to "win" the contest. Normally too, the result of a mediation is a compromise between the two parties' positions.

The absence of the ability of a mediator to provide a binding determination and the fact that mediation requires both parties to have a genuine interest in settling, makes mediation an unattractive procedure to use in loan documents on a uniform basis. Banks usually want to be paid upon default and a forced mediation process doesn't fit the dynamics of most such transactions. If parties are not interested in compromise at the time of the dispute, mediation usually fails, forcing the dispute into litigation. Some financial institutions, however, have combined mediation with arbitration. For example, mediation is first attempted and if the matter is not resolved within a certain period, it is then resolved by binding arbitration. Because of problems with discoverability and the specter of a pending adversarial proceeding, this type of clause often dooms the mediation process to failure in a lender liability context between a debtor and a creditor. Such a clause may, however, have major benefits in loan documents by and between the financial institutions, such as intercreditor agreements, participation or syndication agreements. Parties to these arrangements are often much more interested in having a process available for a negotiated settlement prior to the initiation of an adversarial proceeding

B. Arbitration

Arbitration is an adjudicatory process. It is a method of dispute resolution in which a neutral third party is chosen to hear the matter and then resolve it by rendering a decision which can be enforced under state or federal law. Arbitration commences with the referral of the dispute to one or more impartial persons preferably with an expertise in that type of transaction or business. Arbitration can be either binding or non-binding in nature. However, the use of non-binding arbitration is not often used in agreements which are expected to deal with "prospective" problems and disputes. Normally non-binding arbitration's traditional use is as a means to handle a dispute which has already arisen and where both parties would prefer to avoid the litigation process, but at the same time want to preserve access to the judicial system (e.g., rules of evidence and appeal rights) if the non-binding determination of the arbitrator is not acceptable. When used in this context, it is recommended that the arbitration clause should require the party who rejects the arbitrator's decision and proceeds with litigation bear the costs and expenses of both parties in the event the judicial decision is the same or more onerous than the decision of the arbitrator. Such a clause can be useful in lending weight and credibility to the arbitrator's non-binding decision.

Normally the arbitrator would be chosen from a panel of experts in the substantive area involved in the arbitration. The arbitrator, in conformance with the contractual provisions dealing with the arbitration, hears the facts, proofs and arguments and renders a decision. Arbitration is designed to be confidential and informal with an emphasis on efficiency and economy. Unless specially contracted for, juries are not available. Parties can exercise additional control over the arbitration process by incorporating or deleting specific rules, by establishing discovery procedures, location, rules of evidence, etc. The basis of arbitration while contractual in nature is supported by state and federal arbitration statutes and the rules of various arbitration associations.

Binding arbitration decisions are final unless otherwise provided for by contract. Judicial intervention and review is limited by statute and existing case law. Enforcement of arbitration awards are also facilitated by the state and federal arbitration statutes. Once your private contractual dispute is settled, the power of the state is available for enforcement.

3. Preventative Dispute Resolution (PDR)

In a sense, proper credit assessment and carefully drafted finance documentation can be seen as a form of commercial ADR or, perhaps more accurately, a form of preventive dispute resolution (PDR). Effectively sound credit assessment should lead to a suitable business and legal structuring for the financial integrity of the arrangement. For example, in a commercial loan, the coordinated use of suitable representations and warranties, positive and negative covenants (including detailed financial covenants), conditions precedents, clear default and remedy, ongoing reporting and monitoring and reaffirmation, and choice of law/forum provision are all designed to minimize disputes, and, where disputes arise, to give clarity to the issues so ultimate resolution might be edited (*e.g.*, through use of summary judicial proceedings).

IV. A Closer Look at Arbitration

Specifically

A. The Statutory Basis for Arbitration

Arbitration is a private contractual procedure of resolving disputes outside of the judicial arena. While court process can and is used to enforce rights, decisions and awards, it is the contract, supported by underlying federal and state statutes, that controls the procedure.

Under the Federal Arbitration Act (FAA), a written agreement to arbitrate existing or future disputes between the parties to an agreement is "valid, irrevocable and enforceable, save upon grounds as exist in law or equity for the revocation of any contract."

Section 3 of the FAA provides that a court must stay judicial proceedings pending arbitration if it determines that an issue before it is properly referable to arbitration under an arbitration agreement. The United States Supreme Court has held that if the parties clearly have agreed to arbitration, the determination as to whether a valid agreement to arbitrate exists or whether an agreement to arbitrate that particular claim exists, will be made by the arbitrator. It is also for the arbitrator to decide if the contract as a whole was induced by fraud, is unconscionable or is a contract of adhesion.

The FAA applies to transactions involving interstate or foreign commerce and preempts incompatible state arbitration laws. Through the use of the Commerce Clause in the United States Constitution, the federal courts have expansively construed this provision to encompass matters which appear to have only minimal contacts with interstate commerce. Even if the FAA does not apply, virtually all states now recognize arbitration and have enforced agreements to arbitrate. A significant majority of states have also enacted statutory schemes based on the Uniform Arbitration Act declaring arbitration agreements enforceable. When drafting an arbitration clause serious consideration should be given as to what statute (federal or state) should be incorporated. However, because of the multi-state or national nature of many lending transactions, incorporation of the FAA would normally be the preferred route.

B. Administrative Organizations and Forum

Parties may agree to the forum for arbitration. The matter can be handled privately between the parties and an arbitrator of their selection, without the services of an arbitration administrative organization or they can elect to be governed by rules or administrative organizations that will handle the adjustment issues. In loan documents, parties use of a professional arbitration administrative organization should be designated. On a national basis, the most commonly used administrative organizations by financial institutions are the American Arbitration Association ("AAA") and J.A.M.S./Endispute ("JAMS").

The use of established administrative organizations helps ensure standards of consistency and predictability. Both AAA and JAMS issue standard procedural rules specifying the mechanics, fees, selection of arbitrators and the like. The incorporation of that organization's rules can be used as a "filler" for issues not specifically covered by the arbitration section in the loan documents. In addition to providing various sets of rules for the conduct of a particular arbitration, they also perform a number of administrative functions. These administrative functions include providing an administrative staff for case handling, including scheduling hearings, sending notices, providing hearing rooms and distributing documents. They also will determine arbitrator fees and bill the party for these fees. AAA and JAMS differ significantly from a third major arbitration group entitled the Center for Public Resources ("CPR"). CPR is an alliance of several hundred corporate general counsel, law firms, legal academics and judges. It is not an administrating organization. Its major role is educational in nature with a goal to integrating alternative dispute resolution techniques into the mainstream of legal practice. In 1989 CPR issued its Rules for Non-Administered Arbitration of Business Disputes. However, while CPR is not usually used in arbitration clauses due to its "non-administration" format, counsel who are involved in drafting arbitration clauses or handling arbitration matter should be aware of its policies and procedures.

This significant growth in the arbitration "business" makes it incumbent upon attorneys to make sure that they have a working knowledge of the available organizations for arbitration and the particular rules and procedures which control each of those organizations. Simply incorporating boilerplate or standard arbitration language can provide an attorney and his or her client an unpleasant surprise when it comes to such matters as filing costs and expenses, discovery restrictions, rules of evidence, requirements to follow the law, available remedies and rights of appeal to the courts.

The fee structure and procedure for filing claims is dictated by the applicable forum and rules. Administrative fee structures are varied and the rules should be carefully read prior to accepting an arbitration provision. The amount and extent of such fees can come as a rude surprise to a claimant and his counsel. You will usually find an initial filing fee (oftentimes based on the amount of the claim) and if there is a counterclaim that party will also be paying a filing fee. Additional fees include daily hearing fees, cancellation or postponement fees and hearing room rentals. These costs and fees will be in addition to each party's own personal attorneys' fees (if an attorney is used) and expenses. As example, the filing fee of AAA is based on the amount of each claim and counterclaim as disclosed when the claim and counterclaim are filed and is due and payable at the time of filing. AAA's present filing fee structure is:

<u>Amount of Claim</u>	<u>Filing Fee</u>
Up to \$10,000	\$500
Above \$10,000 to \$50,000	\$750

Above \$50,000 to \$100,000	\$1,250
Above \$100,000 to \$250,000	\$2,000
Above \$250,000 to \$500,000	\$3,500
Above \$500,000 to \$1,000,000	\$5,000
Above \$1,000,000 to \$5,000,000	\$7,000

When no amount can be stated at the time of filing, the minimum fee is \$2,000, subject to increase when the claim or counterclaim is disclosed.

When a claim or counterclaim is not for a monetary amount, an appropriate filing fee will be determined by the AAA.

The minimum filing fee for any case having three or more arbitrators is \$2,000.

The administrative fee for claims in excess of \$5,000,000 will be negotiated.

This is much different from normal court filing fees where such fees are usually the same for the \$50,000 lawsuit as they are for the \$50 million lawsuit. In addition, on going costs, such as the per diem payable to the arbitrator, are normally payable in advance or as the arbitration proceeds. While this "up front" expense differs from the standard court process, because of the speed and efficiency of arbitration, arbitration usually results in far lower litigation costs and fees than would be incurred in a judicial proceeding.

C. Arbitrators and Their Selection

Proponents of arbitration assert that arbitrators are often better able to resolve complex commercial disputes than many judges and most juries. Arbitration clauses can name experts or panels of experts to serve, can specify procedures for selecting arbitrators and can specify qualifications for the arbitrators. Special attention should be paid in drafting an arbitration clause so as to ensure the selection of an arbitration panel consisting of experts familiar with the practices and technical issues of the banking industry.

A carefully selected panel of experts is likely to comprehend the facts presented more quickly and intelligently and is more likely to decide the case on the facts presented than on emotional factors that typically appeal to lay jurors.

The arbitrator or arbitrators need not be lawyers. However, in a loan context, only designating a banker or other person familiar with the financial practices as the single arbitrator would be unwise. For an arbitration panel, however, consideration might be given to having one of the arbitrators be a non-lawyer with extensive financial experience.

In drafting an arbitration clause, carefully spell out the qualifications and expertise required for particular arbitrators or ensure that qualified panels of neutrals will be available by the particular arbitration administrative organization.

For most commercial transactions, the use of more than a single arbitrator is not recommended. While a three person panel may be advisable for large dollar matters, the use of such a panel for the standard commercial transaction is often prohibitively expensive and time-consuming. Attempting to schedule three neutrals for the same

time for an extended period is virtually impossible. In the long run, use of such panels can be more expensive and time-consuming than the use of a courtroom.

A major complaint from the bar has been a concern that many arbitrators do not have the experience or expertise to handle particular matters. Arbitration services such as AAA and JAMS are attempting to respond to this concern by having selected panels of experts available for particular types of matters. Because of the accelerated pace of arbitration, the availability of expert neutrals is a critical issue which will have to be more seriously addressed by arbitration administrative organizations if arbitration for financial disputes is to succeed in the long run. Having an attorney as an arbitrator whose background is patent law or personal injury law or even a retired judge whose background is criminal law poses real and serious concerns to the attorney and banking client wanting to use arbitration. Without an assurance of expertise and knowledge of the particular field, most of the benefits of arbitration quickly disappear.

D. Discovery and Motion Practice

Unless specifically agreed by the parties to the contrary, discovery and motion practice are limited or nonexistent in arbitration. While discovery may be permitted under federal law on the issue of whether a valid agreement to arbitrate exists, discovery on the merits will ordinarily be denied by the arbitrator in absence of exceptional circumstances. This can be a "double-edged sword" to a lender arbitrating a dispute with its Borrower. On the one hand, by eliminating discovery and motion practice, a substantial factor contributing to high litigation costs and delay is eliminated from the proceeding. On the other hand, limited discovery may be necessary to properly prepare for the arbitration hearing. Further, by eliminating motion practice, many essential pre-trial remedies otherwise available would also be eliminated (e.g., claim and delivery, attachment, summary judgment).

E. The Arbitration Hearing

The arbitration hearing is set by the parties in conjunction with the arbitrator or panel of arbitrators. A preliminary hearing is often first scheduled (in person or by telephone) to handle such matters as discovery, witness lists, briefs and other procedural issues which, if handled first, will enhance the value and conduct of the hearing itself. Often times, the arbitrator will require written briefs to be filed prior to the actual hearing. Since timing is often short, forcing counsel to focus in writing on the merits of their case is an invaluable tool for an arbitration. The actual hearing typically takes place at a neutral locale, such as in a conference room at the offices of the arbitration service.

Most commercial arbitration statutes grant parties the right to counsel but do not require that a party be represented by an attorney.

The hearing itself is conducted by the arbitrator. Parties present their respective cases to the arbitrator, including the presentation of evidence and the examination of witnesses. One simplifying factor is that the arbitrators normally are not bound by the rules of evidence. While this may simplify matters, it can be dangerous; especially when one considers the non-appealability of arbitration.

The arbitrator thereafter reaches a decision and makes the award expeditiously. The typical award merely states which party prevails and the amount to which such party is entitled. Arbitrators rarely explain the rationale of their awards or give opinions. In

support of this practice, courts will not inquire into the rationale in any review or approval of the award. If a party believes a mistake was made in determining the award, he or she may ask the arbitrator to reconsider. Typically, however, when asked to reconsider an award, arbitrators will reaffirm the award without explanation.

F. Enforcement of the Award

Most parties comply with the arbitration award voluntarily in accordance with its terms. This compliance is expected in light of the parties' desire to avoid costly and time-consuming litigation as evidenced by the choice of arbitration initially. However, sometimes when the hard reality of having to pay hits, it may take the authority of the state to facilitate collection.

If payment is not made voluntarily, proceedings are then brought to the appropriate court to confirm the award and perhaps also to enter a judgment on the award. Such a proceeding would usually be brought in the form of an application to the court to confirm the award. Reference should be made to the applicable arbitration statute or court rules.

G. Judicial Review

The scope of judicial review of arbitration proceedings or awards is generally limited to (1) the selection of the arbitrators, (2) the conduct of an orderly hearing and the opportunity of all parties to present their proof, and (3) whether the award was within the scope of the arbitrators' authority (as established by the arbitration agreement). It has long been established that:

"[i]f the award is within the submission, and contains the honest decision of the arbitrators, after a full and fair hearing of the parties, a court of equity will not set it aside for error, either in law or fact."

Consequently, in practice, unless a statutory ground for vacating or modifying the award exists, the award will be confirmed. Uniformly, under the FAA and the state arbitration statutes, there are essentially four statutory grounds for vacating an arbitration award:

- (1) where the award was procured by corruption, fraud, or undue means;
- (2) where there was evident partiality or corruption by the arbitrator;
- (3) where the arbitrator was guilty of misconduct, including any misbehavior by which the rights of any party have been prejudiced; or
- (4) where the arbitrator exceeded his or her powers granted under the arbitration contract.

Most state courts have held that the above-statutory grounds for judicial review are exclusive, whether as part of the Federal Arbitration Act or the Uniform Arbitration Act (which more than half of the states have adopted). Limited judicial review became even more limited in a recent decision of the California Supreme Court in which the Court held that an award reached by an arbitrator pursuant to a contractual agreement to arbitrate is not subject to judicial review except for those specific statutory grounds

as provided in the applicable arbitration act and that further, the existence of an error of law by an arbitrator, even though apparent on the face of the award and even though it causes a substantial injustice does not provide grounds for judicial review.

V. Arguments and Issues Concerning Arbitration

A. Excessive Jury Awards

Arbitration is one method often suggested as an antidote to the damage awards (both compensatory and punitive) given to debtors for various claims, including lender liability claims. Jurors with no knowledge or expertise in the commercial area, or more specifically the financial industry, are much more likely to be influenced by plaintiffs' emotional appeals of bad faith or other alleged wrongdoing, wanting to "correct the harm" by punitive measures against the wrong-doer. By resolving disputes in arbitration rather than before a jury, it is possible that any punitive damage award would be significantly lower than the judicial alternative. To date, there have been relatively few known large punitive damage awards by arbitrators.

B. "Threatened" Liability Claims

As most lenders have experienced in the workout context, borrowers, with increasing frequency, have threatened to bring suit for damages based on various lender liability claims. Whether or not the threat is real or there is likelihood that the claimant would be awarded damages at trial, these "threats" are utilized by even unsophisticated debtors as a means of avoiding liability for legitimate loan obligations. Often this results in workout agreements much more favorable to the borrower than is otherwise warranted because the lender would rather suffer smaller losses at the workout phase than incur significant legal costs and risk punitive damages if sued.

Arbitration proponents suggest that binding arbitration clauses deter this negotiation strategy because borrowers will see their threats as less meaningful when played before an unsympathetic and professional arbitration panel. Plaintiff lawyers may also be less inclined to take a case involving lender liability claims if it is to be heard before an arbitration panel. Consequently, the use of arbitration clauses may serve to decrease the occurrence of unmeritorious claims. Although no new empirical studies have been published since the Rand Study, financial institutions have continued to experience less litigation since using arbitration clauses.

C. Time and Expense

The process of arbitration is usually less time-consuming and expensive than traditional litigation. Disputing parties privately can schedule arbitration proceedings to commence soon after disputes arise. Conversely, complex pretrial discovery procedures and congested court dockets make prompt judicial dispute resolution virtually impossible.

Costs of litigation are usually much higher than that of arbitration when discovery and motion practice are so integral to the litigation process.

D. Arbitrators' Special Knowledge and Expertise

If selected on the basis of special knowledge of and experience pertaining to the relevant law and commercial practices, arbitrators are better-suited than most judges and virtually all juries handle complex commercial disputes. Such an arbitrator should be able to analyze complex cases and issues without as much explanation or guidance required by judges unfamiliar with the area or inexperienced jurors. Carefully selected arbitrators would be able to develop a more accurate understanding of the commercial dispute and its complex issues and their special knowledge and expertise would further serve to speed the process along and reduce the risk of unpredictable results so often faced in litigation.

The key to having capable and desirable arbitrators is the specification of the expert, necessary qualifications and/or the selection process in the arbitration clause. Ideally, the arbitration panel should consist of experts knowledgeable in the practices and technical issues of the banking industry.

E. Adversarial Nature, Privacy

Because litigation tends to be more adversarial in nature than arbitration, parties with valued, long-standing relationships might prefer arbitration (or mediation) to litigation so as not to destroy those relationships. As discussed earlier, mediation and non-binding arbitration also are useful tools in situations in which parties are interested in "maintaining the relationship." Further, the fact that arbitration proceedings are not of public record decreases the possibility of a lender receiving unwanted publicity in connection with the dispute.

F. Limitation on Class Actions

The great weight of case law authority holds that arbitrations cannot be conducted on a class action basis unless the parties have agreed that a class action is an available remedy. These case decisions are primarily based upon Section 4 of the FAA which requires that the courts give effect to the parties' arbitration agreement and unless provided for in the arbitration agreement, the courts lack the power to consolidate arbitration proceedings unless the arbitration agreement authorizes consolidation. The court is only allowed to enforce the arbitration agreement as the parties write it and absent a provision providing for the class treatment of disputes, courts have no authority to certify class arbitration. In contrast to Dickler and Keating, at least one other state court, consistent with federal practice, held that arbitrations cannot proceed on a class action basis without the arbitration provision allowing for such class treatment. To order class arbitration without such a provision would re-write the contract between the parties.

G. The Arbitration Award

Arbitrators typically do not provide written opinions or even orally discuss their rationale in arriving at the stated award. Arbitrators may not always engage in thoughtful analysis of a dispute because they do not have to reveal to the disputing parties the reasoning for their decisions." Arbitrators are also notorious for making "compromise" awards in the interest of fairness, even when one party should clearly win on the merits based on established legal precedent. Further, there is the risk that arbitrators may treat emerging theories of law as established law when in fact such theories may be anything but settled.

H. Judicial Review and Nonappealability

There is no appeal from an arbitrator's decision if rendered pursuant to the FAA or the Uniform Arbitration Act as adopted by most states. As discussed above, there are only certain circumstances in which a court can even review the arbitration process or monetary award. This further increases the risk of compromise awards when one position clearly should prevail at law and the risk that arbitrators will not base their decision on established theories of law. As a result, arbitrator's errors which could have been reversed through an appeal to the appellate courts (if the case had been originally tried in the courts) will not get beyond the arbitration stage. This risk is especially serious in connection with the continuing ""emerging theories" in connection with lender liability.

I. Avoiding Arbitration Through Non Joinder of Necessary Parties

Unless all the necessary parties to a dispute are bound by the arbitration clause, a party may be able to avoid enforcement of the arbitration clause under state law. For example, California's Arbitration Act contains a number of grounds which would allow a court to refuse to enforce an arbitration agreement or to delay its commencement. Those grounds include:

- (1) the situation where a party to the arbitration agreement is also a party to litigation with a third party arising out of the same or related transactions and there is the possibility of conflicting rulings on a common issue of law or fact, or
- (2) where the court determines there are other issues between the parties which are not subject to arbitration and which are subject to a pending action, a determination of which may make arbitration unnecessary.

J. Provisional Remedies; Scope of Clause

If an all-inclusive arbitration clause is used (e.g , all claims or disputes arising under or in connection with the loan shall be subject to arbitration), the lender may be precluding the availability of pre-trial remedies traditionally available to lenders, such as claim and delivery and attachment. Consequently, when drafting an arbitration clause for loan documents, the lender must carefully and specifically state what disputes are subject to arbitration.

Parties may identify certain types of claims arising out of a particular transaction as being arbitrable and certain others as not. In order to preserve quick access to the court to obtain desirable pre-trial remedies, it may be advisable to split the proceedings by excluding from a general arbitration clause the determination of whether the loan is in default and the subsequent related proceedings including entry of judgment on the debt.

Historically, several jurisdictions prevented the bifurcation of proceedings arising out of a single transaction. This was known as the ""intertwining" doctrine which granted district courts the discretion to try all claims together in federal court when presented with both arbitrable and non-arbitrable claims arising out of the same transaction.

The U.S. Supreme Court held that under the FAA, a federal district court may not deny a motion to compel arbitration of state law claims under an arbitration agreement on the ground that the claims are intertwined with non-arbitrable federal claims. The Court concluded that the primary purpose of the FAA is to ensure the enforcement of arbitration agreements, not to promote judicial efficiency.

Responding to the concern that a state arbitrator's fact finding might have a collateral estoppel effect on non-arbitrable federal claims, the Court stated that "it is far from certain that arbitration proceedings will have any preclusive effect on the litigation of non-arbitrable federal claims."

K. Formalities

In all jurisdictions, the agreement to arbitrate must be written. In some circumstances the agreement need not be signed by the parties but in the lender-borrower situation it is advisable for a lender to obtain a borrower's signature to the agreement. To compel arbitration, a party needs to establish (1) the existence of an agreement to arbitrate, (2) that the claim is arbitrable, and (3) that the right to compel arbitration has not been waived.

L. Contracts of Adhesion

Contracts of adhesion will be upheld unless it can be shown that the agreement to arbitrate was unconscionable under the circumstances. In a Supreme Court case the McMahons were customers of the brokerage firm Shearson/American Express, Inc. Within the scope of that relationship, the McMahons signed certain "fine print" customer account cards providing for arbitration of disputes relating to their accounts. In response to the argument that the arbitration clauses in the account cards were void as contracts of adhesion, the Court upheld the agreement to arbitrate stating that ""absent a well-founded claim that an arbitration agreement resulted from the kind of fraud or excessive economic power that would provide grounds for the revocation of any contract," the clause should prevail. Nevertheless, if the terms of an arbitration clause appear onerous and one-sided, a court may conclude that enforcement of such an agreement is unfair. For example, the California Court of Appeals denied confirmation and enforcement of an arbitration award on the grounds of unconscionability, based on, among other things, that the lender required the California Borrower to pay substantial filing and hearing fees (\$850 on a \$2,000 claim) and arbitrate in a distance locale, *i.e.*, Minnesota.

M. Rescission; Fraud in the Inducement

An arbitration clause may be rescinded upon any grounds justifying the rescission of a contract. Quite frequently litigated is the claim that the arbitration clause was fraudulently induced and therefore should be rescinded.

An arbitration clause within a broader contract is generally considered to be a several part of the contract. If a court in an action to enforce the arbitration clause determines that the arbitration clause was fraudulently induced, it will not compel arbitration. If it is determined that the otherwise enforceable clause was not so induced, the court must compel arbitration, leaving all arbitrable issues to the arbitrator, including questions regarding the validity of the underlying contract.

N. Waiver

A party who fails to act in accordance with the arbitration agreement runs the risk of losing its right to compel arbitration thereunder. Such inconsistent actions may be construed as a waiver of the right to compel arbitration. The bringing of an action at law or the assertion of a counterclaim in an action is usually held to be such a waiver. Some courts, however, have not found a waiver when the other party is not prejudiced by the participation in litigation.

Waiver may also be found by the failure to object to the initiation of court proceedings by the other party, by otherwise participating in litigation, or by delay or failure to perform the necessary steps leading to arbitration.

O. Third Party Claims

Neither arbitration agreements nor arbitration decisions are binding on third parties. In most financial transactions, there are a number of related third parties such as junior secured creditors, guarantors or sureties, and affiliates of the debtor who may have been "harmed" by the lender's alleged wrong-doing or may be liable to the lender for the borrower's indebtedness. By proceeding with arbitration only with the borrower, the lender could conceivably be facing a myriad of claims by or against others in separate litigation. In cases not governed by the FAA, the lender may be able to stay the arbitration pending the joinder and resolution of all claims and parties in litigation, if the law of the applicable state so allows, but this would defeat the original purpose of the arbitration agreement. It may also destroy the ability of the lender to enforce arbitration against the debtor. At the very minimum, a lender should obtain an agreement to arbitrate from all guarantors and sureties involved in the transaction.

P. Punitive Damages

The majority rule is that an arbitrator does not have the authority to award punitive damages even if the arbitration clause specifically authorize such awards. The distinction between arbitration as a private forum and the public nature of traditional litigation and the virtual lack of judicial review of arbitrators' awards were significant factors in establishing the majority rule. Furthermore, some courts seem to look at the right to impose punitive remedies as beyond the scope of traditional contract law. The attitude seems to be that the right to punish is best reposed in the state rather than in a third party through contract.

There are several decisions, however, that have upheld punitive damage awards by arbitrators under the FAA and certain state arbitration statutes. The court in Willoughby upheld a broad arbitration clause which conferred authority to (1) consider the disputes between the parties, and (2) fashion appropriate remedies by which those disputes might be resolved. The court concluded that the goals of arbitration would be thwarted by limiting the remedies under a broadly framed arbitration clause, especially when punitive damages were "neither explicitly nor implicitly prohibited by the agreement."

Q. Multiple Damages and Attorneys' Fees

Even in those situations where punitive damages would not be allowed, it does appear that an arbitrator may award multiple damages. The United States Supreme Court held

that an arbitrator under a general arbitration clause, could arbitrate both Securities Act and civil RICO claims which the plaintiff brought against his broker. Civil RICO mandates that a prevailing party recovers treble damages plus its attorneys' fees.

An arbitrator, however, is not normally authorized to award attorneys' fees to a prevailing party unless those attorneys' fees are expressly provided for in the arbitration contract. This is supported by Section 10 of the Uniform Arbitration Act which essentially provides that unless there is an agreement to award attorneys' fees, they will normally not be included in an award by an arbitrator. In addition, the AAA Commercial Arbitration Rules themselves do not provide for the awarding of attorneys' fees. Generally, expenses of arbitration are to be borne equally by the parties, unless they agree otherwise.

VI. Conclusion Observations

Financial institutions particularly in California and other Western States of the U.S., have been increasing the use of ADR as a preferred remedy in their commercial loan transactions. As more East Coast banks accept ADR, its use will also accelerate in the West. Unless a major change occurs in the case law or at the legislative level (which changes are not anticipated), ADR will be found in many, if not, most U.S. loan documents in the future.

While the underpinnings of arbitration are statutory (both federal and state), it must be kept in mind at all times that this is a "contractual" procedure. Careful draftsmanship and clarity of language is paramount. Ambiguities will be resolved against the drafter. With the courts and international treaty generally supportive of arbitration, a loosely or carelessly drafted arbitration provision can result in a matter being arbitrated without any guidelines, procedures or limitations provided to the arbitrator. Without carefully thought-out procedures and terms, the parties can be left with a procedure without case law precedent, rules of evidence or rights of appeal to protect against mistakes or excesses of an arbitrator. It will be the responsibility of counsel to understand the ADR process and to properly protect the client with well-drafted, comprehensive ADR provisions.

More broadly speaking, this increasing U.S. experience with commercial ADR for financial disputes should prove Atranslatable to the NAFTA Context and to other cross-border financial institution dispute situations..

Appendix A

CHECKLIST FOR ARBITRATION

Arbitration clauses are based in contract. They must be in writing and, subject to a small number of statutory and judicial limitations, can be as general or specific as the parties desire. When preparing an arbitration clause, counsel should not rely on boilerplate forms but should carefully consider all aspects of the transaction and how best to fit the arbitration clause to the particular matter. The following is a checklist of issues to consider when preparing an arbitration clause.

Types of Arbitration:

! Mediation

! Mediation/Arbitration (Attempt mediation)

and if not successful proceed to arbitration)

! Nonbinding Arbitration

! Binding Arbitration

Identity of Administering Agency

What set of Administrative Rules

Governing law

(e.g., Federal Arbitration Act, particular state arbitration act, what state law applies, is there a governing law in the loan documents)

Statute of limitations

(e.g., "Any applicable statute of limitation shall be applied.")

Arbitrator to follow the law

(e.g., some Administrative Rules do not require the arbitrator to follow the law of a particular jurisdiction. By requiring the arbitrator to follow the law of a particular jurisdiction, parties should be better able to control predictability but such a clause often can increase to the courts for appeal.

Arbitrator all or only certain disputes

(if a broad form of arbitration clause is desired, the clause should specifically state that the arbitrator can review all matters and disputes directly or indirectly related to the transaction, including actions sounding in both tort and contract.)

Punitive damages

Rules of evidence

Provisional remedies (e.g., attachment, replevin)

Fees (if different from the Rules)

Location of hearing

Judicial reference

Selection of arbitrator

(one or a panel of three, how selected, panel or individual depending on size of matter)

Qualifications of arbitrator

Preliminary Hearing

Discovery

Depositions

Interrogatories

Witness Lists

Briefs

Time limits

Stenographic record

Times to respond

Representation by counsel

Written decision of arbitrator

Time limits on arbitrator

Power to issue sanctions

Power to issue subpoenas

Payment of attorneys' fees, costs and expenses in the award

Limitations on damages

Failsafe for large verdict

(Some financial institutions have drafted arbitration clauses that allow the losing party access to a trial de novo if the award exceeds a certain amount (e.g., \$5,000,000).)

Statement that arbitration decision is binding and final

Statement that courts may issue orders enforcing arbitrator's decision

Appeal rights

Appen

Sample Commercial Mediation Clause

(a) **Agreement to Use Procedure.** The parties have entered into this Agreement in good faith and in the belief that it is mutually advantageous to them. It is with that same spirit of cooperation that they pledge to attempt to resolve any dispute amicably

with the necessity of litigation. Accordingly, they agree if any dispute arises between them relating to this Agreement (the "Dispute"), they will first utilize the procedures specified in this Section (the "Procedure") prior the commencement of any legal action.

(b) Initiation of Procedure. The party seeking to initiate the Procedure (the "Initiating Party") shall give written notice to the other party, describing in general terms the nature of the Dispute, the Initiating Party's claim for relief and identifying one or more individuals with authority to settle the Dispute on such party's behalf. The party receiving such notice (the "Responding Party") shall have five (5) business days within which to designate by written notice to the initiating Party, one or more individuals with authority to settle the Dispute on such party's behalf. (The individuals so designated shall be known as the "Authorized Individuals.")

(c) Direct Negotiations. The Authorized Individuals shall be entitled to make such investigations of the Dispute as they deem appropriate, but agree to promptly, and in no event later than thirty (30) days from the date of the Initiating Party's written notice, meet to discuss resolution of the Dispute. The Authorized Individuals shall meet at such times and places and with such frequency as they may agree. If the Dispute has not been resolved within thirty (30) days from the date of their initial meeting, the parties shall cease direct negotiations and shall submit the Dispute to mediation in accordance with the following procedure.

(d) Selection of Mediator. The Authorized individuals shall have five (5) business days from the date they cease direct negotiations to submit to each other a written list of acceptable qualified attorney-mediators not affiliated with any of the parties. Within five (5) days from the date of receipt of such list, the Authorized individuals shall rank the mediators in numerical order of preference and exchange such rankings. If one or more names are on both lists, the highest ranking person shall be designated as the mediator. If no mediator has been selected under this procedure, the parties agree jointly to request a State or Federal District Judge of their choosing to supply within ten (10) business days a list of potential qualified attorney-mediators. Within five (5) business days of receipt of the list, the parties shall again rank the proposed mediators in numerical order of preference and shall simultaneously exchange such list and shall select as the mediator the individual receiving the highest combined ranking. If such mediator is not available to serve, they shall proceed to contact the mediator who was next highest in ranking until they are able to select a mediator.

(e) Time and Place for Mediation. In consultation with the mediator selected, the parties shall promptly designate a mutually convenient time and place for the mediation, and unless circumstances require otherwise, such time to be not later than (45) days after selection of the mediator.

(f) Exchange of Information. In the event any party to this Agreement has substantial need for information in the possession of another party to this Agreement in order to prepare for the mediation, all parties shall attempt in good faith to agree to procedures for the expeditious exchange of such information, with the help of the mediator if required.

(g) Summary of Views. At least seven (7) days prior to the first scheduled session of the mediation, each party shall deliver to the mediator and to the other party a concise written summary of its views on the matter in Dispute, and such other matters

required by the mediator. The mediator may also request that a confidential issue paper be submitted by each party to him.

(h) Parties to be Represented. In the mediation, each party shall be represented by an Authorized individual and may be represented by counsel. In addition, each party may, with permission of the mediator, bring such additional persons as needed to respond to questions, contribute information and participate in the negotiations.

(i) Conduct of Mediation. The mediator shall determine the format for the meetings, designed to assure that both the mediator and the Authorized individuals have an opportunity to hear an oral presentation of each party's view on the matter in dispute, and that the authorized parties attempt to negotiate a resolution of the matter in dispute, with or without the assistance of counsel or others, but with the assistance of the mediator. To this end, the mediator is authorized to conduct both joint meetings and separate private caucuses with the parties. The mediation session shall be private. The mediator will keep confidential all information learned in private caucus with any party unless specifically authorized by such party to make disclosure of the information to the other party. The parties commit to participate in the proceedings in good faith with the intention of resolving the Dispute if at all possible.

(j) Termination of Procedure. The parties agree to participate in the mediation procedure to its conclusion. The mediation shall be terminated (1) by the execution of a settlement agreement by the parties, (2) by a declaration of the mediator that the mediation is terminated, or (3) by a written declaration of a party to the effect that the mediation process is terminated at the conclusion of one full day's mediation session. Even if the mediation is terminated without a resolution of the Dispute, the parties agree not to terminate negotiations and not to commence any legal action or seek other remedies prior to the expiration of the five-day period if litigation could be barred by an applicable statute of limitations or in order to request an injunction to prevent irreparable harm.

(k) Free of Mediator; Disqualification. The fees and expenses of the mediator shall be shared equally by the parties. The mediator shall be disqualified as a witness, consultant, expert or counsel for any party with respect to the Dispute and any related matters.

(l) Confidentiality. Mediation is a compromise negotiation for purposes of the Federal and State Rules of Evidence and constitutes privileged communication under _____ law. The entire mediation process is confidential, and no stenographic, visual or audio record shall be made. All conduct, statements, promises, offers, views and opinions, whether oral or written, made in the course of the mediation by any party, their agents, employees, representatives or other invitees and by the mediator are confidential and shall, in addition and where appropriate, be deemed to be privileged. Such conduct, statements, promises, offers, views and opinions shall not be discoverable or admissible for any purposes, including impeachment, in any litigation or other proceeding involving the parties, and shall not be disclosed to anyone not an agent, employee, expert, witness, or representative of any of the parties; provided, however, that evidence otherwise discoverable or admissible is not excluded from discovery or admission as a result of its use in the mediation.

Appen

WELLS FARGO BANK, N.A.
ARBITRATION LANGUAGE:

The following is the standard arbitration language used by Wells Fargo Bank, N.A. in its commercial loan documentation in California. If the Loan Documents are not governed by California law, revisions will need to be considered in subsections (4), (5) and (6).

Section ____ . ARBITRATION.

1. **Arbitration.** Upon the demand of any party, any Dispute shall be resolved by binding arbitration (except as set forth in (e) below) in accordance with the terms of this Agreement. A "Dispute" shall mean any action, dispute, claim or controversy of any kind, whether in contract or tort, statutory or common law, legal or equitable, now existing or hereafter arising under or in connection with, or in any way pertaining to, any of the Loan Documents, or any past, present or future extensions of credit and other activities, transactions or obligations of any kind related directly or indirectly to any of the Loan Documents, including without limitation, any of the foregoing arising in connection with the exercise of any self-help, ancillary or other remedies pursuant to any of the Loan Documents. Any party may by summary proceedings bring an action in court to compel arbitration of a Dispute. Any party who fails or refuses to submit to arbitration following a lawful demand by any other party shall bear all costs and expenses incurred by such other party in compelling arbitration of any Dispute.
2. **Governing Rules.** Arbitration proceedings shall be administered by the American Arbitration Association ("AAA") or such other administrator as the parties shall mutually agree upon in accordance with the AAA Commercial Arbitration Rules. All Disputes submitted to arbitration shall be resolved in accordance with the Federal Arbitration Act (Title 9 of the United States Code), notwithstanding any conflicting choice of law provision in any of the Loan Documents. The arbitration shall be conducted at a location in California selected by the AAA or other administrator. If there is any inconsistency between the terms hereof and any such rules, the terms and procedures set forth herein shall control. All statutes of limitation applicable to any Dispute shall apply to any arbitration proceeding. All discovery activities shall be expressly limited to matters directly relevant to the Dispute being arbitrated. Judgment upon any award rendered in an arbitration may be entered in any court having jurisdiction; provided however, that nothing contained herein shall be deemed to be a waiver by any party that is a bank of the protections afforded to it under 12 U.S.C. '91 or any similar applicable state law.
3. **No Waiver; Provisional Remedies, Self-Help and Foreclosure.** No provision hereof shall limit the right of any party to exercise self-help remedies such as setoff, foreclosure against or sale of any real or personal property collateral or security, or to obtain provisional or ancillary remedies, including without limitation, injunctive relief, sequestration, attachment, garnishment or the appointment of a receiver, from a court of competent jurisdiction before, after or during the pendency of any arbitration or other proceeding. The exercise of any such remedy shall not waive the right of any party to compel arbitration or reference hereunder.
4. **Arbitrator Qualifications and Powers; Awards.** Arbitrators must be active members of the California State Bar or retired judges of the state or federal judiciary of California, with expertise in the substantive laws applicable to the subject matter of the Dispute. Arbitrators are empowered to resolve Disputes by summary rulings in response to

motions filed prior to the final arbitration hearing. Arbitrators (i) shall resolve all Disputes in accordance with the substantive law of the state of California, (ii) may grant any remedy or relief that a court of the state of California could order or grant within the scope hereof and such ancillary relief as is necessary to make effective any award, and (iii) shall have the power to award recovery of all costs and fees, to impose sanctions and to take such other actions as they deem necessary to the same extent a judge could pursuant to the Federal Rules of Civil Procedure, the California Rules of Civil Procedure or other applicable law. Any Dispute in which the amount in controversy is \$5,000,000 or less shall be decided by a single arbitrator who shall not render an award of greater than \$5,000,000 (including damages, costs, fees and expenses). By submission to a single arbitrator, each party expressly waives any right or claim to recover more than \$5,000,000. Any Dispute in which the amount in controversy exceeds \$5,000,000 shall be decided by majority vote of a panel of three arbitrators; provided however, that all three arbitrators must actively participate in all hearings and deliberations.

5. Judicial Review. Notwithstanding anything herein to the contrary, in any arbitration in which the amount in controversy exceeds \$25,000,000, the arbitrators shall be required to make specific, written findings of fact and conclusions of law. In such arbitrations (i) the arbitrators shall not have the power to make any award which is not supported by substantial evidence or which is based on legal error, (ii) an award shall not be binding upon the parties unless the findings of fact are supported by substantial evidence and the conclusions of law are not erroneous under the substantive law of the state of California, and (iii) the parties shall have in addition to the grounds referred to in the Federal Arbitration Act for vacating, modifying or correcting an award the right to judicial review of (A) whether the findings of fact rendered by the arbitrators are supported by substantial evidence, and (B) whether the conclusions of law are erroneous under the substantive law of the state of California. Judgment confirming an award in such a proceeding may be entered only if a court determines the award is supported by substantial evidence and not based on legal error under the substantive law of the state of California.
6. Real Property Collateral; Judicial Reference. Notwithstanding anything herein to the contrary, no Dispute shall be submitted to arbitration if the Dispute concerns indebtedness secured directly or indirectly, in whole or in part, by any real property unless (i) the holder of the mortgage, lien or security interest specifically elects in writing to proceed with the arbitration, or (ii) all parties to the arbitration waive any rights or benefits that might accrue to them by virtue of the single action rule statute of California, thereby agreeing that all indebtedness and obligations of the parties, and all mortgages, liens and security interests securing such indebtedness and obligations, shall remain fully valid and enforceable. If any such Dispute is not submitted to arbitration, the Dispute shall be referred to a referee in accordance with California Code of Civil Procedure Section 638 et seq., and this general reference agreement is intended to be specifically enforceable in accordance with said Section 638. A referee with the qualifications required herein for arbitrators shall be selected pursuant to the AAA's selection procedures. Judgment upon the decision rendered by a referee shall be entered in the court in which such proceeding was commenced in accordance with California Code of Civil Procedure Sections 644 and 645.

Apper

BANK OF AMERICA NT & SA
ARBITRATION LANGUAGE

The following is standard ADR language used by Bank of America in commercial loan agreements. Note that if California law does not govern the transaction, this language will have to be modified.

Section ____ ARBITRATION.

(a) This paragraph concerns the resolution of any controversies or claims between any one or more of Borrowers and the Bank, including but not limited to those that arise from:

(i) This Agreement (including any renewals, extensions or modifications of this Agreement);

(ii) Any document, agreement or procedure related to or delivered in connection with this Agreement;

(iii) Any violation of this Agreement; or

(iv) Any claims for damages resulting from any business conducted between any one or more of Borrowers and the Bank, including claims for injury to persons, property or business interests, including without limitation any claim that any action by the Bank or its representatives is tortious.

(b) At the request of any Borrower or the Bank, any such controversies or claims will be settled by arbitration in accordance with the United States Arbitration Act. The United States Arbitration Act will apply even though this Agreement provides that it is governed by California law.

(c) Arbitration proceedings will be administered by the American Arbitration Association and will be subject to its commercial rules of arbitration. The arbitration will be conducted within Los Angeles County, California.

(d) For purposes of the application of the statute of limitations, the filing of an arbitration pursuant to this paragraph is the equivalent of the filing of a lawsuit, and any claim or controversy which may be arbitrated under this paragraph is subject to any applicable statute of limitations. The arbitrators will have the authority to decide whether any such claim or controversy is barred by the statute of limitations and, if so, to dismiss the arbitration on that basis.

(e) If there is a dispute as to whether an issue is arbitrable, the arbitrators will have the authority to resolve any such dispute.

(f) The decision that results from an arbitration proceeding may be submitted to any authorized court of law to be confirmed and enforced.

(g) The procedure described above will not apply if the controversy or claim, at the time of the proposed submission to arbitration, arises from or relates to an obligation to the Bank secured by real property located in California. In this case, both the Borrowers and the Bank must consent to submission of the claim or controversy to arbitration. If all parties do not consent to arbitration, the controversy or claim will be settled as follows:

(i) The Borrowers and the Bank will designate a referee (or a panel of referees) selected under the auspices of the American Arbitration Association in the same manner as arbitrators are selected in Association-sponsored proceedings;

(ii) The designated referee (or the panel of referees) will be appointed by a court as provided in California Code of Civil Procedure Section 638 and the following related sections;

(iii) The referee (or the presiding referee of the panel) will be an active attorney or a retired judge; and

(iv) The award that results from the decision of the referee (or the panel) will be entered as a judgment in the court that appointed the referee, in accordance with the provisions of California Code of Civil Procedure Sections 644 and 645.

(h) This provision does not limit the right of the Borrowers or the Bank to (i) exercise self-help remedies such as setoff, (ii) foreclose against or sell any real or personal property collateral, or (iii) act in a court of law, before, during or after the arbitration proceeding to obtain (A) an interim remedy, and/or (B) additional or supplementary remedies.

(i) The pursuit of or a successful action for interim, additional or supplementary remedies, or the filing of a court action, does not constitute a waiver of the right of the Borrowers or the Bank, including the suing party, to submit the controversy or claim to arbitration if the other party contests the lawsuit. However, if the controversy or claim arises from or relates to an obligation to the Bank which is secured by real property located in California at the time of the proposed submission to arbitration, this right is limited according to the provision above requiring the consent of both the Borrowers and the Bank to seek resolution through arbitration.

(j) If the Bank forecloses against any real property securing this Agreement, the Bank has the option to exercise the power of sale under the deed of trust or mortgage, or to proceed by judicial foreclosure.

Appen

UNION BANK OF CALIFORNIA, N.A.
ARBITRATION LANGUAGE

The following is the standard ADR language used by Union Bank of California, N.A. for commercial loan transactions. The Bank often handles this by a separate agreement rather than incorporating the language into the specific loan documents.

RESOLUTION

**ALTERNATIVE DISPUTE
AGREEMENT**

THIS ALTERNATIVE DISPUTE RESOLUTION AGREEMENT ("Agreement") is made and entered into as of the _____ day of _____, 19 __, by and between the

undersigned ("Obligor") and Union Bank of California, N.A. ("Bank") (Obligor and Bank herein collectively, the "Parties" and individually, a "Party"). Initially capitalized terms used in this Agreement which are not otherwise defined herein shall have the respective meanings set forth in Paragraph 7 of this Agreement.

4. CLAIMS SUBJECT TO ARBITRATION OR JUDICIAL REFERENCE.

(1) Any Claim other than a Claim that arises out of or relates to any obligation under any Subject Document that is secured, in whole or in part, by an interest in real property shall, at the written request of any Party, be determined by Arbitration.

(2) Any Claim that arises out of or relates to any obligation under any Subject Document that is secured, in whole or in part, by an interest in real property shall be determined by Arbitration only with the consent of both Parties. If both Parties do not consent to the determination of any such Claim by Arbitration, then such Claim shall, at the written request of any Party, be determined by Reference.

(3) The determination as to whether or not a Claim arises out of or relates to any obligation under any Subject Document that is secured, in whole or in part, by an interest in real property shall be made at the time the arbitrator or referee is selected pursuant to Paragraph 2 of this Agreement.

5. SELECTION OF ARBITRATOR OR REFEREE. Within 30 days after written demand, or within 30 days after commencement by any Party, of any lawsuit subject to this Agreement, the Parties shall select a single neutral arbitrator pursuant to the Commercial Arbitration Rules of the AAA or a single neutral referee pursuant to the Judicial Reference Procedures of the AAA. However, the arbitrator or referee selected must be a retired state or federal court judge with at least five years of judicial experience in civil matters. In the event that the selection pursuant to such Commercial Arbitration Rules or Judicial Reference Procedures does not result in the appointment of a single neutral arbitrator or a single neutral referee within 30 days, any such Party may petition the court to appoint a single neutral arbitrator or single neutral referee with the judicial experience described above. The Parties shall equally bear the fees and expenses of the arbitrator or referee unless the arbitrator or referee otherwise provides in the award or statement of decision.

6. CONDUCT OF ARBITRATION OR REFERENCE.

(1) Except as provided in this Agreement, the arbitrator shall have the powers provided under Applicable State Law and the Commercial Arbitration Rules of the AAA, and the referee shall have the powers provided under Applicable State Law and the Judicial Reference Procedures of the AAA.

(2) The arbitrator or referee shall determine all challenges to the legality or enforceability of this Agreement.

(3) The arbitrator or referee shall apply the rules of evidence to the same extent as they would be applied in a court of law.

(4) A Party may not conduct discovery unless the arbitrator or referee grants such Party leave to do so upon a showing of good cause. All

discovery shall be completed within 90 days after the appointment of the arbitrator or referee, except upon a showing of good cause by any Party. The arbitrator or referee shall limit discovery to non-privileged material that is relevant to the issues to be determined by the arbitrator or referee.

(5) The arbitrator or referee shall determine the time of the hearing and shall designate its location based upon the convenience of the arbitrator or referee, the Parties and any witnesses. However, such hearing shall be commenced within 30 days after completion of discovery, unless the arbitrator or referee grants a continuance upon a showing of good cause by any Party. At least 7 days before the date set for such hearing, the Parties shall exchange copies of exhibits to be offered as evidence, and lists of the witnesses who will testify, at such hearing. Once commenced, the hearing shall proceed day to day until completed, unless the arbitrator or referee grants a continuance upon a showing of good cause by any Party. Any Party may cause to be prepared, at its expense, a written transcription or electronic recordation of such hearing.

(6) Subject to the provisions of this Agreement, the arbitrator may award, or the referee may report, a statement of decision providing for any remedy or relief, including without limitation judicial foreclosure, deficiency judgment and equitable relief, and give effect to all legal and equitable defenses, including without limitation statutes of limitation, the statute of frauds, waiver and estoppel.

(7) The award of the arbitrator or the statement of decision of the referee shall be supported by written findings of fact and conclusions of law delivered by the arbitrator or referee to the Parties concurrently with such award or statement of decision.

(8) In the event that punitive damages are permitted under Applicable State Law, the award of the arbitrator or the statement of decision of the referee may provide for recovery of punitive damages provided that the arbitrator or referee first makes written findings of fact that would satisfy the requirements for recovery of punitive damages under Applicable State Law. Any such punitive damages shall not exceed a sum equal to three times the amount of actual damages as determined by the arbitrator or referee.

(9) The arbitrator shall have the power to award or the referee shall have the power to report a statement of decision providing for reasonable attorneys' fees (including a reasonable allocation for the costs of in-house counsel) and costs to the prevailing party.

(10) In the event that Applicable State Law provides that publications or communications made in a judicial proceeding are subject to a litigation privilege, such litigation privilege shall apply to the same extent to publications or communications made in the Arbitration or Reference.

7. **PROVISIONAL REMEDIES, SELF-HELP AND FORECLOSURE.** No provision of this Agreement shall limit the right of any Party (a) to exercise self-help remedies including, without limitation, set-off, (b) to foreclose against or sell any collateral, by power of sale or otherwise or (c) to obtain or oppose provisional or ancillary remedies from a court of competent jurisdiction before, after or during the pendency of the Arbitration or Reference.

The exercise of, or opposition to, any such remedy does not waive the right of any Party to Arbitration or Reference pursuant to this Agreement.

8. **FINAL, BINDING AND NONAPPEALABLE JUDGMENT.** Any court of competent jurisdiction shall, upon the petition of any Party, confirm the award of the arbitrator and enter judgment in conformity therewith. Any court of competent jurisdiction shall, upon the filing of the statement of decision of the referee, enter judgment thereon. Any such judgment shall be final, binding and nonappealable.

9. **MISCELLANEOUS.** In the event that multiple claims are asserted, some of which are found not subject to this Agreement, the Parties agree to stay the proceedings of the claims not subject to this Agreement until all other claims are resolved in accordance with this Agreement. In the event that claims are asserted against multiple parties, some of whom are not subject to this Agreement, the Parties agree to sever the claims subject to this Agreement and resolve them in accordance with this Agreement. In the event that any provision of this Agreement is found to be illegal or unenforceable, the remainder of this Agreement shall remain in full force and effect. In the event of any challenge to the legality or enforceability of this Agreement, the prevailing Party shall be entitled to recover the costs and expenses, including reasonable attorneys' fees, incurred by it in connection therewith. Applicable State Law shall govern the interpretation of this Agreement. This Agreement fully states all of the terms and conditions of the Parties' agreement regarding the matters mentioned in, or incidental to, this Agreement. This Agreement supersedes all oral negotiations and prior writings concerning the subject matter hereof.

10. **DEFINED TERMS.** As used in this Agreement, the following terms shall have the respective meanings set forth below:

(1) **"AAA"** shall mean the American Arbitration Association.

(2) **"Applicable State Law"** shall mean the law of the state in which this Agreement is executed by Obligor; provided, however, that if any Party seeks (i) to exercise self-help remedies, including without limitation set-off, (ii) to foreclose against or sell any collateral, by power of sale or otherwise or (iii) to obtain or oppose provisional or ancillary remedies from a court of competent jurisdiction before, after or during the pendency of the Arbitration or Reference, the law of the state where such collateral is located shall govern the exercise of or opposition to such rights and remedies.

(3) **"Arbitration"** shall mean an arbitration conducted pursuant to this Agreement in accordance with Applicable State Law, and under the Commercial Arbitration Rules of the AAA, as in effect at the time the arbitrator is selected pursuant to Paragraph 2 of this Agreement.

(4) **"Claim"** shall mean any claim, cause of action, action, dispute or controversy between or among the Parties, including any claim, cause of action, action, dispute or controversy alleged in or subject to a lawsuit between or among the Parties, which arises out of or relates to:

(i) any of the Subject Documents,

- (ii) any negotiations, correspondence or communications relating to any of the Subject Documents, whether or not incorporated into the Subject Documents or any indebtedness evidenced thereby,
- (iii) the administration or management of the Subject Documents or any indebtedness evidenced thereby, or
- (iv) any alleged agreements, promises, representations or transactions in connection therewith, including but not limited to any claim, cause of action, action, dispute or controversy which arises out of or is based upon an alleged tort or other breach of legal duty.

(5) "Reference" shall mean a judicial reference conducted pursuant to this Agreement in accordance with Applicable State Law and under the Judicial Reference Procedures of the AAA, as in effect at the time the referee is selected pursuant to paragraph 2 of this Agreement.

(6) "Subject Documents" shall mean any and all documents, instruments and agreements previously, concurrently or hereafter executed by Obligor in favor of Bank, or between Obligor and Bank, which incorporate by reference an alternative dispute resolution agreement or another agreement providing for the resolution of Claims between or among the Parties by arbitration or judicial reference, any and all related documents, instruments and agreements, and any and all extensions, renewals, amendments, substitutions and replacements of any of the foregoing; and "Subject Document" shall mean any one of such Subject Documents.

11. WAIVER OF RIGHT TO TRIAL BY JURY. In connection with an Arbitration or Reference, or any other action or proceeding, the Parties hereby expressly, intentionally and deliberately waive any right they may otherwise have to trial by jury of any Claim.

This Agreement is duly executed by the Parties as of the date first written above.

("Bank") Union Bank of California, N.A. By: _____
 Title: _____ Printed Name: _____

("Obligor") _____ By: _____
 Title: _____ Printed Name: _____

By: _____ Title: _____
 Printed Name: _____

**The ICC Arbitration System and the Resolution of International
Financial Transaction Disputes**

Horacio Grigera Naón
Paris

Conference
Non-Judicial Dispute Settlement in International Financial Transactions

Law Centre for European and International Cooperation (R.I.Z.)

Cologne, March 22-23, 1999

Dr Horacio A. Grigera Naón

Secretary General
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Dr. Grigera Naón , presently Secretary General of the International Court of Arbitration of the International Chamber of Commerce, has been a practitioner in the field of international business law and international commercial arbitration for approximately twenty-five years and has widely published on those topics.

Dr Grigera Naón, an elected member of the American Law Institute, who prior to his present position was a Senior Counsel with the International Finance Corporation at Washington, D.C., holds LL.B. and LL.D. degrees from the University of Buenos Aires and LL.M. and S.J.D. degrees from Harvard Law School and is also a member of the Buenos Aires, New York and U.S. Supreme Court bars.

RESCHEDULING PUBLIC AND PRIVATE INT'L DEBT

ADR in Financial Disputes in the Americas - The OAS perspective

William M. Berenson
Washington, D.C.

Conference
Non-Judicial Dispute Settlement in International Financial Transactions

Law Centre for European and International Cooperation (R.I.Z.)

Cologne, March 22-23, 1999

William M. Berenson

Organization of American States
17th Street and Constitution Avenue
N.W. Washington, D.C. 20006

William M. Berenson is the current Director of the Department of Legal Services for the General Secretariat of the Organization of American States. He is also an adjunct professor at American University's Washington College of Law, where since 1984 he has taught a survey course in United States law for foreign lawyers in the LL.M. international legal studies program.

Mr. Berenson has worked in both the private and public sectors as a litigator and a legal advisor on a wide range of issues involving, inter alia, tax, labor, corporate, energy, antitrust, development banking, estate planning, contract, real estate, transportation, immigration, trade and public international law. He has also advised on privatization efforts in Latin America.

Mr. Berenson is the author of articles on privatization, telecommunications regulation, international banking, and other legal and political subjects. He has also lectured throughout Latin America and the United States on issues related to his practice and teaching, including: the privileges and immunities of public international organizations; the relationship between the United Nations and OAS in peacekeeping; privatization; estate taxation and planning, particularly for nonresident aliens; and constitutional law.

During 1972 and 1973, Mr. Berenson lived in Uruguay where he completed research on interest-group politics under a Ford Foundation Foreign Area Fellowship. Since then, Mr. Berenson has traveled on business throughout Latin America and has worked extensively on projects in Bolivia, Brazil, Costa Rica, Nicaragua, and Puerto Rico. In 1997, he was visiting professor in the Post Graduate Studies in Comparative Law Program of the Law School of the Universidad Central in Caracas, Venezuela, where he taught a survey course in United States law.

Mr. Berenson received his J.D. from Boston University (1978), where was Note and Case Editor of the Boston University Law Review. He received both M.A. and Ph.D. degree in political science from Vanderbilt University (1972 and 1975) and an A.B. from Dartmouth College (1969). He also completed studies in statistics at the University of Michigan in 1970 and was a Research Fellow at the Center for International Studies of the Massachusetts Institute of Technology („MIT“) during 1974. From 1990-92, he served as the Chairman of the International Development and Investment Committee of the Federal Bar Association. In 1982, Mr. Berenson was elected president of AYUDA, Inc., the non-profit bilingual legal services agency in the District of Columbia, where he served as a board member for many years. He is admitted to the practice of law in the District of Columbia, Virginia, and Massachusetts.

Mr. Berenson is originally from Marblehead, Massachusetts (north of Boston). Presently, he resides in Arlington, Virginia.

March 18, 1999

OUTLINE OF REMARKS

by

William M. Berenson

ABSTRACT

I. The OAS Institutional Mechanism for the Promotion of ASR for financial disputes in the Americas

A. State/State Conflicts

1. Charter
2. Bogota Pact

B. State/Individual /adequacy of IFI mechanisms)

1. Wide spread acceptance of ICSID
2. MIGA

C. Individual/ Individual

1. Pre-Panama Convention Mechanism
2. Panama Convention (Jurisdiction - personal, subject matter; choice of law - procedural, substantive; enforcement)
3. Convention for Enforcement of Foreign Judgments and Arbitral Awards
4. Inter - American Commercial Arbitration Commission

II. Current OAS Efforts to promote the use of ADR in financial disputes

A. Promotion of Cooperative Relations

B. Arbitration Training Projects

CONTROLS. Inter - American Juridical Committee, Rio Course

D. Support to FTAA Negotiation Group on Dispute Settlement

E. In-country developments

III. Debt Restructuring in Latin America

A. Absence of Significant OAS Action

1. Inter American Juridical Committee
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1. Mechanisms
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MECHANISMS FOR THE NON-JUDICIAL RESOLUTION OF FINANCIAL
DISPUTES IN THE AMERICAS, WITH A FOCUS ON THOSE
PROMOTED BY THE ORGANIZATION OF AMERICAN STATES

William M. Berenson¹

I. INTRODUCTION

The primary objective of this paper is to trace the impact of the Inter-American System, and in particular, the Organization of American States, on the promotion of non-judicial dispute mechanisms for the resolution of disputes in the Americas. Many of the mechanisms promoted by the Organization since its inception as the "Union of American Republics" in 1889 are applicable to the resolution of financial disputes, as well as to other disputes involving commerce and civil matters.

We begin by describing the underlying principles and structure of the Organization which have historically contributed to its role as a promotor of arbitration and other non-judicial dispute resolution mechanisms for more than one hundred years. We then turn to a discussion of the specific mechanisms either established or endorsed by the Organization of American States for the resolution of financial and other commercial controversies between states, between persons and states, and between private persons. Finally, we conclude with a discussion of the Organization's programs during the last decade to train arbitrators and mediators, to provide technical support to the Negotiating Group for Dispute Resolution of the Free Trade Agreement of the Americas ("FTAA"), and to encourage the more wide-spread adoption and institutionalization of alternative dispute resolution mechanisms in the Member States.

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II. THE ORGANIZATION OF AMERICAN STATES: A FRAMEWORK CONDUCTIVE TO THE PROMOTION OF ARBITRATION AND OTHER NON-JUDICIAL DISPUTE RESOLUTION MECHANISMS IN THE HEMISPHERE

A. An Overview of the Organization

The Organization of American States ("OAS") is a regional governmental treaty organization of thirty-five American States² within the United Nations.³ The principal purposes of the Organization, as established in its Charter, include: strengthening the peace and security of the American continent, the promotion of representative democracy,, the pacific settlement of disputes, the common defense, the solution of political, legal, and economic problems among the American States, the promotion of cooperative action for development, the eradication of extreme poverty, and the limitation armaments so as to facilitate the availability of resources to development activities.⁴ Like the United Nations, the Organization achieves its purposes through a number of organs: its General Assembly of all the Member States, which meets regularly once a year and is the supreme organ"⁵ of the Organization; its Permanent Council of permanent resident representatives of the Members in Washington, D.C.; the Inter-American Council for Integral Development ("CIDI"); the OAS General Secretariat ("GS/OAS"), and a number of more specialized organs established under the Charter, by other treaties, or by Resolution of the General Assembly.⁶ One of those organs, which has historically worked to promote arbitration in the Americas, is the Inter-American

² Actually, only thirty-four participate in its activities because the Government of Cuba was suspended by Resolution in 1962.

³ See OAS Charter, Article 1.

⁴ See OAS Charter, Art. 2.

⁵ See Art. 54.

⁶ See OAS Charter, Article 53.

Juridical Committee in Rio de Janeiro.⁷ Another is the Specialized Conference in Private International Law ("CIDIP").⁸

The present Charter of the Organization was drafted in 1948 at the Ninth International American Conference in Bogota. Since then, it has been amended four times.⁹

B. The Organization as an Historical Engine for the Promotion of Arbitration in the Hemisphere

At its birth at the First International American Conference in 1889, the Organization was baptized the "Union of American Republics," and its Secretariat was called the "Commercial Office of the American Republics." Later, at the Third Inter-American

⁷ See OAS Charter, Articles 99-105. The Inter-American Juridical Committee is the advisory organ of the Organization in juridical matters. Its purpose is to promote the development and codification of international law and to study issues relating to the integration of the developing countries of the hemisphere as well as the possibilities of attaining uniform legislation.

⁸ CIDIP is a "Specialized Conference" within the meaning of Articles 122-23 of the Charter. The Specialized Conferences "deal with special technical matters or to develop specific aspects of inter-American cooperation," and they meet when convoked by the General Assembly or the Meeting of Consultation of Ministers of Foreign Affairs. CIDIP is responsible for having developed both the most important conventions on commercial arbitration in the inter-American system -- the Inter-American Convention on International Commercial Arbitration ("the Panama Convention" of 1975) and the Inter-American Convention on Extraterritorial Validity of Foreign Judgments and Arbitral Awards ("the Montevideo Convention" of 1979).

⁹ See Protocol of Buenos Aires (1967); Protocol of Cartagena de Indias (1985); Protocol of Washington (1992); and Protocol of Managua (1993).

Conference in Buenos Aires in 1910, the Union of American Republics and its Secretariat were transformed into the "Pan American Union" under the Pan American Union Treaty. From 1889 until the adoption of the 1948 Charter, the American States celebrated nine International American Conferences in which the American States negotiated, elaborated, and endorsed a number of important inter-American treaties pertinent to both public and private international law. The Pan American Union, under its Treaty, served as the Permanent Secretariat of those Inter-American Conferences.¹⁰

Prior to the Amendment of the OAS Charter by the 1967 Protocol of Buenos Aires, the American International Conferences performed many of the same policy functions for the OAS and its institutional predecessors as the OAS General Assembly plays today. At that very First International American Conference in which American Republics created the Union of American Republics, they also adopted a treaty called the "Arbitration Project." That treaty called for the arbitration of all matters over diplomatic privileges, territorial limits, indemnities, navigation treaties, and other treaties. The Project, which was signed by Bolivia, Brazil, Ecuador, El Salvador, the United States, Guatemala, Haiti, Honduras and Nicaragua, made such arbitration obligatory except in those matters which would compromise the independence of the affected State Parties.

More important for the purposes of this paper, in the Second American Conference held in Mexico City in 1901, a number of the American Republics adopted a treaty for the "Arbitration of Pecuniary Claims Against States." The State parties included the United States, Uruguay, Argentina, Chile, Costa Rica, and most of the Central American Republics.¹¹ That treaty, which had a ten

¹⁰ See Conferencias Internacionales Americanas 1889-36, Recopilacion de Tratados y Otros Documentos, (Dotación para la Pax Internacional, Washington, D.C. 1938). This, and its two companion volumes contains the text of treaties adopted by the American Conferences, as well as the minutes, resolutions, and other useful primary source materials.

¹¹ Id.

year life, was reaffirmed and extended for an indefinite term at the Fourth International American Conference in 1910, the same Conference which created the Pan American Union.¹² It obligates the contracting parties to submit to binding arbitration any dispute for damages between their citizens and the State parties, provided that the dispute cannot first be resolved by diplomatic means and merits the cost of arbitration.¹³

"Pecuniary" arbitration continued to be a theme of recurring interest to the American Republics during the first three decades of this century. At the Fifth Conference in Santiago in 1923, the American Republics adopted a resolution recommending: (a) the creation of Chambers of Commerce that would sponsor "extrajudicial arbitration" for the resolution of commercial disputes; (b) the promotion of a system for the easy resolution of disputes between merchants and industrialists; and (c) the further study of the principles of binding arbitration by Pan American Union. Again, at the Sixth International American Conference in Havana in 1928, the Member States reiterated this Resolution.¹⁴ The Seventh International American Conference meeting in Montevideo in 1933, adopted a resolution creating "An Inter-American Commercial Agency" for the purposes of promoting the use of binding arbitration for the solution of commercial disputes. That resolution became the birth certificate of the Inter-American Commercial Arbitration Commission ("IACAC").¹⁵

¹² See Inter-American Treaties and Conventions, GS/OAS 1993, Treaty Series No. 9.

¹³ It provides that the governing law of the arbitration is "international law," and that in those cases in which the parties cannot agree to an ad hoc forum, the arbitration will be conducted the Permanent Arbitration Court at the Hague in accordance with the provisions of the Hague Convention.

¹⁴ Conferencias Internacionales Americanas, *supra*, at pp. 250 and 425.

¹⁵ The Resolution went on to suggest standards for agreements between Chambers of Commerce to promote commercial arbitration, based on a 1916 Agreement between the Buenos Aires

In the last third of this century, the OAS, through its Special Conference in Private International Law, endorsed the adoption of two important treaties which form the cornerstone of inter-American commercial arbitration for private persons under the auspices of the Inter-American system. They are the Inter-American Convention on Commercial Arbitration of 1975 and the Inter-American Convention on Territorial Effectiveness of Foreign Arbitration Awards of 1979.¹⁶

III. OAS MECHANISMS FOR THE PEACEFUL RESOLUTION OF DISPUTES

In a 1992 Resolution,¹⁷ the Inter-American Juridical Committee classified disputes of an international character into three categories: Those involving one sovereign state against another; those involving a person (legal or natural) against a sovereign state; and those involving a citizen or national of one sovereign state against a citizen or national of another.¹⁸ We now turn to discussion of the OAS' role in facilitating the non-judicial resolution of disputes in each of those categories.

Exchange and the United States Chamber of Commerce. *Id.*, at p. 523.

¹⁶ See Sistema Interamericano, a traves de tratados, convenciones y otros documentos, vol. 1, F.V. Garcia Armador, ed. (General Secretariat, Washington D.C. 1981), at pp. 454-58, 485-89.

¹⁷ CJI RES. 1-4/92, "Arbitration Between States and Between Private Economic Agents Among Themselves and with States Regarding International Legal Transactions, the Purpose of Which is Private in Nature."

¹⁸ See, e.g., Guillermo Fernandez de Soto, El Arbitraje Internacional y el Estado (Pamphlet published by Bogota Chamber of Commerce); Charles R. Norberg ("General Introduction to Inter-American Commercial Arbitration," unpublished paper (IACAC, Washington, D.C. 1997); Enrique Lagos, "Remarks," International Conference on Dispute Resolution in the Global Market Place, ABA Section of Dispute Resolution (April 4, 1998).

A.. State Against State

The principal mechanisms within the inter-American system for the resolution of disputes among the American States are the OAS Charter itself and the American Treaty on Pacific Settlement ("Bogota Pact").¹⁹ And although those mechanisms have not directly been used by the member states to resolve their financial disputes, they most likely had an indirect impact on establishing the predominant motif of cooperation, understanding, economic linkages, and partnership for development which has contributed to the resolution of those disputes in other fora. In that regard, the brief discussion which follows of the pertinent provisions of the OAS Charter encouraging the pacific settlement of disputes through negotiations, conciliation, and other means within the parameters of hemispheric cooperation is relevant.

As for cooperation, the Preface to the Charter states that the contributions of the American States to "progress and civilization of the world will increasingly require intensive continental cooperation." Among the "purposes" of the Organization stated in Article 2 of the Charter are "the pacific resolution of disputes" and the promotion "by cooperative action" of economic, social, and cultural development. Similarly, Article 3, which sets out the principles governing the Organization states reaffirms that controversies are to be settled by "peaceful procedures" and that "economic cooperation is essential to the common welfare and prosperity of the peoples of the continent."

Article 20, which sets out general principles governing relations among states, affirms that no state "may use or encourage the use of coercive measures of an economic or political character to force the sovereign will of another state or obtain from it advantage of any kind." (Emphasis added). In that same section of the Charter, Article 26 states that "no

¹⁹ See Basic Instruments of the Organization of American States, Treaty Series No. 61, at pp. 91-107.

dispute shall remain without definitive settlement without a reasonable period of time.

As regards the pursuit of integral development, the Charter exhorts each Member State not to take measures that will prejudice another and to work towards common resolution of development related problems and disputes. Article 35 states: "Member states should refrain from practicing policies and adopting actions or measures that have serious adverse effects on the development of other Member States." Similarly, Article 37 provides that Member States shall "join together in seeking a solution to urgent or critical problems that may arise whenever the economic development or stability of any Member State is seriously affected by conditions that cannot be remedied through the efforts of that State." Provisions such as these reinforce the spirit of understanding and mutual cooperation that must prevail in the Paris Club and other fora for the peaceful settlement of financial disputes among States if such settlement efforts are to succeed.

The Charter gives to the OAS Permanent Council an important role in efforts to resolve disputes among the member states by way of consensual non-binding conciliation, fact finding, and ad hoc mediation. Article 84 entrusts the Permanent Council with keeping "vigilance" over friendly inter-state relations and assisting the Member States with "the peaceful settlement of their disputes." Articles 85-90 set out a procedure by which a party not otherwise already engaged in a dispute resolution process under the Charter may ask the Permanent Council to use its "good offices to resolve the dispute". Upon receipt of such a request, the Permanent Council must "assist the parties and recommend procedures" for settling the dispute. With the consent of the parties, the Council may establish ad hoc Committees to investigate the facts and recommend solutions to the controversy.

In conducting its activities and reaching its conclusions in this process, the Council is bound to "observe the provisions of the Charter and the principles and standards of international law, as well as . . . the existence of treaties in force between the parties." Notwithstanding their availability, no American States to date have sought the good offices and other

conciliatory services of the Council under Articles 85-90 to resolve their financial differences.

The other principal multilateral agreement governing the peaceful resolution of disputes among the American Republics is the Bogota Pact, signed at the 1948 Ninth International American Conference which give birth to the modern OAS and the Charter. Article 1 of the Bogota Pact obligates the parties to that multilateral treaty "to refrain from the threat of the use of force, or from any other means of coercion for the settlement of their controversies, and to have recourse at all times to pacific procedures." The rest of the treaty sets out the recommended tools and mechanisms in some detail: good offices, investigation and conciliation, judicial procedure, and arbitration.

From a practical perspective, however, the Pact of Bogota does not merit further discussion in this paper. As many commentators have noted, it is a treaty which was destined to disappoint expectations from the outset.²⁰ As a result, Only thirteen of the thirty-five Member States have ratified it, and one, El Salvador, has since denounced it. Many of those who have ratified it have rendered it virtually inapplicable by way of reservations. For more than half a century, the Bogota Pact has hardly been used. And it is unlikely to be used in the future, particularly for the resolution of financial disputes, because neither the United States, Canada, Venezuela, Argentina, nor the entire Caribbean States of the OAS are Members.²¹

To date, neither the provisions for the peaceful solution of disputes under Articles 84-90 of the Charter nor the Bogota Pact

²⁰ See Policarpo Callejas Bonilla, "Los Medios de Solución Pacífica de Controversias en el Sistema Interamericano, Comité Jurídico Interamericano ("CJI"), VIII Curso de Derecho Internacional (General Secretariat, Washington, D.C. 1987), at pp. 158-71; "Informe de Grupo A," Quinto Curso de Derecho Internacional, CJI (General Secretariat 1978), at pp. 541-550.

²¹ See Table of Ratifications, A-42, www.oas.org/en/prog/juridico/firmas/a-42.

have been utilized by the Member States for the resolution of financial disputes. They remain, however, one of a number of mechanisms for non-judicial dispute resolution for financial and other controversies that may arise. The obvious disadvantage they have over other mechanisms, however, is that they are exclusively inter-American institutions. That is, they are only applicable to disputes that may arise among the OAS Member States and are not available for resolving financial disputes with European sovereigns and other states outside the Americas.

B. Individual Against State

1. The International Center for Settlement of Investment Disputes ("ICSID")

With the exception of several regional trade agreements referenced below and the bilateral investment treaties ("BIT"s) among a number of the OAS Member States, there are no treaties or conventions within the inter-American system which establish vehicles or mechanisms for conciliating, arbitrating, or otherwise resolving disputes which cannot be otherwise amicably negotiated between sovereign states and citizens or nationals of other states. This is an area in which the World Bank's ICSID predominates and virtually preempts the field. Indeed, twenty-one of the OAS Member States are now parties to the ICSID Convention.²² Notably absent are Brazil, Mexico, and Canada, but they have access to ICSID's conciliation, mediation, fact finding, and arbitration services by way of the Additional Facility expressly created for the resolution of disputes involving Non-ICSID Convention Parties or nationals of non-ICSID parties.

At last count, the number of arbitrations conducted by ICSID since its inception since 1965 has numbered only 54.²³ This falls in comparison to the number of private international

²² ICSID 1998 Annual Report (Washington, D.C. 1998), at pp. 17-19.

²³ See ICSID Cases, Doc.ICSID/16/Rev.6 (Sept. 30, 1998).

arbitrations reputedly conducted by the American Arbitration Association and International Chamber of Commerce, which number about five hundred per year. Nonetheless, ICSID appears to be the preferred organ for the non-judicial settlement of investment disputes between States and individuals. Of the 1,100 bilateral investment treaties ("BITs") estimated to have been in force in 1997,²⁴ over 900 included clauses in which the contracting parties consented to arbitration under the auspices of ICSID.²⁵ Both the North American Free Trade Agreement and the Free Trade Agreement Between Venezuela, Colombia, and Mexico ("TLC-3") provide an investor with the option of adjudicating investment disputes in the local courts or through arbitration under ICSID, the ICSID Additional Facility,²⁶ or through the United Nations Commission on International Trade Law ("UNCITRAL").²⁷

²⁴ See Antonio Parra, "Provisions on the Settlement of Investment Disputes in Modern Investment Laws, Bilateral Investment Treaties and Multilateral Instruments on Investment," Foreign Investment Law Journal, vol. 12 (Fall 1997).

²⁵ Alejandro A. Escobar, "Three Aspects of ICSID's Administration of Arbitration Proceedings," News From ICSID, Vol. 14 No. 2 Summer 1997.

²⁶ See Kenneth J. Vandavelde, United States Investment Treaties, Policies and Practice, (Kluwer, Boston 1992), at p. 165.

²⁷ Jose Luis Siqueiros, "Metodos de Solución de Controversias en los Esquemas Ineramericanos de Integración y Libre Comercio," XXIII Curso de Derecho Internacional, CLJ (General Secretariat, Washington D.C. 1996). See, also, North American Free Trade Agreement ("NAFTA"), Art. XI, Sec. B. ICSID's Secretary General, Ibrahim Shihata reports in "Recent Developments in ICSID," News from ICSID, vol. 15 (Winter 1998): "Consents to ICSID Convention, ICSID Additional Facility, and UNCITRAL Rules arbitration are all found in NAFTA; in the Colonia Investment Protocol of Mercosur; and the Colombia-Mexico-Venezuela Free Trade Agreement."

ICSID's attractiveness as a mechanism for resolving investment disputes for investors and sovereign states alike is probably attributable to the balance of investor and host country interests represented under the ICSID Convention.²⁸ Through ICSID, investors have direct access to a respectable and reliable international forum, and under the rules, the refusal of the host state to continue with arbitration already consented to under the Convention or by way of agreement cannot frustrate the process. For their part, individual state parties can refuse, in ratifying the convention, to submit entire classes of disputes to ICSID; and they can subsequently add or delete such classes with due notice. The host countries can also require, as a pre-condition to ICSID jurisdiction, the exhaustion of local remedies. Unless the parties agree otherwise, either in the agreement or subsequently, the laws which apply to the ICSID arbitration are the laws of the host state, together with international law as applicable.²⁹ The process is depoliticized by Article 27 of the convention, which prevents a Member State from asserting diplomatic pressure on behalf of an individual investor national once the arbitration has been joined.³⁰

²⁸ Ibrahim F.I Shihata, "The Settlement of Disputes Regarding Foreign Investments: The Role of the World Bank, with Particular Reference to ICSID and MIGA," Current Legal Issues Affecting Central Banks, Vol. 1, Robert C. Effros, ed. (IMF Washington, D.C. 1992).

²⁹ See Ibrahim F.I. Shihata and Antonio R. Parra, "Applicable Substantive Law in Disputes Between States and Private Foreign Parties: The Case of Arbitration under the ICSID Convention," ICCA Congress Series No. 7, Efficient Arbitration Proceedings/The Law Applicable in International Arbitration (A.J. Vandenberg ed. 1995).

³⁰ See, also, ICSID Basic Documents (Convention, Administrative and Financial Regulations, Institution Rules, Arbitration Rules, Conciliation Rules) International Centre for Settlement of Investment Disputes (Washington, D.C. 1995); ICSID Additional Facility for the Administration of Conciliation, Arbitration, and Fact Finding Proceedings, ICSID/11 (Washington,

Recourse to ICSID and its dispute resolution procedures (mediation, conciliation, or arbitration) is completely voluntary. Nonetheless, once consent is given (either by way of adherence to the Convention, by way of an investment treaty, or other bilateral agreement), it is irrevocable by the parties.³¹ All 129 ICSID members (countries that have ratified the Convention) are obligated to recognize and enforce ICSID judgments.³²

Article 25(1) of the ICSID Convention limits the availability of ICSID as a dispute resolution mechanism to "any legal dispute arising out of an investment" between a Contracting state and a national of another Contracting state.³³ Nonetheless, the potential scope of that jurisdiction is quite broad because the Convention leaves the term "investment" undefined. Thus, in the practice ICSID has taken jurisdiction over disputes involving construction and the delivery of services relating to investments, as well as the more traditional investment disputes.³⁴

D.C. June 1979); ICSID 1998 Annual Report, ICSID (Washington, D.C. 1998); "An Overview of ICSID," www.worldbank.org/html/exdr/icsid.htm.

³¹ ICSID Convention, Article 25(1).

³² ICSID Convention, Articles 53-55. Although each ICSID Member is obligated to enforce an ICSID award, Article 55 of the Convention recognizes that the obligation to enforce "shall not be construed as derogating from the law in force in any Contracting State relating to immunity of that State or of any foreign State from execution."

³³ For an in-depth analysis of the jurisdiction provisions within Article 25, see Christopher Schreuer, "Commentary on the ICSID Convention," Foreign Investment Law Journal, vol. 12 (Spring 1997).

³⁴ See Alejandro Escobar, supra, at p. 5.

The roster of cases published by ICSID attests to its success and acceptance as a facilitator of investment disputes involving OAS Member States.³⁵ Of the thirty-eight arbitration decisions taken under the auspices of ICSID since 1965, fourteen involved OAS Member States. It is anticipated that ICSID will continue to predominate as the agency for the resolution of those disputes in the region.

2. The Multilateral Investment Guarantee Agency

The World Bank established its Multilateral Investment Guarantee Agency ("MIGA") in 1988 to promote foreign investment in developing countries by providing insurance to investors against losses due to: government restrictions on currency transfers; government expropriation; breach of government contracts for which there is no reasonable and fair means of recourse; and war and civil disturbance.³⁶ Like ICSID, MIGA is a semi-autonomous treaty agency within the World Bank composed of member governments. Currently, it has 142 member governments who are parties to the Convention.³⁷

Due to the emergence of Latin America as a particularly dynamic region for growth and prosperity in the 1990s, MIGA has had a particularly strong presence in the region.³⁸ Thirty-three

³⁵ ICSID Cases, Doc. ICSID/16/Rev. 6 (September 30, 1998).

³⁶ See Article XI, Convention Establishing the Multilateral Investment Guarantee Agency ("MIGA Convention"), www.miga.org/convent.htm. See, also, Ibrahim Shihata, The Settlement of Disputes Regarding . . . supra, at pp. 180-185.

³⁷ See Membership List as reprinted from Convention Booklet, www.miga.org/convent.htm.

³⁸ The OAS General Secretariat ("GS/OAS") has sponsored several programs in conjunction with MIGA's economic development outreach and activities. In April 1997, MIGA and the General Secretariat were "cooperating organizations" at an Investor's Forum for the Caribbean organized by the Caribbean Tourism Organization in the Bahamas. In that same month, MIGA

of the thirty-five OAS member states are members or are in the process of ratifying the MIGA Convention. By the end of 1997, MIGA reported that it had issued one hundred separate guarantees to investors investing in its Latin American and Caribbean members.³⁹

Under Article 23 of its Convention, MIGA is obligated to "encourage the amicable settlement of disputes between investors and host countries," and MIGA's Legal Department undertakes a range of mediation and outreach activities for that purposes. The objective is to avoid the need for more formal international conflict resolution procedures, such as arbitration. MIGA reports that its mediation and outreach efforts have been successful over the last few years in that regard.⁴⁰

Inasmuch as MIGA is an insurance agency, it assumes the rights of the insured investor against the host country once it pays out a claim on the investor's behalf. Article 57 of the Convention, together with Annex II of the same, sets out the process for resolving such claims. That process requires the parties to attempt to negotiate their differences prior to seeking negotiation and conciliation. If that fails, the parties must submit the dispute to binding arbitration, unless they first agree to resort to conciliation. Unless the parties otherwise agree, the process proceeds under detailed provisions provided in Annex II, with reference to ICSID and its rules for resolving certain procedural questions.⁴¹ If the parties do not appoint

participated in a GS/OAS sponsored strategy workshop for government tourism officials at the XVII Inter-American Travel Congress of the OAS in Costa Rica.

³⁹ "MIGA in Latin America and the Caribbean," www.miga.org/migim/miga_lac.htm.

⁴⁰ Id.

⁴¹ Article 4(g) of Annex II provides that the applicable law shall be the MIGA Convention, the Agreements between the parties, MIGA's by-laws and regulations, the applicable rules of international law, the domestic law of the member country

arbitrators within the time specified and if they cannot agree on arbitrators within the time periods or agree to have the Secretary General of ICSID appoint them, then the President of the International Court of Justice intervenes to make the appointment. Article 4(j) of Annex II of the Convention requires each Member to "recognize the award rendered as binding and enforceable within its territories as if it were a final judgment of a court in that member," and each state must execute the award to the extent it does "not derogate from the law in force relating to immunity from execution."⁴²

World Bank General Council and Secretary General of ICSID Ibrahim Shihata has observed that the very intervention of MIGA as a player and interested party in the investment arena is a factor which should facilitate the amicable resolution of investor disputes with borrowing states. He notes that MIGA is in a position to evaluate the claims of the parties, recognize possible solutions, and take affirmative measures to resolve the dispute (as do most guarantors in the commercial context) before the dispute results into a loss to the investor which requires payment of a claim and recourse to the measures set out in Annex II of the Convention.⁴³

In conclusion, the instruments of the Inter-American System (other than the aforementioned regional and bilateral trade

concerned, and the investment contract. If the parties agree, the Tribunal can apply equity, "ex aequo et bono," as the rules of decision.

⁴² Article 57(b) of the MIGA Convention provides that when MIGA is action as a subrogee of an investor, it has the option of entering into an agreement with the host member country for resolution of the matter under an alternative process. Nonetheless, whatever process is selected must be based on Article II and must be approved by MIGA's Board prior to undertaking the underlying guarantee.

⁴³ Ibrahim Shihata, "Settlement of Disputes Regarding Foreign Investments . . . supra, at p. 185.

treaties) and the OAS provide virtually no direct support or mechanisms for the resolution of disputes between investors and sovereign states. Indeed, there is little reason for it to do so. For one, the mechanisms established under ICSID and MIGA appear to be adequate. Most of the OAS Member States are parties to both the ICSID and MIGA conventions, and there appears no movement at this time for the creation of a regional apparatus to replace them.

C. Individual Against Individual

The Inter-American System's most direct and tangible contribution to the promotion of non-judicial dispute resolution mechanisms has been in the area of resolving disputes between individuals. In that regard, the OAS Special Conference in the Development of Private International Law ("CIDIP") developed and sponsored two important treaties in the 1970s -- the Inter-American Convention on International Commercial Arbitration (the "Panama Convention") and the Inter-American Convention on Territorial Effectiveness of Foreign Arbitration Awards (the "Montevideo Convention"). These two Conventions, however, are not the only multilateral conventions in force for the facilitation of arbitration and the enforcement of arbitral awards within the OAS Member States. Twenty OAS Member States are also State Parties to the 1958 United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the "New York Convention"), which is similar in content to the OAS' 1975 Panama Convention.⁴⁴

Of the sixteen OAS Member States that have ratified the Panama Convention, two are not also parties to the New York Convention. They are Brazil and Honduras. There are six OAS Member states that are parties to the New York Convention but are not parties to the Panama Convention. They are Canada, Bolivia,

⁴⁴ Negotiating Group on Dispute Settlement ("NGDS"), Restricted Document No. 6 (Feb. 8, 1999). This document contains the full text of these three conventions, together with the corresponding ratification tables published by GS/OAS and the UN on the internet.

Convention.⁴⁶ In fact, the provisions of both Conventions, with some notable exceptions, are quite similar.

Both Conventions require the corresponding State parties to recognize the validity of a written agreement to arbitrate and properly issued arbitration awards. Article 1 of the Panama Convention states that "an Agreement in which the parties undertake to submit to arbitral decision any differences that may arise or have arisen between them with respect to a commercial transaction is valid." Similarly, Article II of the New York convention specifies: "Each Contracting State shall recognize an agreement in writing under which the parties undertake to submit to arbitration all or any differences which have arisen or which may arise between them" ⁴⁷

Article 4 is the key provision of the Panama Convention because it is that Article that requires the State parties to recognize and enforce unappealable arbitral decisions or awards "in the same manner as that of decisions handed down by national or foreign ordinary courts, in accordance with the procedural laws of the country where it is to be executed and the provisions of international treaties." The corresponding provision in the New York Convention is Article III. It states that each State party "shall recognize arbitral awards as binding and enforce them in accordance with the rules of procedure of the territory where the award is relied upon"

Article 5 of the Panama Convention establishes the grounds under which a State Party may refuse to enforce an arbitral award. They include those instances in which a competent state authority finds (a) that the agreement to arbitrate is invalid by way of incapacity of one of the parties or otherwise; (b) that the award relates to a dispute not within the scope of the arbitration (c) that the defendant was not duly notified or otherwise given the opportunity to mount a defense under the applicable rules; (d) that the

⁴⁶ See Norberg, *supra*, at p. 2.

⁴⁷ Under both conventions, the writing may be a telegram. The Panama Convention permits the agreement to be a telex as well.

Tribunal was improperly constituted under the rules or the Tribunal failed to carry out the arbitration in accordance with the agreement of the parties, the applicable rules, or the applicable State law; (e) that the decision has been annulled or suspended by a competent authority in the State it was made; (f) that the subject of the dispute cannot be settled by arbitration under the laws of the State asked to enforce the award; and (g) the recognition of the decision would be contrary to the public policy of the State asked to enforce the award. Article VI provides that the competent State authority considering a request to annul or suspend an arbitral award may suspend the execution pending its findings. The corresponding provisions in the New York Conventions are virtually identical.

Article 3 of the Panama Convention provides that in the absence of an express agreement between the parties, "the arbitration shall be conducted in accordance with the Rules of Procedure of the Inter-American Commercial Arbitration Commission ("IACAC").⁴⁸ The New York Convention has no analogous provision, and indeed, the Panama Convention is considered somewhat unique because of Article 3.⁴⁹ The automatic application of the IACAC Rules under Article 3, is of particular importance because those rules contain the detailed provisions for the appointment of arbitrators, choice of law, and the conduct of the process.⁵⁰ It is to a discussion of those Rules to which we now turn.

b. The Rules of Procedure

The arbitration process commences when one party serves the other with a Notice of Arbitration under Article 3 of the

⁴⁸ That is the very Commission which the Seventh International Conference urged the American Chambers of Commerce to create in 1933.

⁴⁹ See Horacio A. Grigera Naón, "Arbitraje Comercial Internacional," XIX Curso de Derecho Internacional, CJI (General Secretariat 1992).

⁵⁰ Of course, the parties can agree to use other rules as suggested in Article 3 and as further elaborated in Article 1 of the IACAC Rules of Procedure.

IACAC Rules.⁵¹ Once the Notice of Arbitration is served under Article 3 of the IACAC Rules, the process moves forward rather automatically regardless of whether the respondent responds, until and unless it is resolved or the complaint is withdrawn.⁵² The parties can agree to have one arbitrator, but if they do not agree, the default provision in the rules calls for three.

The IACAC plays an active role in appointing arbitrators if the parties cannot reach agreement on who is to serve. For example, if there is to be just one arbitrator and they cannot agree, the Commission appoints the arbitrator. Similarly, where there are three arbitrators, the IACAC will appoint members to the panel when a party fails to make an appointment and/or when the two arbitrators appointed by the parties are unable to agree on the third.⁵³

⁵¹ The Rules discussed below are the 1988 IACAC Rules, which are in force in the United States. Several years ago, IACAC revised those Rules, but the United States has not yet approved the revised version. When it ratified the IACAC Convention, the United States added the following reservation:

The United States of America will apply the rules of procedure of the IACA Commission which are in effect on the date that the United States of America deposits its instrument of ratification, unless the United States of America makes a later official determination to adopt and apply subsequent amendments to such rules.

The United States deposited its instrument of ratification on September 27, 1990, when the 1988 Rules were in force. Thus, in the United States, those rules will continue in force pending approval of the newer rules by the United States government.

⁵² See, e.g., IACAC Rule 28, which allows the Tribunal to proceed with the Hearing if one party does not show up and to decide on the evidence before it if one of the parties fails to produce evidence as requested by the Tribunal or as otherwise required under the Rules.

⁵³ See IACAC Rules, Articles 6-14.

The arbitral tribunal, once appointed, "may conduct the arbitration in such manner as it considers appropriate," provided it treats each party equally and gives it the opportunity to present its case within the Rules. The Tribunal must hold oral hearings for presentation of evidence and argument if requested by either party. If there is no such request, the oral proceedings are optional. The parties must serve the tribunal and each other simultaneously all documents and information presented. The parties may agree upon the place of arbitration and the language of the proceedings. Absent an agreement, the Parties decide.⁵⁴

From a practitioner's standpoint, the provisions in the Rules governing the Statement of Claim and Statement of Defense are helpful. They require the parties to state with particularity at the outset the pertinent facts and the points at issue. Those requirements help the Party and Tribunal focus the proceedings and move them along.⁵⁵

On questions of law, the Tribunal has the authority to rule on its own jurisdiction and the validity of the underlying arbitration agreement. In that regard, Article 21(2) specifically provides that an arbitration clause within a commercial agreement has the force of an independent agreement to arbitrate, and a decision by the tribunal declaring the commercial agreement null and void shall not necessarily void the arbitration clause in that agreement.⁵⁶ If the parties designate the applicable law in the arbitration agreement or subsequently by mutual agreement, the Tribunal is bound to apply it. Absent such designation, however, the Tribunal may apply that law which it deems to be appropriate; however the Tribunal cannot use equity -- *ex aequo et bono* -- unless the parties expressly agree and the applicable law so permits. In all cases, the Tribunal is bound to take into account the terms of the underlying contract, customary trade and usage.⁵⁷

⁵⁴ IACAC Rules, Articles 15-17.

⁵⁵ IACAC Rules, Articles 18-21.

⁵⁶ IACAC Rules, Article 21.

⁵⁷ IACAC Rules, Article 33.

As for evidence, each party has the burden of proving the facts material to his claim or defense. The Tribunal may order the parties to produce documents, exhibits, experts, and other witnesses. The rules of evidence are relaxed, and the Tribunal is permitted to accept written signed statements in lieu of oral testimony. The Tribunal has discretion to determine the admissibility, relevance, materiality and weight of the evidence offered."

The Tribunal is entitled to make partial and interim awards. All awards must be in writing and are final and binding. Unless the parties otherwise agree, the Tribunal must state the reasons for its decision. A decision which gives only a "number" is insufficient. The awards are private, and will not be made public unless the parties agree or the law of the country where it is made requires publication.⁵⁸ The Tribunal may entertain post judgment motions to interpret the award, correct it, and increase it, all within thirty days of the requesting party's receipt of the award.⁵⁹ The Rules require the Tribunal to include in the award the costs of the arbitration,⁶⁰ which includes the fees of the arbitrators, travel, experts, travel and witnesses and their travel, the successful parties legal costs, and the administrative fee of the IACAC.⁶¹

⁵⁸ IACAC Article 32.

⁵⁹ IACAC Rules, Articles 35-37.

⁶⁰ IACAC Rules, Articles 38-41.

⁶¹ The Inter-American Commercial Arbitration Commission administers arbitration activities under the Convention and its Rules. With its present headquarters in Bogota Colombia, it maintains national sections in Argentina, Bolivia, Brazil, Colombia, Chile, Costa Rica, the Dominican Republic, Ecuador, Guatemala, Mexico, Panama, Paraguay, Peru, Spain, Uruguay, and the United States. The Commission works directly in other states where there are no permanent national sections established or through affiliates. Not only does the Commission facilitate arbitration, but it also provides mediation and conciliation services on request. The Commission also sponsors jointly with the General Secretariat of the Organization of American States and other organizations an

2. The Montevideo Convention

The Montevideo Convention on the extraterritorial validity of foreign judgments and arbitral awards was intended to complement the Panama Convention. It includes provisions relevant to the operational enforcement of judgments similar to those in Article IV of the New York Convention -- specifically rules regarding the documents of proof required to request execution of arbitral awards by the competent authorities in the Member States. The coverage of the Montevideo Convention is possibly broader than the Panama Convention. It also applies to "arbitral awards in all matters not covered by the Inter-American Convention on International Commercial Arbitration" ⁶²

Unfortunately, the small number (ten) of state parties to the Montevideo Convention and the fact that the United States is not a State party diminishes its potential as a major force for promoting arbitration in the region. Moreover, all of the Contracting States of the Convention, except for Brazil, are also Contracting Parties to the New York Convention, and all the Contracting Parties to the Montevideo Convention, except for Bolivia, are also contracting parties to the Panama Convention. Thus, the net additional contribution of the Montevideo Convention the promotion of arbitration in the hemisphere over and above that already provided by the Panama and New York Conventions has been de minimis.

In conclusion, it is obvious that the New York, Montevideo, and Panama Conventions overlap to in many respects. Almost two thirds of the OAS Member States are State Parties to at least one of those Conventions. Together, those Conventions increase the legal certainty that an arbitral award that is res judicata in the country where it was rendered will be enforceable in another ⁶³. Therefore, they

ambitious training program in non-judicial dispute resolution for arbitrators, mediators, and attorneys. See Norberg, supra, at pp. 4-6.

⁶² Montevideo Convention, Article 1.

⁶³ Jacob Dolinger, "International Commercial Arbitration," XXIII Curso en Derecho Internacional, CJI

are essential to the viability of arbitration as a reliable dispute resolution mechanism in the Americas.⁶⁴

IV. RECENT OAS EFFORTS TO PROMOTE THE USE OF ALTERNATIVE DISPUTE RESOLUTION ("ADR") IN THE AMERICAS

A. The Inter-American Juridical Committee's Resolution I-4/92, Endorsed by General Assembly Resolution AG/RES. 1166 (XXII-O/92)

In 1992, the OAS General Assembly adopted Resolution AG/RES. 1166 (XXII-O/92) which transmitted to the Member States a series of conclusions and recommendations of the Inter-American Juridical Committee for the promotion of arbitration and other non-judicial dispute-resolution mechanisms. The Committee's recommendations were set out in its Resolution CJI/RES. I-4/92 entitled "Arbitration between States and Between Private Economic Agents Among Themselves

(General Secretariat , Washington, D.C.1996); Horacio A Grigera Naón, "Reconocimiento y Ejecución de Laudos Arbitrales en America Latina," in Arbitraje en los Conflictos Económicos Internacionales, " XIII Conferencia Interamericana de Arbitraje Comercial (Cámara de Comercio de Bogota, Santafé de Bogota, D.C. 1995), pp. 75-106.

⁶⁴ The OAS's commitment to arbitration and non-judicial dispute mechanisms is reflected in its own agreements with its Member States over its privileges and immunities and the functioning of its offices. For example, the OAS Headquarters Agreement with the Government of the United States, which entered into force in November 1994, obligates the OAS submit to arbitration under either the IACAC or American Arbitration Association any private commercial and personal injury suits (other than suits involving its staff) which it cannot otherwise resolve by other non-judicial means. That Agreement also provides for a special small claims (under \$3,000) procedure under special rules and paid for entirely by the Organization. The Organization's Multilateral Agreement on Privileges and Immunities, which is in force in thirteen Member States, requires the Organization to resolve private law disputes through alternative dispute resolution measures. All of the Organizations' bilateral agreements with Member states for operations outside Headquarters have similar language.

and with States Regarding International Legal Transactions, the Purpose of Which is Private in Nature." Those conclusions and recommendations included the following:

(a) It is viable for states, as sovereign entities to negotiate among themselves private transactions, either bilateral or multilateral States may stipulate that any disputes that may arise as a consequence of those agreements are to be settled by peaceful means.

(b) To avoid undesirable confrontations in the area under analysis, the parties should avail themselves of various methods for settling their disputes among these are investigation of the facts, prior consultation, negotiation, mediation, and conciliation. When these mechanisms fail to bear fruit, arbitration is a suitable procedure.

(c) In the international instruments that stimulate investments at the bilateral and multilateral level, including those that create some type of insurance to guarantee against the political risks of the investor in the host country, mechanisms must be adopted to settle any disputes that may arise. Those disputes may arise between the host state and the investor or between the host state and the multilateral investment guarantee agency ("MIGA") when the latter underwrites the loan.

Under such circumstances, all possible negotiation and conciliation procedures should be exhausted before the parties resort to arbitration.

If it comes to arbitration, then the International Centre for Settlement of Investment Disputes ("ICSID") and the procedure stipulated in Appendix II of the MIGA can provide the parties with a proper forum and mechanism.

(d) Traditionally, the Latin American countries have upheld the Calvo Doctrine some of them have incorporated it in one way or another into their constitutions or laws. Several Latin American countries (Argentina, Chile, Peru, Uruguay, and

Venezuela) are negotiating or have concluded investment protection treaties that give the investor recourse to international arbitration. One possible interpretation is that these countries are of the view that the essential purpose of the Calvo Doctrine [the doctrine that host states will give investors the same rights as nationals to pursue litigation in the host's state's courts] is to avoid having to invoke diplomatic protection and the kinds of grave abuse that this led to up until the first half of this century. Arbitration between the investor and the state eliminates the invocation of diplomatic protection and those would serve the purpose, if not the letter, of the Calvo Doctrine.

. . . . An increasing number of states . . . have signed or are negotiating investment protection agreements and that make provisions for arbitration between the investor and the state.

(f) The ICSID is also a valid option for stimulating an increased flow of foreign investment.

(g) The Committee urges the governments of the countries of the Hemisphere that have not yet done so to sign, ratify, or accede to the Conventions on International Commercial Arbitration which were concluded in New York (1958) and Panama (1975).

(h) The Committee further recommends to the governments of the region that their laws in the area of private arbitration be modernized, suggesting that they be updated as a function of the precepts of the Model Law on International Commercial Arbitration proposed by UNCITRAL.

(i) . . . government and nongovernment agencies -- including chambers of commerce, bar associations, and centers of studies in the region -- ought to make for a better understanding of arbitration as a suitable means of settling disputes.

(j) . . . the inter-American Commercial Arbitration system should be strengthened . . . and the

activities of the Inter-American Commercial Arbitration Commission should be fostered through the establishment of new and active national sections.

(Emphasis added).

The Committee's recommendations and the General Assembly's decision to transmit them to the OAS Member States are the foundation of a the Organization's commitment to broaden the use of non-judicial dispute resolution mechanisms in the hemisphere. The current programs of the General Secretariat to develop technical cooperation and partnership for development activities in the ADR area are a large part of the Organization's effort to comply with the obligations that commitment entails.

B. The General Secretariat's Cooperation and Technical Support Programs in the Area of Non-Judicial Dispute Resolution

The OAS General Secretariat is presently working in two areas which will inevitably result in greater recourse to arbitration and other non-judicial dispute mechanisms in the hemisphere. One is the area of training in alternative dispute resolution for arbitrators and mediators. The other is providing technical support to the Negotiation Group on Dispute Settlement ("NGDS") for the Free Trade Agreement of the Americas ("FTAA") Negotiations.

1. Arbitrator Training⁶⁵

⁶⁵ One cannot mention training in arbitration by the OAS and its organs without noting the work of the Inter-American Juridical Committee ("IJC") in this Area. For twenty-five years, the IJC has been hosting an annual course in Rio de Janeiro in International Law for young lawyers from its Member States, who attend the course under a competitive scholarship offered by the OAS. The faculty draws upon IJC members and includes other judicial luminaries from around the world. A recurring topic in the course in recent years has been ADR, and in particular, arbitration. In 1996, more than half the course was devoted to non-judicial dispute resolution mechanisms. The IJC publishes the lectures of the faculty in the annual

Through the Department of Legal Cooperation of the Secretariat for Legal Affairs, the OAS General Secretariat has sponsored a series of arbitrator and mediator training programs in the OAS Member States as part of the Organization's partnership for development. In 1998, workshops were held in Bolivia, Colombia, Chile, Ecuador, and Paraguay, in collaboration with the Inter-American Commercial Arbitration Commission and local Chambers of Commerce. Approximately sixty businessmen, practicing attorneys and law school professors were trained in each workshop on non-judicial dispute resolution techniques. Experienced trainers and arbitrators from the OAS Member States served as the faculty.

For 1999, the Department of Legal Cooperation plans to implement an even more ambitious training program in conjunction with the Inter-American Commercial Arbitration Commission, the Association of Ibero-American Chambers of Commerce, the Central American Federation of Chambers of Commerce, and the American Arbitration Association. Subject to the level of funding secured, two-day workshops are planned for Argentina, Brazil, the Dominican Republic, Mexico, Panama, Peru, Venezuela, Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua. Training is to be in the form of lectures and

proceedings of the course. The result is a substantial body of learned literature on the topic of arbitration and other ADR in the Americas. See, e.g., José Luis Siqueiros, "Métodos de Solución de Controversias en los Esquemas Interamericanos de Integración y Libre Comercio," XXIII Curso en Derecho Internacional, CJI (General Secretariat, Washington, D.C. 1996); Jacob Dolinger, "Solution of Latin-American External Debt y International Arbitration," XVII Curso en Derecho Internacional, CJI (General Secretariat, Washington, D.C. 1990); Jacob Dolinger, "International Commercial Arbitration," XXIII Curso en Derecho Internacional, CJI (General Secretariat, Washington D.C. 1996); Horacio A Grigera Naón, "Arbitraje Comercial Internacional," XIX Curso en Derecho Internacional, CJI (General Secretariat, Washington, D.C. 1992).

in-class exercises, including moot arbitrations, which are designed to promote inter-active learning.⁶⁶

2. Negotiation Group on Dispute Settlement

The Miami Summit of the Americas of December 1994, mandated the negotiation of a Free Trade Agreement of the Americas by the year 2005. Since then, the Trade Ministers of

⁶⁶ The Inter-American Development Bank through its Multilateral Investment Fund, has provided substantial counterpart funding to a Chambers of Commerce in the American States for the development and enhancement of commercial dispute resolution mechanisms. In October 1996, it awarded \$622,000 to El Salvador's UTE and Chamber of Commerce and Industry for a project entitled "Modernization of Commercial Law and Dispute Resolution Reform." Similarly, in December 1996, it awarded \$720,000 to the Chamber of Commerce of Ecuador for a "Mediation and Arbitration Center Project," and in May 24, 1995, \$1,220,000 to the Chamber of Commerce of Bogota for an "alternative Methods of Settling Business Disputes" project.

the OAS Member States have been meeting regularly to structure and carry out those negotiations. To assist them in the process, the Ministers have established eleven specialized working groups.⁶⁷

The group established to assist in negotiating the dispute settlement provisions for the FTAA is now called the Negotiation Group on Dispute Settlement ("NGDS"). When formed in May 1997, it was called "the Working Group on Dispute Settlement."⁶⁸ The Group's initial mandate was to:

⁶⁷ They are: Market Access; Customs Procedures and Rules of Origin; Investment Standards and Technical Barriers to Trade; Sanitary and Phitosanitary Measures; Subsidies; "Antidumping," and Countervailing Duties; Smaller Economies; Government Procurement; Intellectual Property Rights; Services; and Dispute Settlement. See The Belo Horizonte Ministerial Declaration (May 16, 1997), www.sice.oas.org/FTAA/belo/minis_e.stm

⁶⁸ Id.

(1) Compile an inventory of dispute settlement procedures and mechanisms included in agreements, treaties and arrangements of integration existing in the hemisphere and those of the WTO, appending legal texts; (2) On the basis of this inventory, identify areas of commonality and divergence among dispute settlement systems in the hemisphere, including with respect to the extent to which these systems have been employed; (3) Exchange views following internal consultations with the private sector, regarding mechanisms to encourage and facilitate the use of arbitration and other means of alternative dispute resolution for the settlement of international commercial disputes; (4) Recommend methods to promote understanding of the procedures under the WTO Rules and Procedures Governing the Settlement of Disputes; (5) In light of the various subjects to be covered by the FTAA agreement and other relevant factors, exchange views on possible approaches to dispute settlement under the FTAA agreement in line with the World Trade Organization, understanding on Rules and Procedures Governing the Settlement of Disputes; and (6) Make specific recommendations on how to proceed in the construction of the FTAA in this area. (Emphasis added).

Soon after the group was formed, the Department of International Law of the GS/OAS Legal Secretariat and of the GS/OAS Trade Unit jointly prepared the analytical compendium of dispute resolution measures in the regions existing trade agreements for the group.⁶⁹ Since then, the Trade Unit has retained a full-time trade-law specialist to staff this Group at the FTAA Secretariat in Miami.

NGDS just completed its Second Meeting in the first week of March 1999. The minutes indicate that some delegations have

⁶⁹ See "Dispute Settlement Mechanisms in Regional and Sub-regional Trade and Integration Arrangements," unpublished compendium prepared by the Secretariat for Legal Affairs and the GS/OAS Trade Unit (General Secretariat, Washington D.C. 1998).

mentioned as areas for inclusion on the Group's agenda the settlement of disputes between an FTAA member state and private individual of another member State and the possibility of including in the FTAA investment chapter a provision that would allow a private party to activate the dispute resolution mechanism, but there is no consensus to include those kinds of provisions in a draft negotiating text at this time.⁷⁰

Nonetheless, it is likely that the NGDS will eventually agree to include some mechanism for the arbitration of private investment disputes and other conflicts between individuals which arise within the framework of the Agreement. As pointed out earlier in this paper, both NAFTA and the TLC-3, as well as the majority of the BITs among the OAS Member States, contain such provisions and the members of the group and their staff are quite familiar with the terms of those Agreements and the compelling reasons underlying the decision to include private dispute resolution provisions in a comprehensive trade pact.

V. CONCLUSIONS

Since its very beginning as the Union of American Republics in 1889, the OAS has demonstrated a commitment to promoting and facilitating the peaceful resolution of disputes among states and individuals. It continues working at this commitment today through its support of the FTAA Negotiation Group on Dispute Settlement and through its partnership for development programs in arbitration and mediation training. The 1933 Resolution triggering the creation of the Inter-American Commercial Arbitration Commission and the promulgation of the Panama and Montevideo Conventions guaranteeing the enforcement of properly issued arbitral awards in a significant number of the Member States have contributed significantly to confidence in arbitration as a viable dispute resolution mechanism in the hemisphere.

But perhaps the most significant contributions of the Organization to dispute resolution are those which are the least

⁷⁰ "Chair's Summary Discussion on Guidelines Document for the Work of the Negotiating Group on Dispute Settlement," FTAA.ngds/w/10/rev.1 (March 5, 1999) (Restricted)..

tangible and the most difficult to measure. They are its contribution to the spirit of hemispheric cooperation and mutual respect as set out in the Charter; its role in spreading common values such as respect for the rule of law, governance through representative democracy, regard for human rights; and its institutional support for the settlement of disputes through constructive and continuing dialogue. Those elements have established the seed bed in which the confidence in non-judicial dispute mechanisms can firmly root and grow. And the OAS, through its Charter, its programs, and its activities, has been nurturing and strengthening that seed bed now for more than one hundred years.

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London

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Non-Judicial Settlement in International Financial Transactions

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Speakers Notes
Diagrams and Selected Appendices

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Renegotiating Debt in a Bankruptcy Context Living in the Shadow of the law

The assignment for this paper is to address the issues involved in renegotiating debt in a bankruptcy context. My background, experience and academic interests are in U. S. law and my presentation will be limited to U. S. experience. This paper does not address the complexities of U.S. bankruptcy law. The revised manuscript prepared following this presentation will address relevant technical issues as footnotes.

It can certainly be said that in consensual, nonjudicial resolution of financial disputes through debt renegotiation, the parties act in the longshadow of the bankruptcy law. This means that in a debt renegotiation, where default in the debt obligation has occurred or is imminent and where the exercise by the creditor of its rights and remedies may call into question the status of the debtors solvency, the course and objectives of the negotiations must be viewed at all times and positions as well as measured by all parties to the debt renegotiations against the ever present alternative of failure of consensual agreement and resort by one or more of the parties to remedies available under bankruptcy laws and the likely financial consequences of such actions for each of the parties. Debt renegotiation in the context where bankruptcy is the obvious distasteful alternative most often involves multiple creditors as well as debtor affiliated parties, such as shareholders, either insiders or independent, partners, loan guarantors and other third parties who may have acted with or on behalf of the debtor and may ultimately become creditors or parties in interest in bankruptcy.

Principles of Consensual Debt Restructure.

For the debtor to keep control over its assets in a consensual debt renegotiation, the debtor must have the cooperation of all creditors who would be affected by the restructure, because creditors of the debtor who feel that their position would be prejudiced would be incentivized to force a bankruptcy of the debtor. For the debtor to obtain the cooperation of its creditors, it must first convince its creditors that the debtor should retain control over its assets. The debtor has several alternatives.

The debtor can demonstrate to the creditors that the results of the restructure will leave each creditor in a more favorable position than they would enjoy in bankruptcy, where proceedings are adversarial in nature and more time consuming and expensive than consensual, non-judicial debt restructure.

The debtor can demonstrate to the creditors that it is honest and that current difficulties arise from unforeseeable market conditions or from errors of judgement of former management of the debtor

The debtor can show the creditors that the debtor has developed the necessary factual and financial information and that the facts and information support a consensual debt restructure that will work for the benefit of the creditors.

The debtor can discover the the creditors "Achilles heel"; a position that the creditor would have substantial risk of losing in bankruptcy and how the debtor can eliminate that risk for the creditor through the consensual debt restructure. For example, the debtor could provide "new value" such as new collateral or cross collateralization to the creditor in exchange for a key missing element of the proposed restructure such as a working capital loan.

The debtor can offer an incentive to the pertinent creditor such as a perfectible preference to reduce the creditors risk, or a financial incentive to restructure such as a participation in the increased value of the collateral asset or the business of the debtor after restructure and rehabilitation.

The most common reasons that multi-creditor consensual debt renegotiations fail are that either one or more creditors want more favorable treatment than the other creditors are offered while demanding assurance that no other creditor has received more favorable treatment; one or more creditors are convinced that the debtor has not been forthcoming with the factual and financial information presented in support of the proposed debt renegotiation or is attempting to hide assets or sources of money that are not readily apparent; or that the the debtor is proposing a restructure that is much more favorable to the debtor than its fate would be in bankruptcy, at the expense of the creditors

For all of the foregoing reasons, the debtor must propose a debt restructure that follows the basic principles of bankruptcy:

Full Disclosure.

The temptation of the debtor as it slips into a defensive mode with its creditors is to limit the information provided to the creditor out of fear of attack by the creditors. The debtors tend to cling to the the thought that no news is good news for the creditors. Often, creditors feel the same; thinking that it is better not to know the true state of affairs because recognition may imply fault, blame or necessitate unpalatable action. It is essential to a successful consensual debt restructure that the debtor make full and fair disclosure of its financial condition to all of its creditors. It is only through this process that the creditors can be convinced that their better interests will be served by cooperating in a consensual process of debt renegotiation rather than by pressing the debtor with hope of achieving preferential treatment. Also, until an individual creditor's frame of reference is expanded through effective communication and disclosure of the debtors entire financial condition, that creditor will focus only on its own problem credit, discounting competing claims in assessing the implications of its actions on the debtor

or on the other creditors. Finally, since full disclosure would ultimately be required in bankruptcy, by providing the information early in the process of consensual restructure, the debtor can control the format and detail in which the facts and financial information are presented. A potential disadvantage of early disclosure of the deteriorating factual and financial context facing the debtor is that disclosure may precipitate creditor enforcement action, including involuntary bankruptcy, before the debtor is fully prepared with alternatives.

Fair Treatment of each Creditor within a class and among Classes of Creditors
The cornerstone of a successful consensual debt restructure with multi-party creditors is fair and equitable treatment of each creditor and each class of creditor, recognizing the relative strengths and weaknesses of their respective positions but without preferring or favoring one creditor or class of creditor over another except in recognition of their respective legal or economic status in bankruptcy. To prefer any creditor or to treat any other creditor on an inequitable basis, will motivate the remaining creditors to seek individual preferential treatment. Most creditors, however do not want to appear to be treated as a member of a group where the creditor may be deemed to have some obligation to the group or any group other member or to subject its decision making authority to any other party.

Maximum Recovery by Creditors.

The proposal for consensual debt restructure must convince the creditors that its implementation will maximize their recovery and that such recovery will exceed their respective projected recoveries in bankruptcy, before the creditors will consider any residual interests accruing to the debtor under the proposal.

4. Long Term Survival of the Debtor as a Going Concern.

The consensual debt restructure plan must demonstrate that the debtor will be able to survive financially for a sufficient time to complete the plan and repay its obligations to

the creditors. This may mean that in order to convince the creditors of the debtors favorable long term prospects, the debtor may be required to reorganize its management, reduce its overhead and other costs, divest nonproductive lines of business and establish a long term business strategy which will support the final repayment of the creditors at the earliest date and on the best possible terms. If the debtor cannot convince the creditors, they will not cooperate and the consensual plan of debt restructure will fail.

Demonstrate the Superiority of Creditor Recovery on a "Going Concern" Basis Versus a "Liquidation" Basis.

The debtors proposal for debt restructure and repayment over time must establish convincingly that the creditors will recover a much greater percentage of their debt on the basis of the debtor continuing its operations as a going concern, performing its obligations under the restructured debt arrangements, than they will under a forced liquidation in bankruptcy. If the debtor cannot so convince the creditors and if the creditors are able to absorb the losses presented by an immediate forced liquidation, that will be their choice.

Provision for Federal Income Taxes.

Under most circumstances, federal income taxes arising from asset repossession and resulting recapture of taxable gain in excess of a depreciated tax basis, will be immediately payable even though the debtor has no available cash, unless the underlying debt obligation in excess of the debtors tax basis in the asset is discharged in bankruptcy. The debt renegotiation plan must provide for the payment of taxes as a part of the plan. This is particularly important in the U. S. with respect to individual debtors, because the Internal Revenue Service is the debtors most unforgiving creditor. The creditors must be given to understand that the debtor fears the Internal Revenue Service more than any other creditor. Unless the tax claims are handled

correctly, the debtor may find himself working for the taxing authorities forever, whereas the debtor can eliminate general creditor claims as well as taxes arising from liquidation in bankruptcy, by discharge in bankruptcy.

Release From Liability.

The reward to the debtor for facing unpleasant economic facts and making full disclosure of those facts to the creditors and taking the time and going to the effort and expense to formulate, negotiate and implement a consensual plan of debt restructure is to obtain a release from liability for debt repayment, or exculpation. Typically creditors firmly resist exculpation. Only when convinced that the debtor has been honest and forthcoming, making full disclosure of its financial condition, that the credible prospects for return under the plan of restructure will exceed the prospects for return under available alternatives, including forced liquidation and that if the debtor is not exculpated consensually, it will seek exculpation judicially in bankruptcy, will the creditors grant exculpation. The concept of exculpation, correlating to the concept of discharge of the debtors obligations and the granting of a fresh start under bankruptcy law, is logically consistent only where the plan supporting the restructured debt essentially provides for an orderly liquidation of the debtors obligations over time. If, in fact, the plan provides for the continuation of the debtors operations as a going concern, the resulting terms of the renegotiated debt need not be more favorable to the debtor than the original terms regarding liability.

Theory of Consensual Debt Restructure.

Consensual debt restructures in lieu of bankruptcy are based on the fundamental assumption that the debtor has been honest and forthright in its operations and that the debtors current economic difficulties necessitating debt restructure are due to honest mistakes of business judgment or market conditions not

reasonably susceptible of anticipation or accommodation by the debtor or its creditors. The current global phenomenon of currency crises and financial dysfunction resulting, in some cases in dramatic deflation and asset devaluation, present precisely those circumstances.

Resolution of the resulting financial problems between a debtor and its creditors then, need not necessarily involve a violently adversarial process. A calm and dispassionate evaluation of the factors leading to the defined economic problems necessitating debt restructure should lead to a fairly clearly defined set of options under existing legal and financial structures for problem resolution. The mission of both the debtor and its creditors in a consensual debtor debt renegotiation is to move past adversarial posturing and to seek to understand the underlying root of the economic problem and allocate the loss occasioned by the problem in accordance with the legal and economic facts. If the debtor and its creditors see the facts clearly, their interests should be aligned in resolving the allocation of loss in the most expeditious and cost effective manner possible. The parties to the renegotiation are in the position to suffer the most pain in the absence of a consensual agreement and are in the position to gain the greatest economic benefits from its success. A consensual debt restructure requires, and is the product of this alignment.

The organization of the legal and economic facts into a plan for debt restructure, however, involves a complex set of interrelated decisions which, in each case, must be measured against the available alternatives, including the most immediate and distasteful alternative, debtor liquidation in bankruptcy. The test in each case for each of the constituent decision makers, including the debtor, creditors, partners, investors, employees and advisors, is to measure and prioritize the consequences of each decision under the various alternatives. A consensual debt restructure should produce an alignment of the constituents best legal, economic and personal interests. A correct

alignment among the constituents in the face of the legal and economic facts will produce a mutual desire to complete the restructure

Performance incentives or inducements may be built in respect to any or all of the constituents. Examples of such incentives or inducements include preferential treatment for risk-taking by creditors, incentive fees or participation in residual asset values and limitations on the debtors personal liability for debt repayment under appropriate circumstances. If the desire, action and performance by the debtor, combined with the time and space afforded by the proposed debt restructure program will not produce a greater repayment to creditors than a liquidation in bankruptcy, the creditors will not permit any economic incentive or inducement to the debtor. The objective of the consensual debt restructure and the definition of its success is the effectuation of the lowest cost and most efficient allocation of loss on the most equitable basis, considering the facts and the law, which produces the maximum repayment to creditors. Every decision and the consideration of every alternative in the debt renegotiation process must be considered against this test of success.

Debtors proposing a consensual debt renegotiation in the face of bankruptcy must understand that, at least initially, the creditors may not appear to react to the proposal rationally. The role and motivation of loan officers and creditor management are often inconsistent with the requirements of the workout process. Many decision-making motivations for these individuals are personal to them and relate to internal "political issues" such as compensation, budget allocations and blame. Decisions may also emanate from external pressures on the creditor, such as pressure from shareholders, regulators, accountants and rating agencies. Often the responsible officers of the creditor are not given any incentive and, perhaps, do not have the capability, to fully explore and understand their factual and legal position. The debtor must be mindful of the problems presented by these anomalous situations and of the

impact of the state of mind of the various decision makers on their approach to the workout process. It should go without saying, that the creditor must be aware of the potential existence of such circumstances and deal with them openly and appropriately.

Although it is the objective of a consensual debt restructure to avoid adversary posturing, it may be necessary for the debtor or the creditors to utilize adversarial tools, such as ancillary bankruptcy proceedings (of a subsidiary or affiliate, for example), litigation and other aggressive and adversarial actions, from time to time, to level the field of negotiations and protect consensual participants from creditors who may seek to obtain an advantage without providing a corresponding benefit to the renegotiation process, or to force reluctant or misguided participants to the bargaining table. These adversarial actions should not be taken in derogation of the consensual restructure, but as a carefully considered component of the process, contemporaneously with the ongoing negotiation process, on a "dual track" with it. Adversarial action as a component of the process of consensual debt renegotiation is often required where responsibility for negotiations on behalf of a creditor must be moved out of the hands of a defensive loan officer, who may desire to avoid the issues and protect his or her position in the creditor organization, or where responsibility for negotiations on behalf of a debtor rests with an individual whose ego and self image dominate strategy. In each of these situations, responsibility and control must be moved into the hands of professional problem solvers.

Creditors will often take a very tough position from both a legal and business point of view to flush out the level of commitment and will of the debtor who has proposed the renegotiation in lieu of bankruptcy. The debtor must remain calm, stick with the proposed workout plan and utilize appropriate adversary proceedings sparingly, but with sufficient definition and purpose to protect its position and move the

process forward, stopping short of polarizing positions. Of course, if the debtor has not prepared fully and presented a realistic statement of the legal and economic facts as a part of the proposal, the debtor will not be successful.

The renegotiation process must recognize creditor preference for reaching separate individual debt renegotiations, rather than global agreements. Creditors consistently demonstrate a strong desire to avoid master creditor agreements which extend over a long period of time, despite the fact that the creditors would face those same circumstances in the debtors bankruptcy. Each debtor plan should, therefore seek to accommodate the individual creditor relationships to the maximum possible degree through consistent treatment and, if possible, to accomplish satisfaction of undersecured or unsecured claims through individual assets which can be segregated on a fair and equitable basis, either from proceeds from asset liquidation, as collateral or given in satisfaction of the debt. Only where unsecured and undersecured claims cannot be satisfied in this way should a collateral pooling mechanism be utilized. Creditors will often prefer to waive their unsecured or undersecured claims to avoid the complication of participation in a complex collateral pool or they may be willing to advance new funds outside of the collateral pool context, but subject to a requirement for additional collateralization or specific cross collateralization not related to the other unsecured or undersecured claims, in effect, creating creditor-by-creditor collateral pools. An important component of the debtors overall workout plan will be to clearly communicate to the creditors that undersecured or unsecured claims can be waived or collateralized if new consideration (or "new value") is given. In addition, if there is enough collateral to go around; if it can be divided equitably and if there is an incentive to the debtor to go through this process, a master or global collateral pool, analogous to what would otherwise be the debtors estate in bankruptcy, may not be required.

The purpose of a collateral pool is to effect a mechanism to capture equity in the debtors assets, on a going concern basis, for the repayment of unsecured or undersecured creditors. If the difference between the value of that pool of equity, calculated on a going concern basis as opposed to a liquidation basis in bankruptcy, is large enough, the debtor may reasonably propose to reserve a residual interest in the pool of equity as an incentive to maximize the value pool through ongoing operations. Collateral pools are an important plan component in consensual debt restructurings with multiple creditors, but are not necessary if unsecured and undersecured claims can be otherwise satisfied on a fair and equitable basis.

There is no magic to consensual debt renegotiation in lieu of bankruptcy; just the hard work of uncovering, organizing and recording the economic and legal facts, developing a detailed knowledge of the circumstances and communicating all of this information clearly and consistently to the constituents of the proposed debt restructure. This means also that, as through the process of negotiations new information develops and emerges, it must also be communicated. The legal and economic facts will define the plan for the debt restructure, and internal and external relationships will be changed, based upon the the development of these changing facts, legal positions and economic conditions. Debt renegotiations in lieu of bankruptcy are difficult under the optimum circumstances. They require the alignment and agreement of a large number of disparate parties, each of whom will undoubtedly discover through the negotiation process that their assumed legal and economic position is not what it was assumed to be or that it has changed from the position it was assumed to be as a result of the process. These changes must be recognized and accepted. Alternative positions and decisions based upon the evolving legal and economic facts must be measured in each case against the legal and economic alternatives, notably debtor liquidation in bankruptcy, measured against the

anticipated effectiveness of the debtors proposals and the relative costs of the alternatives. Where there are reasonable prospects for the development and execution of a consensual plan, both the creditors and the debtor have a duty to pursue it and to honestly and vigorously seek its implementation.

Evolution of Bankruptcy Law as a Context-for Consensual Debt Renegotiation.

An awareness of the evolution of bankruptcy law brings appropriate context to the resolution of current ongoing international problems of financial distress. Historically, the U.S. has addressed the problem of debtor insolvency through its bankruptcy laws. The Bankruptcy Act of 1800 was the first bankruptcy law adopted by the United States Congress. This act followed closely the English Statute of Bankrupts. In turn, the origins of the English law may be traced back to the law of other European countries, the Italian city-states of the 14th century and even further, to the Roman Empire.

The various practices employed in dealing with the problem of a debtor who either refused, or was unable to pay its debts date back as far as the practice of the extension of credit itself. In primitive and ancient cultures, public opinion provided two sanctions by which a debtor could be compelled to perform his part of a contract. Each of these sanctions was extremely powerful: one was religious, based on public humiliation of the debtor; the other more primitive and severe: execution.

In 13th century England, the common law provided for imprisonment of the debtor until he "made agreement (with his creditors) or his friends for him". Imprisonment was intended to compel payment of the debt and not to punish the debtor for his failure to pay.

The most important early English bankruptcy law was the Statute of Bankrupts. This law was directed toward punishment of fraudulent debtors and only applied to debtors who were merchants, providing that a debtor who committed an "act of

bankruptcy” was to be reputed, deemed and taken for a bankrupt. Upon complaint, the Lord Chancellor could appoint a commission of “wise, honest and discrete persons who were authorized to seize the property of the bankrupt and sell it for the payment, pro rata, of the debts of the bankrupt. The bankrupt, however, remained liable to the extent that his creditors were not paid in full. The commissioners had the power to imprison the bankrupt and, by virtue of a later statute, the bankrupt could be subject to pillory and the loss of an ear as well. The design of early bankruptcy law was to protect creditors and to punish debtors who were trying to avoid payment of just debts.

In the early 18th century, the harshness with which bankrupts were treated was greatly reduced by laws which provided for the granting of discharge to the bankrupt of the debts owing at the time of bankruptcy. This development was attributed to the notion that bankrupts were not always fraudulent and sometimes failed because of circumstances beyond their control and further, that such bankrupts were entitled to relief. Society had recognized that unlimited incarceration of the debtor did not usually lead to payment to his creditors. Bankruptcy laws at this time also applied to non-merchants, who however, after released, remained obligated to pay the remainder of their debt. The idea behind the distinction between the different treatment of merchants and non-merchants was that merchants necessarily incurred debt in order to conduct business and trade, and merchants could become unable to pay their debts due to accidental losses and without any fault of their own. On the other hand, an ordinary citizen who incurs debts beyond his ability to repay was considered to have committed a species of dishonesty and an injustice to his creditors. According to Blackstone, “Trade cannot be carried on without mutual credit on both sides: the contracting of debts is therefore here not only justifiable, but necessary. And if by accidental calamities, as by the loss of a ship in a tempest, the failure of brother traders, or by the nonpayment of persons out of trade, a merchant or trader becomes

incapable of discharging his own debts, it is his misfortune and not his fault”.

In the U.S., the Congress was given the authority under the Constitution to enact laws concerning bankruptcy. Every bankruptcy law in the U.S. has been the product of some financial crisis or business depression. Bankruptcy legislation in the U.S. is a reflection of changes in economic conditions and viewpoints. It has evolved through periods of pro-debtor and pro-creditor tendencies and compromises. Internationally, the U.S. bankruptcy laws are generally viewed as pro-debtor. The U.S. has generally accepted the principle that bankruptcy is required in the public interest of the nation, apart from the effect of the law upon particular individuals or institutions upon whom the law operates. That is, the interest of the nation lies in the continuation of business and the conservation of property for the mutual benefit of the creditors and the debtor, and not in the sale and distribution of the debtors assets among its creditors, or even in the debtor's own immediate discharge from debt. The forced sale of property and the stoppage of business it entails in times of financial crisis constitutes a loss to the nation at large, as well as to the individual debtors and creditors. Thus, U.S. bankruptcy law has developed into a system which attempts to achieve three objectives: protection of creditors from each other; protection of creditors from dishonest debtors; and protection of the honest debtor from his creditors by means of automatic stay of collection actions and by discharge.

The laws that seek to protect creditors from one another attempt to prevent any one of the creditors from obtaining more than its proportionate share of the debtors assets. Such a law provides for a stay to prevent a “rush to the courthouse” and to provide time and a forum for the collective execution of process directed against all of the property of the debtor for the benefit of, and at the common expense of all of the creditors. When the debtor is unable to pay all of its debts, the principle of contribution is invoked, and any loss due to the debtors insolvency is thereby spread among all of

its creditors. The bases for this process of collective execution are both legal and economic. In order to achieve these objectives, a method of managing the debtor's estate during the pendency is required. Some person or entity must be given control over all of the property of the debtor to manage, collect and distribute all of the assets. When this process is handled pursuant to bankruptcy law, the expense of the process and resultant depletion of the debtor's estate to the detriment of the creditors is significant.

The objective in a consensual debt renegotiation in a bankruptcy context is, through voluntary, transparent and forthright action by the debtor, to inspire in the creditors a high level of trust and confidence in the debtors fundamental adherence to the principles of bankruptcy law and the likelihood of achievement of their mutual objectives; the objectives of bankruptcy law, by voluntary and consensual management, and thereby to avoid the polarization and expense of a judicial achievement of those same objectives and to thereby maximize repayment. If the underlying business of the debtor is viable, notwithstanding current financial distress, the best return to the creditors is almost always achieved by continuation of the business as a going concern through consensual non-judicial debt restructure.

Why Most Creditors Do Not Rush To Foreclose, Precipitating Debtor Bankruptcy.

Short term regulated lenders such as banks and thrifts often seem to react to debtor proposals for consensual debt restructure in an irrational manner. While one might expect these institutions to seek the best business resolution to a defaulted debt situation, that is often not their initial reaction. Unfortunately, from the banker's perspective, the best business decision often conflicts with the permitted accounting treatment of a proposed restructure. Bank stock analysts and rating agencies put enormous emphasis on the ratio of a banks loan loss provisions to its

non-performing assets. The higher the ratio, the stronger the balance sheet and therefore the safer the institutions deposits and equity. The best way for the institution to improve this ratio is to reduce the denominator that is non-performing assets. The reduction of non-performing assets in an environment of widespread financial crisis is probably the single most important objective for the banker, because a high ratio of nonperforming assets to risk assets draws immediate criticism from the rating agencies and the bank regulators. As non-performing assets increase, the rating agencies lower the rating of the bank's deposits thus increasing the bank's interest expense, narrowing its spread of operating income (profit) and its ability to continue to deal flexibly and rationally with new non-performing assets, leading to a vicious downward spiral that can result in bank failure.

Restructured loans arising from debt restructured in the face of potential debtor bankruptcy almost always are classified as "troubled debt restructures." Regulatory accounting principles require that troubled debt restructures, even if they are yielding what might otherwise be considered a market rate of interest, must be reflected on the bank's balance sheet as a non-performing asset, thus increasing the bank's reported non-performing assets, impairing the ratio to loan loss provisions, even though the restructure may make excellent business sense, considering the alternatives. Unfortunately, the best business decision for the regulated institution as a creditor may conflict with the permitted accounting treatment of a restructure, leading to protracted negotiations while the creditor, often to the bafflement of the debtor, struggles to improve the restructure of the debt to satisfy its secret agenda, classification of the renegotiated debt as a performing asset, even though the ultimate economic and legal reality of the agreement is less favorable to the creditor than the debtor's proposal might have been.

The same accounting and reporting pressures often work for the benefit of the

debtor, however, who may be facing repossession proceedings, specifically foreclosure of real property. Foreclosed real property must be reported by the regulated institution as inventory. Generally Accepted Accounting Principles and regulatory accounting principles require that inventory be carried on the institution's books at the lower of cost or market value. Therefore, when the institution forecloses on the asset, it is required to have the asset appraised by an independent qualified appraiser and required to mark the asset's value to market value and to charge the difference between the loan balance and the independently determined market value of the repossessed collateral against the institution's loan loss reserve. This generally results in a charge against the institution's capital. Loss of capital is as important to the institution as its ratio of reserves to non-performing assets. The threat posed by collateral foreclosure to the creditor institutions reported financial condition does not end with the foreclosure and initial write-off. On each anniversary after foreclosure, the creditor must order a new appraisal and again mark the asset to market value, this time as a direct charge against the institution's capital. The required mark to market value of the foreclosed asset only applies to mark downs. The institution is never permitted to increase the reported value based on an increase in the appraised value of the foreclosed asset. These accounting principles discourage a rush by the creditor to foreclose. Further, banks worldwide have learned from bitter experience that foreclosed assets in their hands are worth much less than those same assets are worth in the hands of the industry. Opportunity funds and vulture funds recognized early on the pressure on banks to reduce or eliminate nonperforming assets, including foreclosed assets, and became skilled at acquiring those assets at prices far below their realistic values, but enabling the banks to report the entire proceeds from sale immediately as performing assets. As a result, if the bank believes that the debtor proposing a consensual debt restructure is honest and capable, the bank will likely

understand that the debtor can realize more value from the asset over time than the bank would realize, and that therefore, the proposed debt restructure would ultimately be in the best interest of the bank, as creditor.

Advantages of Consensual Loan Renegotiation in Lieu of Bankruptcy.

Consensual loan restructures fix the rights of the parties and avoid the uncertainties of litigation and bankruptcy. Consensual restructures are more flexible; workouts permit all legitimate agreements to accomplish the consensual intent of all parties, limited only by the depth and breadth of their imagination. Consensual restructures tend to preserve higher asset values and therefore debtors can be given incentives to maximize recoveries and limit deficiency liabilities. Restructures outside of bankruptcy are generally less expensive, both from an administrative perspective and from a legal perspective, avoiding the costs and burdens of litigation and bankruptcy. Consensual loan restructures allow debtor management (who must have been determined to be honest, credible and capable) to retain continuing control of the debtor ongoing business. The debtor avoids the "stigma" of bankruptcy, which still intimates that there is some element of dishonesty or fraud in a debtors failure to pay its debts by seeking refuge in bankruptcy. By renegotiating the terms of troubled debt so that the new terms can be honored under the changed circumstances, debtor principals and guarantors may avoid or defer liability on personal guarantees. As part and parcel of the debt renegotiation, creditors can obtain acknowledgment and affirmation of the debtors obligations and of the validity of liens and encumbrances as well as waivers of defenses, setoffs and counterclaims, correct deficiencies in loan or security documents and possibly obtain additional loan collateral and guaranties of repayment.

Disadvantages to Consensual Loan Restructures in Lieu of Bankruptcy from the Debtors Perspective.

Since a restructure is a consensual arrangement, neither the debtor nor cooperating creditors can bind non-assenting creditors nor stop litigation or foreclosure proceedings by uncooperative creditors. Success in consensual debt renegotiation in lieu of bankruptcy requires substantial unanimity of all creditors. The required unanimity is difficult to achieve. Claims by governmental agencies are frequently more difficult to deal with in debt renegotiations because these entities tend to be less flexible; they have no incentive to seek the overall optimum business resolution. Frequently their rules and regulations do not permit flexibility. Additional problems include the debtors inability to reject burdensome leases or other executory contracts; inability to recover property in possession of foreclosing creditors or to defeat prior attachment, garnishment or levy; and inability to recover preferential, fraudulent or voidable transfers that otherwise might be avoidable in bankruptcy. Also, the debtor has no convenient forum (such as an experienced bankruptcy court) for expeditious resolution of disputes, enforcement of sales free and clear of liens and encumbrances, determination of the priorities of liens and claims and the like.

Disadvantages of Consensual Loan Restructures in Lieu of Bankruptcy from the Creditor's Perspective.

Unlike bankruptcy, consensual renegotiation of debt does not subject the actions of the debtor to judicial scrutiny and control. Participation in a consensual loan renegotiation might have the effect of perpetuating ineffectual or dishonest management. It may also permit continued erosion of collateral or other asset values if control of the timing and price of liquidation remains with the debtor. Participation in a consensual debt renegotiation does not preclude a subsequent bankruptcy filing if the

restructure fails.

Conditions for a Successful Consensual Debt Renegotiation.

Participation in a consensual debt renegotiation makes little sense if the crucial components of a successful restructure are not present. These components, however, depend to some extent upon the attributes of the particular case. For example, inability of the debtor to survive in the long term as a going concern is inconsequential if the renegotiation contemplates an orderly liquidation of assets, as opposed to continuing ongoing business operations. Many consensual debt restructure initially contemplate long-term survival of the debtor but, as negotiations progress, evolve into more or less of an orderly liquidation. Some factors important to the success of consensual debt renegotiations include the availability of adequate liquidity (cash) to fund the restructure, readjusted and realistic expectations of all parties to the renegotiations, adequate disclosure of information (which should be at least equivalent in scope and detail to disclosure in a formal bankruptcy proceeding, since the consensual restructure is, in essence, a private bankruptcy proceeding); flexibility and appreciation of the legal rights and the economic and practical leverage of each of the participants, absence of significant avoidable transfers which prefer one creditor over others in the same class, as well as equal treatment creditors within each class; and apparent fairness in the treatment of differing creditor and equity classes. The restructure must also enjoy the continued cooperation and support of critical creditors, debtor employees and management personnel; creditor confidence in management as well as in the debtor's business plan; and creditor confidence in the debtors ability to operate profitably within the constraints of the market place as well as the applicable regulatory climate.

Pitfalls for Creditors to Avoid in a Consensual Debt Renegotiation

Assuming that the key requirements for a successful consensual debt renegotiation in lieu of bankruptcy are present, creditors must be vigilant to avoid inducing others to extend credit to the debtor, paying the debtors employees without making adequate provision for trust fund taxes or funding the debtors payroll with knowledge that debtors management will not withhold or surrender appropriate taxes, failing to comply with bulk transfer laws, failure to take immediate possession of surrendered collateral, becoming enmeshed in unintended admissions, waivers or releases during negotiations, or exercising management control over the debtor.

Some Observations Regarding the Debtors Preparation of a Proposal for Consensual Debt Renegotiations in Lieu of Bankruptcy

The debtor must develop a factual, as opposed to a visceral or superficial, understanding of its current financial difficulty. This necessitates analysis of the debtors balance sheet, creditor by creditor, clarifying the claims of each of its creditors on the debtors assets. The debtor management must be certain that those members of its management team as well as outside advisors, including attorneys and accountants, appraisers and consultants understand the principles outlined in this paper. Then, identify those participants who will be the most effective communicators to and negotiators with the creditors, which need not be those with the largest ego or the most at stake, personally. The debtor must be certain that its principals are dedicated and possess the will to address the difficult process that will follow. The most crucial initial determination generally seems to be to ascertain the exact sources and amounts of the debtors reliable cash flow. The next crucial decision is which creditors must be paid to survive the plan preparation process and which creditors can safely be delayed in payment.

Consistent with the initial concerns regarding source, amounts and reliability of cash flow is the necessity of developing tight control over cash flow. The next step in the process would be to prepare a detailed cash flow forecast based on realistic assumptions, which must be clearly articulated, in writing. Payments must be prioritized and receipts must be accelerated. The sources of cash flow must be assessed as to their reliability. Consideration should be given to the advisability of supplementing operating cash flow with capital sources, such as asset liquidations, working capital loans and "involuntary" working capital loans (involuntary in the sense that revenues otherwise dedicated to debt service payments are withheld by the debtor and used to fund current operating requirements - creditors naturally frown on this practice). The next step at this stage is to address management and staff issues, including staff shrinkage as well as other cost reduction strategies.

As cash flow crises become more manageable, at least for the short term, the debtor must make a credible and realistic assessment of present and future values of its assets, clearly articulating the bases for and assumptions supporting the valuations, including projected liquidation horizons and prices. The debtor must assess the outside forces that can defeat future cash flow recovery and asset value recovery as well as strategies to mitigate those possibilities. The threatening outside forces include permanent or indefinitely prolonged changes in market conditions, changes in government laws, rules, regulations or policies, including tax policies, foreign competition, volatility of capital, currency devaluation or instability and other "external shocks and exogenous events".

Before the debtor can go to its creditors with a proposal, the debtor must have a coherent and credible "story" to tell. The story must be based on the legal and economic facts, projections and the detailed assumptions which support those projections. The story must articulate the debtors structure going forward and its

prospects for survival as a going concern, including specifically the terms and conditions of the indebtedness which must be renegotiated to permit the successful restructure of the debtors obligations as well as the factors which must induce the creditors to agree to the proposal, as opposed to pursuing litigation, collection and possible bankruptcy of the debtor. If the debtor can establish some degree of initial credibility with the creditors, it must immediately seek a general standstill in order to gain time and space to develop, negotiate, refine and implement its proposal.

As the debtors plan is communicated to its constituents, additional facts, positions and information will emerge which will have to be addressed and accommodated or otherwise dealt with. The debtor must let the emerging factual information guide the evolution of its plan for debt renegotiation, being bound only by the principles explored earlier in this paper. As this process evolves, the debtor should continue to seek alignment of the various constituents of the plan, based only on the mutual understanding of the legal and economic facts and the available distasteful alternatives to the debtors proposal for consensual debt renegotiation. The debtor management must accept the staff shrinkage and cost controls implicit in the plan and the staff remaining must be educated about the plan and dedicated to it.

The pivotal creditor or creditors are next on the list for debtor action. If the debtor can enlist its, or their support, agreements should be finalized and documented as soon as is practicable. To wait for some sort of "global" conclusion is to court disaster. As soon as the crucial participants become committed to the restructure, the debtor must not waste a moment but then move forward with the other creditors in small groups or individually. The debtor must always be mindful that while the renegotiations' success for the debtor must be substantially unanimous, each creditor is concerned primarily with its own deal; the creditors concern with the other creditors is that the other creditors aren't preferred and that the other creditors can't impair or

affect that creditors agreement with the debtor The debtors fate is to persevere in this limbo

Attachments:

Diagrams Debtor Workouts Risks and Alternative Courses of Action

Selected Appendices
From Author's Related
Works Form of Release and Indemnity Provisions for use in
Modification Agreements

Settlement Agreement - Form

Creditor Analysis Worksheets

I. Credit File Review

II Project File Review

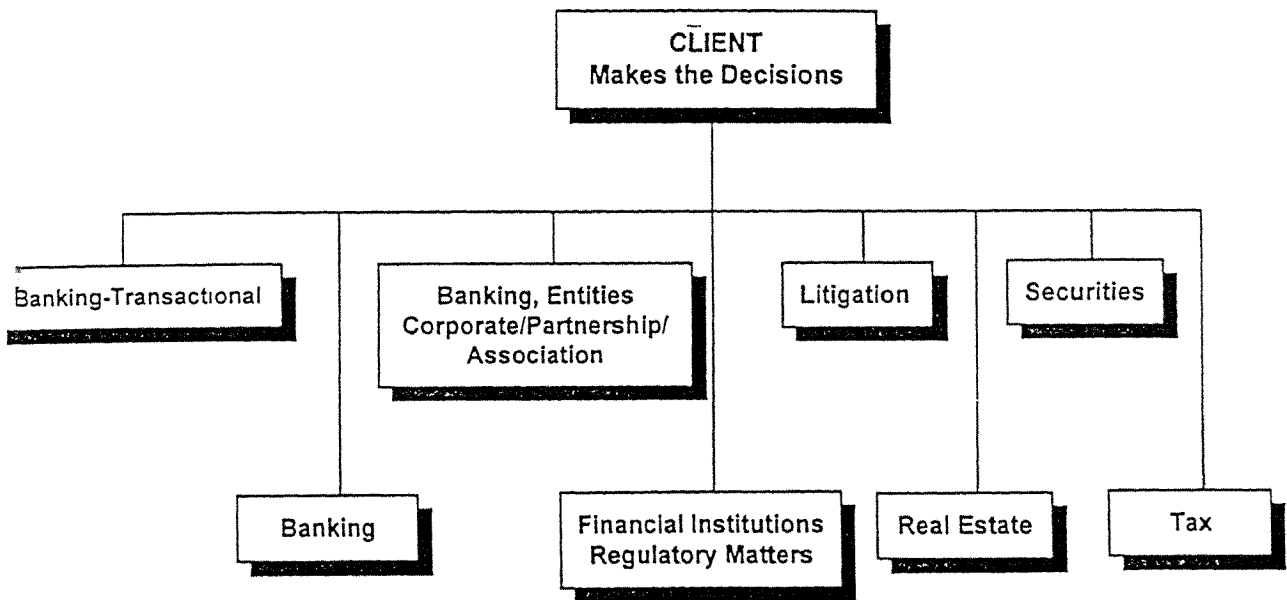
III Legal File Review

Loan File Review

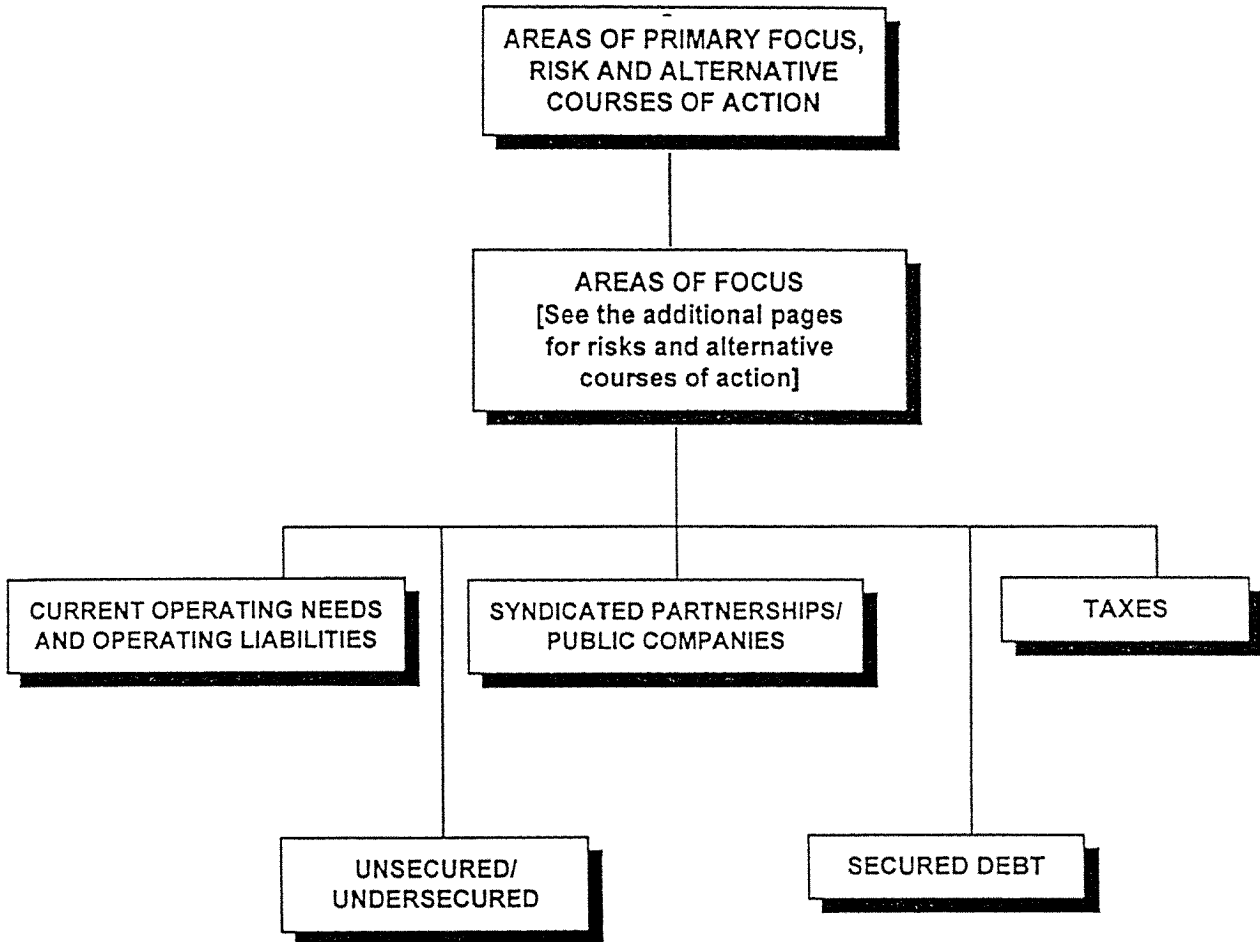
Federal Income Tax Analysis (1991)

Workout Analysis Paper - Assessment of Debtor Position

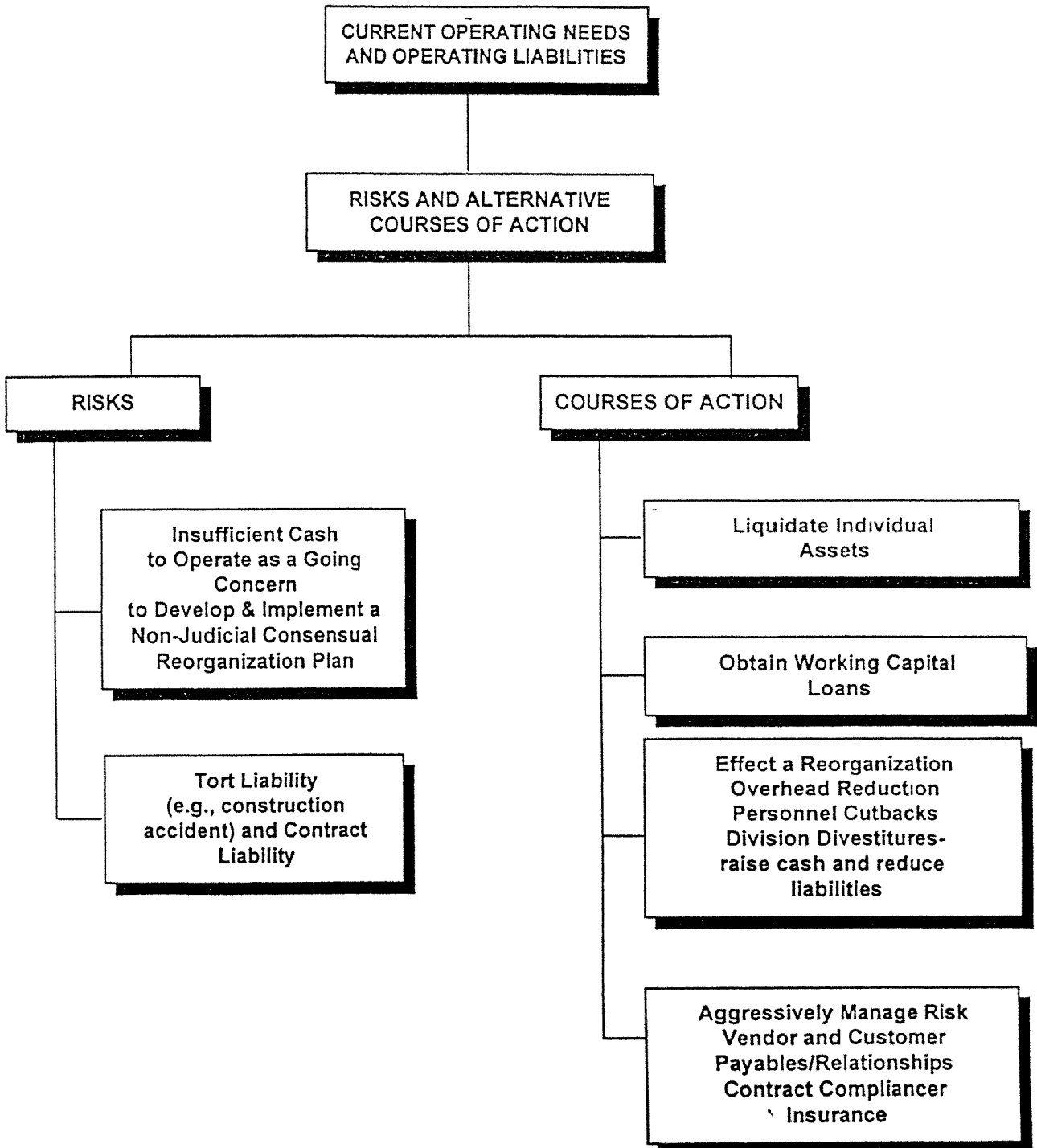
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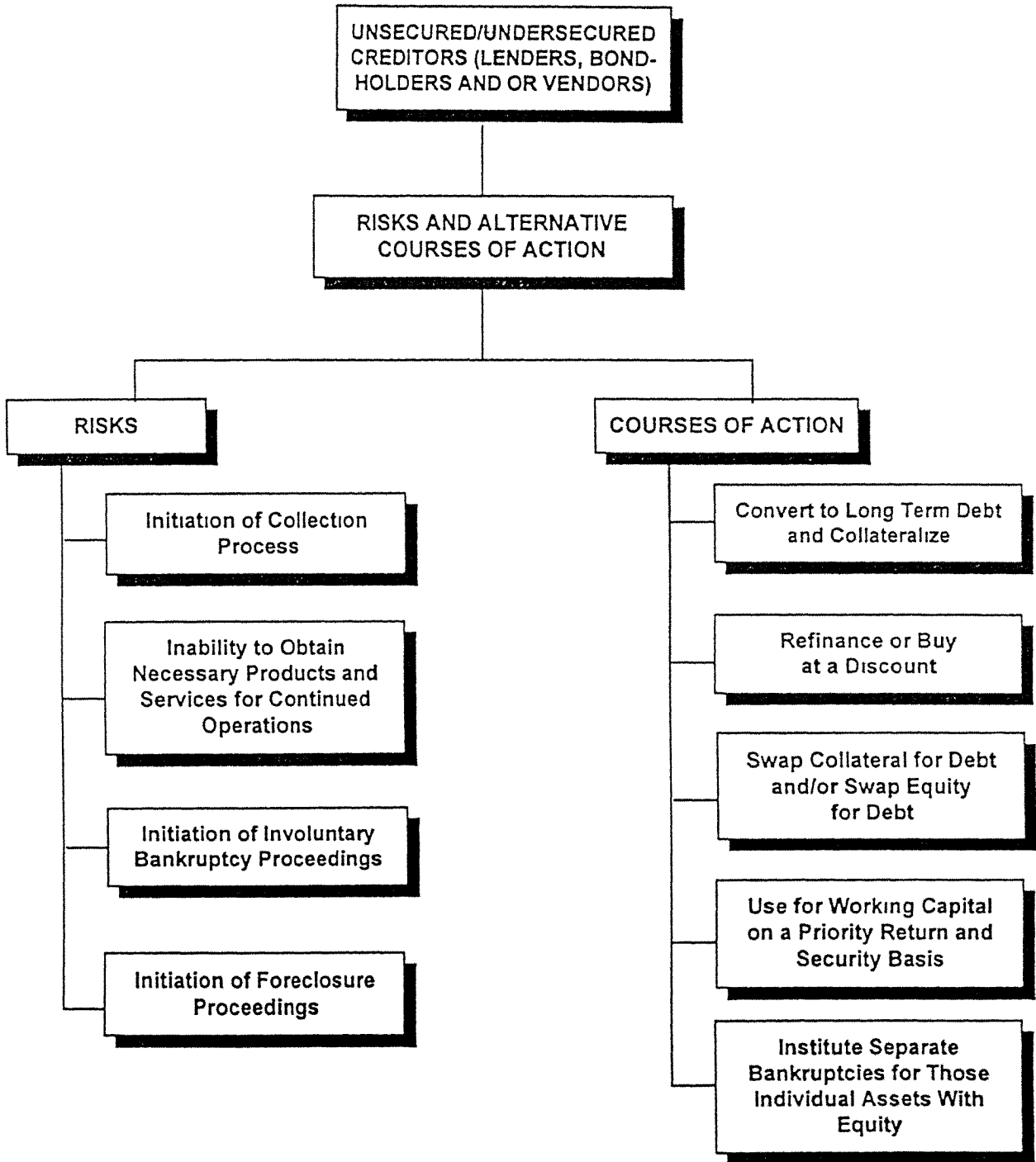
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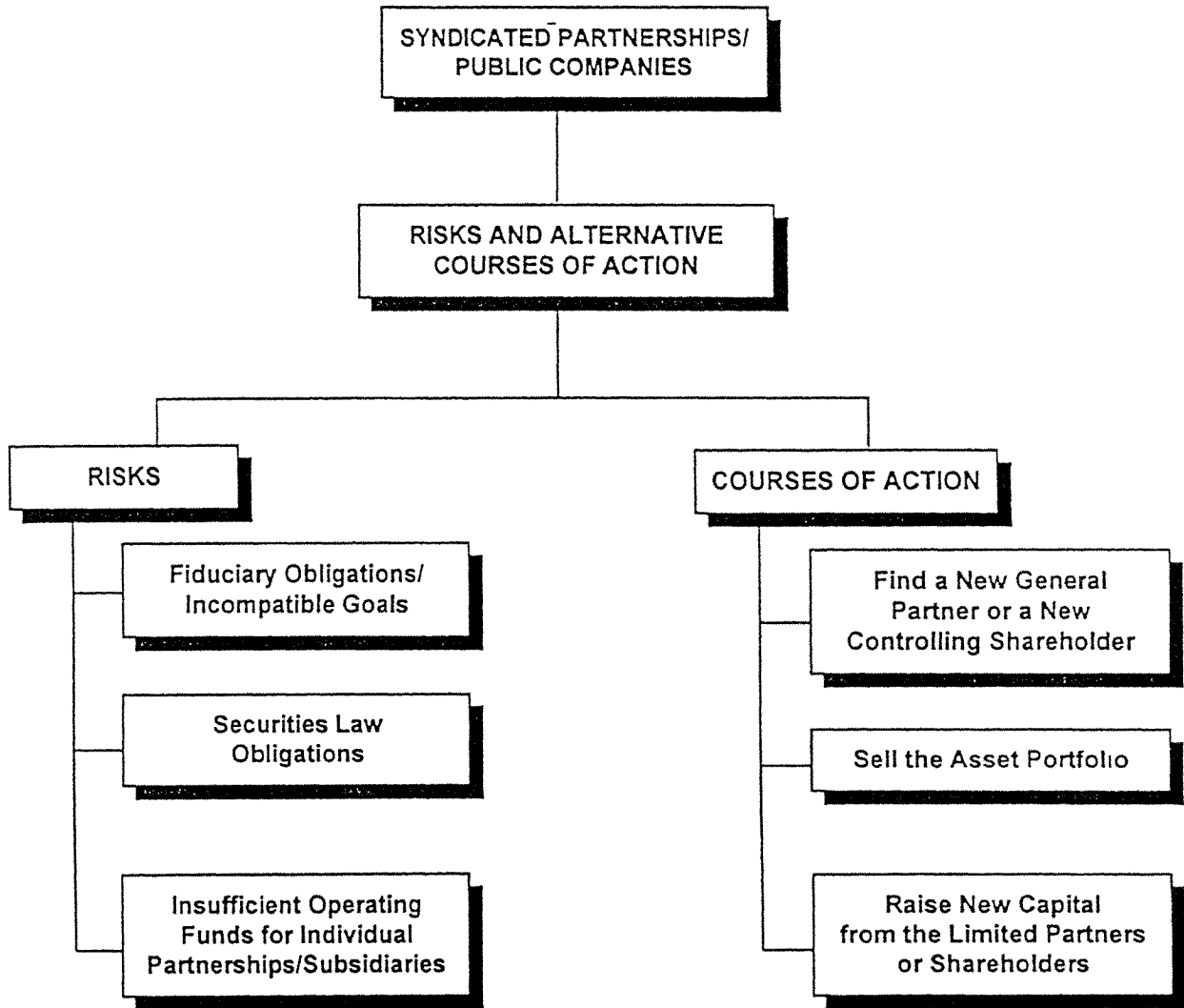
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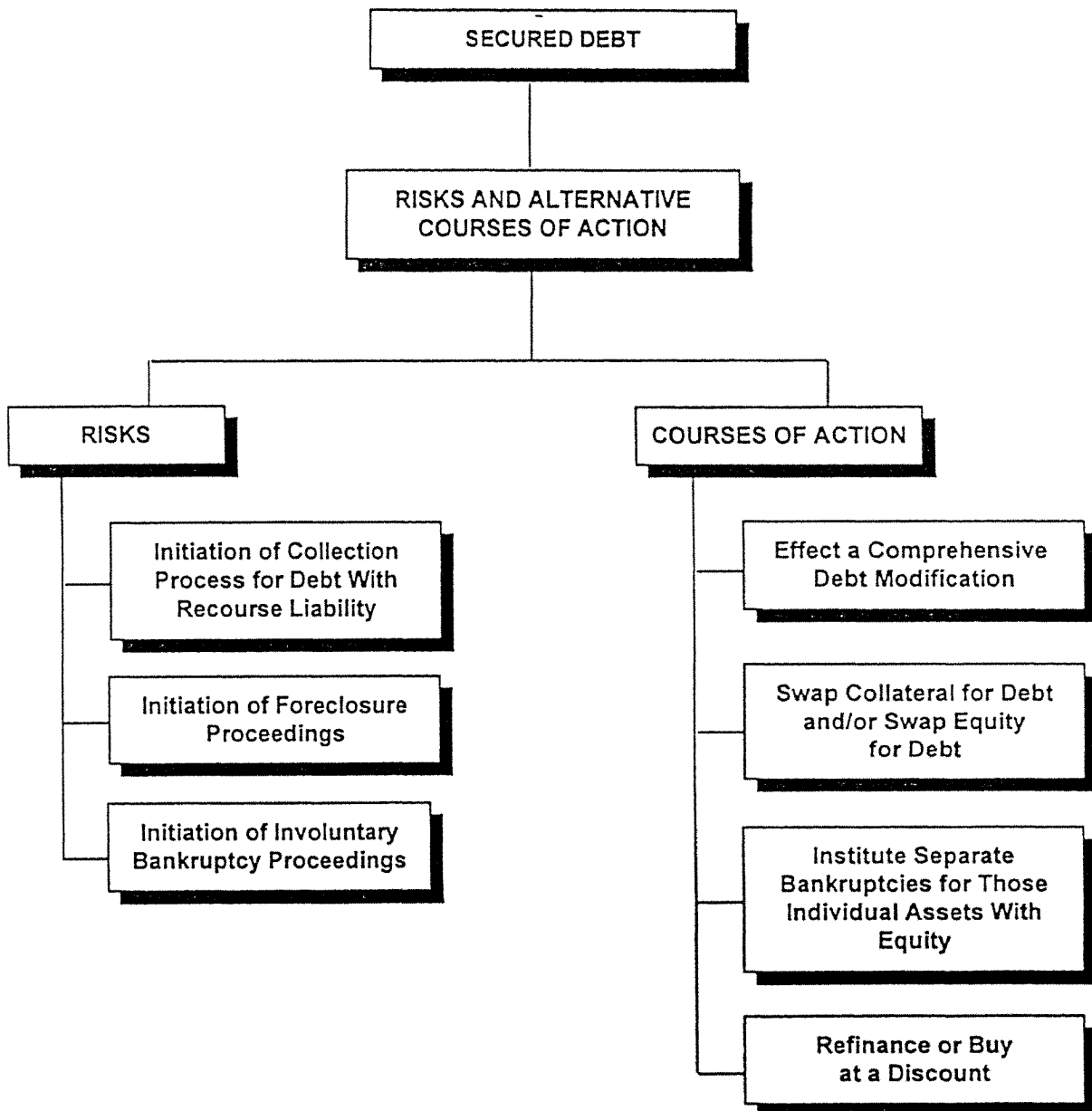
DEBTOR WORKOUTS



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Renegotiating Syndicated Loans

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RESTRUCTURING SYNDICATED LOANS - THE LEGAL RELATIONS BETWEEN THE PARTIES

BY MICHAEL GRUSON, SHEARMAN & STERLING

ABSTRACT

Since the global debt crisis that commenced in the early eighties, it has become quite customary for the lenders of syndicated loans to get together with a borrower who is unable to service the loan in order to renegotiate the loan and to develop a debt restructuring program. In these cases the lenders usually do not wish to rely on the rigid provisions of insolvency law, because they believe an extrajudicial arrangement will be more beneficial or insolvency laws are not available because the borrower is a sovereign.

1. THE LEGAL RELATIONSHIP BETWEEN THE MEMBERS OF A LENDING SYNDICATE BEFORE A RESTRUCTURING

In a syndicated loan a group of banks join together to advance funds to a particular borrower on identical terms and pursuant to a single loan agreement. Legally speaking, each lender has made a separate loan. Each member of the lending syndicate is only responsible for its own loan commitment. Syndicated loans have a centralized management and decision-making structure but the role of the agent bank is merely ministerial. Any decision-making by a majority or qualified majority of lenders with binding effect on all lenders has to be expressly provided for in the agreement.

2. INTERCREDITOR RELATIONS DURING A RESTRUCTURING

If the borrower becomes unable to service the loan, it is in the mutual interest of both the borrowers and the lenders that all lenders join the restructuring negotiations and that no lender resort to an individual legal action. The question arises whether an individual lender is restricted from enforcing its rights during a restructuring process by any legal rules other than the explicit rules of the loan agreement. The following cases have been decided by U.S. courts:

(a) Credit Français International, S.A. v. Sociedad Financiera de Comercio, C.A.

The court found an implied obligation of individual lenders not to commence legal action against a borrower when other banks had decided to refrain from such measures, because the lenders form a joint venture. This decision which was not followed by other courts was probably the result of a rather badly drafted loan agreement.

(b) A.I. Credit Corp. v. The Government of Jamaica

A single lender brought suit to recover amounts due to it under a restructuring agreement, even though virtually all other signatories to the agreement had accepted a further rescheduling of principal amounts falling due under the restructuring agreement. The court granted plaintiff's motion for a summary judgement on the ground that the Jamaican restructuring agreement unambiguously gave individual banks the right to sue individually for amounts then due.

(c) Allied Bank International v. Banco Credito Agricola de Cartago

The debtor, the Government of Costa Rica, had not engaged in restructuring negotiations but had unilaterally repudiated payment on loans of certain state-owned banks. While the action was still pending before the district court, the parties began to negotiate a rescheduling of debt and later signed a rescheduling agreement which plaintiff alone did not accept. The Court of Appeals held for plaintiff lender. It held that neither Costa Rica's unilateral restructuring of private obligations nor an agreement of the parties to renegotiate the loan agreement renders the underlying obligations unenforceable.

(d) CIBC Bank and Trust Company (Cayman) Ltd v. Banco Central do Brasil

Brazil had become unable to make regular payments under a 1988 restructuring agreement and the parties (other than the plaintiff) had embarked on a new round of restructuring negotiations which resulted in a new agreement of 1992. Plaintiff sought payment of accrued and unpaid interest under the 1988 agreement and acceleration of the entire principal amount owed. Plaintiff did not have the required majority of outstanding debt to accelerate and the other creditor blocked acceleration. Plaintiff sought to have debt held by the other creditor disregarded because the other creditor was controlled by the debtor, but the court refused to go beyond the unambiguous terms of the agreement and also rejected the argument that the borrower had breached an implied covenant of good faith and fair dealing by blocking plaintiff from accelerating.

(e) New Bank of New England, N A v. Toronto Dominion Bank

This was an action by a minority lender under a syndicated loan agreement to compel the majority lender to exercise the remedy of accelerating a defaulted loan. The court held that the terms of the loan agreement gave the majority of lenders discretion whether or not to accelerate and that the terms of the agreement precluded the minority lender from compelling the majority lenders to accelerate and foreclose. The court refused to rewrite the unambiguous agreement by including implied obligations of the majority.

These decisions reveal that U.S. courts strictly enforce the provisions of the loan agreements and do not find implied rules which would take away the minority lender's right to enforce its claim in court or obligate the majority lender to abstain from exercising their contractual rights to accelerate or to refuse to accelerate. *Credit Français* must be seen as a singular decision based on uncommon circumstances.

3. RELATIONSHIP BETWEEN LENDERS AS A GROUP AND BORROWER DURING A RESTRUCTURING

The question has been raised whether a restructuring has an effect on the legal relationship between the lenders as a group and the borrower.

Pravin Bankers Associates, Ltd. v. Banco Popular del Peru

The court stayed plaintiff's action seeking payment of principal and interest owed by a Peruvian bank for a period of eight months. The Peruvian bank was being liquidated and the decision is partly based on the accepted notion that a U.S. court should recognize foreign bankruptcy proceedings. However, the court also stated that a stay was necessary to permit lenders and borrower to restructure the loan without the threat of enforcement actions by individual lenders and that U.S. policy encouraged restructuring negotiations.

After an eight month stay (which in effect amounted to an 18 month delay) the court revisited the tension between the rights of a minority creditor to enforce its rights under the contract and the interests of the majority creditors and the borrower in having an orderly restructuring process. Balancing the relevant interests with special regard to the responsibility of New York as one of the foremost commercial centers of the world, the court decided to grant plaintiff's motion for summary judgement and held that enforcement of the terms of the credit agreement comported with United States policy.

4. CONCLUSION

(a) In connection with restructuring syndicated loans the terms of the loan agreement governs and will be strictly enforced. One basic right of a creditor is to enforce its claim

(b) The courts have not read implied terms into credit agreements which would facilitate the restructuring process, either by increasing the right of a minority lender or decreasing the rights of the majority lenders or by modifying the rights of the lenders as a group.

(c) In a recent case, however, the court stayed enforcement procedures for a period of time in order to give the lenders and the debtor the opportunity to restructure the loan. This stay had a similar function as the automatic stay imposed by bankruptcy laws. At the end of the period, the basic right of a lender to enforce his claim prevailed

(d) All above decisions (except for the *Credit Français* case) were rendered by one court, the U.S. District court for the Southern District of New York.

**Arbitration and Dispute Settlement Clauses Used by Development
Banks and Other International Financial Agencies**

Mads Andenas
London

Conference
Non-Judicial Dispute Settlement in International Financial Transactions

Cologne, March 22-23, 1999

DISPUTE RESOLUTION IN STRUCTURED FINANCE

**Arbitration and Other Dispute Settlement
in Project Financing**

Julian D M Lew
London

Conference
Non-Judicial Dispute Settlement in International Financial Transactions

Law Centre for European and International Cooperation (R.I.Z.)

Cologne, March 22-23, 1999

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Professional expertise

- International commercial transactions affecting investments, distribution, agency, licensing and construction contracts, international trade finance, trading arrangements with developing countries, Eastern Europe, EC law and arbitration arising out of all such transactions.
- Involved with international commercial arbitration for more than 25 years. Particularly advises on arbitration matters, acting as counsel and as an arbitrator.
- Has been involved with many kinds of arbitration proceedings including under the ICC, LCIA, AAA and UNCITRAL Arbitration Rules. Has acted as a co-arbitrator, single/sole arbitrator and chairman of tribunals in various kinds of arbitration.

Panel of Arbitrators

- American Arbitration Association
- Australian Centre of International Commercial Arbitration (Melbourne)
- Bahrain: GCC Commercial Arbitration Centre
- British Columbia International Commercial Arbitration (Vancouver)
- Cairo Regional Centre for International Commercial Arbitration
- The Chartered Institute of Arbitrators
- Dubai Chamber of Commerce
- Hong Kong International Arbitration Centre
- Arbitral Centre of the Federal Economic Chamber, Vienna
- Arbitration Court attached to the Economic Chamber of the Czech Republic and Agricultural Chamber of the Czech Republic

Academic positions

1986 to date	Head, School of International Arbitration, Centre for Commercial Law Studies, Queen Mary and Westfield College, University of London
1984 to 1986	Senior Visiting Fellow, Centre for Commercial Law Studies, Queen Mary and Westfield College, University of London

Professional qualifications

1976 to 1979	Associate Professor of Law, University of Namur
1970	Barrister-at-law, Middle Temple (resigned 1984)
1981	Solicitor of the Supreme Court
1985	Attorney-at-law, State of New York

Other qualifications

1976	Fellow, Chartered Institute of Arbitrators
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Miscellaneous activities

- Director, London Court of International Arbitration
- Corresponding member, ICC Institute of International Business Law and Practice
- Chairman, Working Party on Intellectual Property Disputes and Arbitration of the International Chamber of Commerce, Commission on International Commercial Arbitration
- Chairman, Arbitration Practice Sub-committee of the Arbitration Committee of The Chartered Institute of Arbitrators
- Member, Arbitration Committee of The Chartered Institute of Arbitrators
- Chairman, Committee on Arbitrability of Intellectual Property Disputes (Committee Q 106) of the International Association for the Protection of Intellectual Property (AIPPI)
- Chairman, Working Group on Law Reform 1991-95, The Chartered Institute of Arbitrators

Professional membership

- British Institute of International and Comparative Law
- London Court of International Arbitration
- The Chartered Institute of Arbitrators
- American Society of International Law
- International Bar Association
- Swiss Arbitration Association
- French Arbitration Committee

Education

- | | |
|-----------|---|
| 1969 | LLB (Hons) University of London |
| 1970-1971 | Academy of International Law, The Hague |
| 1974 | Visiting research scholar, Max Planck Institut fur Ausländisches und Internationales Privatrecht, Hamburg |
| 1977 | Doctorat special en droit international-Catholic University of Louvain, Belgium (Magna cum Laude) |

Languages

- | | |
|----------|---------------------|
| English: | Mother tongue |
| French: | Very good knowledge |

Publications

Books and articles on the law governing international commercial arbitration, East-West trade, EC and international trade law, including.

- *Applicable Law in International Commercial Arbitration* 1978, Oceana, Dobbs Ferry, New York
- *International Trade: Law and Practice* editor, 1985, 2nd edition, 1990, Euromoney, London
- *Contemporary Problems in International Commercial Arbitration* editor, 1985, Kluwer/CCLS, London
- *The Immunity of Arbitrators* editor, 1990, Lloyds of London Press, London
- *Enforcement of Foreign Judgements* co-editor (with Louis Garb), 1994, Kluwer Law and Taxation Publishers
- „Interest on Money Awards in International Arbitration in *Making Commercial Law - Essays in Honour of Roy Goode* editor in Ross Cranston, Clarendon Press, Oxford 1997
- „Determination of Applicable Substantive Law“ in *International Business Law*, Vol 25, No 4, April 1997, pp 157-160.
- *Contemporary International Law Issues: New Forms New Applications*, contributor, „Party Autonomy and the Application of Mandatory Public Law in Arbitration“. 1997 Hague joint Conference of the American Society of International Law, T.M.C. Asser Instituut, The Hague, 1998
- *Final Report on Intellectual Property Disputes and Arbitration*. ICC Commission on International Arbitration. The ICC International Court of Arbitration Bulletin, Vol. 9, No 1, May 1998
- „Arbitration in England and under English Law“ in *Arbitragem Comercial Internacional*, editor, Adriana Noemi Pucci, Editora LTR, Sao Paulo, 1998

Conference on
“Non-judicial dispute settlement
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**ARBITRATION
and
OTHER DISPUTE SETTLEMENT
IN PROJECT FINANCING**

by

Dr Julian D M Lew¹

Introduction

When drafting or assessing the worth of dispute resolution clauses in any contract, the starting point of course must be the question what are the potential disputes? Once these are identified, further questions arise. What is or are the most appropriate mechanisms(s) for dispute resolution between these parties? Should processes of mediation or conciliation be adopted? Ad hoc or institutional arbitration? Or are the parties content to rely on state courts? If arbitration is chosen in what forum will the supervisory jurisdiction be? Choice of law must not be ignored when examining a dispute resolution clause. The combined effect of dispute resolution and choice of law clauses determines the extent of the parties legal leverage on the dispute resolution procedure²

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² Wolfgang Peter: 'Arbitration and Renegotiation of International Investment Agreements' (1986) at page 118

In project finance, the factors influencing the decision about suitability of methods of dispute resolution change depending on the "stage" of financing.

Disputes are likely to arise, but their nature will change throughout the life of a long-term financing of a large project. At some points there will be a need for resolution. At others, either or both parties will be concerned only with security and enforcement of rights.

Entering into any process of resolution of issues between the parties as part of their ongoing commercial relationship will, at that stage, be irrelevant.

The question which must therefore be asked of any choice of dispute resolution procedure is: does this choice meet the needs of the relative position(s) of the parties at any given time throughout the life of the project? Some flexibility, or at least some thought with regard to dispute resolution must be imported into the deal.

This paper looks at the different stages of a typical financing of a project and analyses at each stage the relative worth and use of arbitration or other dispute resolution mechanisms available to the parties³.

The stages of project finance

Financial analysis, risk analysis and project analysis of the whole project will be considered in the drafting of the loan and credit agreements. Often it is impossible to divorce financing from the nature and purpose of the project itself. The services or products to be supplied or built may be inextricably linked to the service of the debt. Modern forms of external financing of projects include not only loan financing via bank credits granted by private or public banks and/or financial institutions, but also may be combined or indeed exclusively financed by suppliers' credit and export finance, consumer advances or 100% assignment of all revenue to be earned from the project.

The various levels of financing employed by the designers of the project's finance(s) will be dictated by the nature of project itself, viewed in its entirety, i.e. what is to be built, where and who will be involved? In international financing of large projects "who" and "where" become extremely important.

³ I have oversimplified a typical financing in order to provide the reader with an overall idea of the structure of finance from the concern of dispute resolution.

The aim of complex financial networks is to spread the risk, thereby reducing the risk of contract change, regardless of when this change occurs or the many possible or unforeseeable causes of such change. This is the key objective of both borrower and lender throughout all stages of a financing.

The stages of a project, and its financing, can be separated into three main phases:

- (a) The construction phase (completion risk);
- (b) The test or start-up phase ("Will it work?" risk);
- (c) The operation phase (market risk).

The parties involved in the finance may change at each stage and in any event key elements of the contractual relationship will differ⁴.

The lender's position

Traditionally, creditors have understandably favoured litigation before the courts of the creditor's choice. When entering into such agreements, part of the lender's security has been the prior knowledge of the decision-making authority and possible ruling over any disputes arising out of the credit agreement⁵. This has been particularly relevant in agreements between lenders in the Western, developed countries, and borrowers coming from the developing and Third World countries. The lenders have been able to specify the terms of the loan and the dispute settlement provisions. Traditionally, borrowers have had little or no bargaining power. However, certainly with regard to international project finance, the role of international arbitration as a method of dispute resolution is gaining ground⁶. Increasingly, even parties from the developed world have seen the very clear advantage of arbitration to determine the parties' respective rights in these complex, multiparty transnational

⁴ See Nevitt and Fabozzi "Project Finance": Euromoney 6th Edition (1995) Chapter 2: "Criteria for a Successful Project Financing". Also, Wolfgang Peter, *supra* n. 1 at page 249.

⁵ William Park: "Arbitration in Banking and Finance", *Review of Banking Law*, 17 (1998) 213 at page 215; See also Philip Wood: "Project Finance, Sub-ordinated Debt and State Loans" (1995), for the traditionally held view which appears at 12.8, page 101, that "Arbitration is almost never accepted by commercial banks, and has only been allowed by international development agencies, such as the World Bank, and in a few exceptional cases where the State's constitution prohibited this submission to the foreign forum, e.g. Brazil"; See also Philip Wood: "International Loans, Bonds and Securities Regulation" (1995), at 5.57 - 5.62 for a discussion of arbitration as a method of settling disputes by commercial financiers (pages 85-87).

arrangements. Whatever dispute resolution mechanism is chosen, it must work. It is my firm view that any dispute resolution procedure must be suitable and above all practicable in terms of the needs of the parties in every specific case. This should always be the overriding consideration when applying the key factors of choice of dispute resolution to each stage of the international financing of a large project.

Key factors and considerations

The nature and interests of those financing a project or servicing the debt changes throughout each stage. Key factors which apply to each stage of financing when considering dispute resolution are as follows:

- (i) speed and cost;
- (ii) finality;
- (iii) confidentiality;
- (iv) flexibility of procedure;
- (v) expert knowledge/commercial approach/decision *ex aquo et bono*;
- (vi) enforcement;
- (vii) arbitrations in default/non-participation by one or more parties.

Other global factors include the international nature of financing, the frequent involvement of states as parties, and the varying forms of public debt supporting the financing. Also, the number of parties involved creates an additional complexity.

Before any financing of the project is agreed, the prudent lender or consortium of lenders will have scrutinised and tested the feasibility studies and projections for the servicing of the debt. At this stage proposed underlying contracts between the project vehicle, the suppliers, the sub-contractors, and those granting any concessions will have been assessed by the legal advisers to the lender(s) with traditionally one thought in mind, i.e. "security". However,

⁶ For the history and growth in importance of arbitration in international finance see Ruiz del Rio: "Arbitration Clauses in International Loans" 4 (No. 3) *J. of Int'l Arb.* 45 (1987).

security is not the only, though it still remains a primary, consideration of lenders in the new generation of project financing developed during the 1990s⁷.

New trends have developed concerning the type, location and scale of projects. Sponsorship of projects, which had hitherto been the domain of governments, are now increasingly backed by private funds. This has influenced enormously the legal framework of projects and their finances. Concerns such as "lender liability", particularly in the context of environmental law, development of take and/or pay mechanisms for the financing of new industrial utilities programmes and the development of concepts of build, operate and transfer, have meant that the traditional lender in project finance today may be more closely involved in the development of the project at each stage, albeit that the servicing of the debt is still dependent upon the success of the project itself. When things go wrong in modern financing, the lender will often find itself with many choices other than the simple choice of enforcement, cutting its losses and getting out. Its link to the development and management of the project may force a lender to take a more gradualistic approach to dispute resolution within its loan documentation.

There are many examples of the alternative dispute resolution methods employed in construction projects. Typically, any large construction project, domestic or international, will involve several parties. The gradualistic approach to dispute resolution has been employed in the construction industry for many years. The enforceability of contractual arrangements for alternative forms of dispute resolution is now, certainly under English law, beyond doubt⁸. The most common methods employed and relevant to project financing include:

- conciliation (use a neutral go-between to aid resolution);
- mediation (a decision is made on terms by a neutral mediator who employs investigative skills during the dispute resolution procedure);

⁷ Roger McCormack: "Project Finance - Legal Aspects", at page 171, in T H Donaldson (ed): "Project Lending" (1992).

⁸ *Channel Tunnel Group Limited -v- Balfour Beatty Construction Limited & Ors* (1993) 2 WLR 262: The House of Lords confirmed that the English Courts would support and enforce clauses providing for dispute resolution procedures other than formal arbitration. Here there was a two-stage procedure for the resolution of disputes. The first stage was a Panel of Experts. The second stage was to be reached in certain circumstances only, when the dispute would be referred to arbitration under the ICC Rules.

- mini-trial (hearing before a panel consisting of a neutral third party and senior executives of all the parties);
- dispute review boards (often cited as one of the most useful alternative dispute resolution techniques in projects, particularly where, at the beginning of a project, the parties select the review board(s) who will be experts in various aspects of the projects)⁹.

From a lender's point of view, the selection of alternative forms of dispute resolution will primarily be assessed in terms of risk where the long-term benefits of alternative dispute resolution at the stage the dispute arises outweighs enforcement. The lender's concern will more often than not, extend not only to ensuring that a lender can take effective security over contracts in the event of default, but also that the key contracts of the project remain in place in one form or another if and when the lender enforces its security¹⁰.

Other forms of dispute resolution will often have to be employed by lenders before enforcement takes place¹¹. The nature of a lender's security will often call for a re-examination of the traditional approach to enforcement. Credit agreements may be of limited recourse or security could take the form of direct agreements where the lender steps into the project company's shoes on default. Lender security in any event may be accompanied by various degrees of management rights over the project. In this context it is extremely difficult for the lender to hive off disputes about financing from the nature of the project itself.

The single hope of the lender when entering any project financing is that the project itself will service the debt. Thus, financial difficulties will, in 99% of cases, stem from either the project or the parties involved in the project. Enforcement where lenders have direct agreement will often be more risky and involve further increased personal liability for the

⁹ For use of experts and their binding influence on the contractual rights of the parties under English law see *Jones -v- Sherwood Computer Services Plc* (1992) 1 WLR 277 and *Nikko Hotels (UK) Limited -v- MEPC Plc* (1990) 28 EG 86.

¹⁰ Vinter: "Project Finance" (1998) 2nd Ed. at 4.4, page 103.

¹¹ The long-term interest is one of the reasons quoted as to why the arbitration provisions contained within World Bank loan documentation have not, as yet, been utilised in a single case. The World Bank employs its own internal resolution procedure to solve disputes before the parties have to resort to arbitration. See generally Augenblick & Ridgway: "Dispute Resolution in World Financial Institutions", 10 (No. 1) J of Int'l Arb. 73. (1993).

lenders (the lender liability factor) than if a lender entered into a process of alternative dispute resolution whilst not in the shoes of the project company. The lender liability factor is becoming increasingly important as a result of the use of direct agreements and/or management rights. This is particularly the case with regard to environmental liability which is often strict, expensive to insure and extremely high risk, often involving unlimited liability. A major concern for banks is the risk of becoming liable for environmental damage if they enforce their security or otherwise take over the running of the project (by virtue of becoming the occupier or manager)¹². One cannot simply look at the traditional default provisions in the credit agreements or loan agreements which in all cases of long-term investment will no doubt be accompanied by acceleration provisions where, in the event of default, the lender can immediately declare the loan due and payable.

Dispute resolution and financial risk during the construction phase

The risk of the lender during the construction phase of any project reaches a peak upon completion. During this phase there will often be no sales collateral and therefore no service of the debt. The lender's security will take the form of extensive guarantees covering inevitabilities like cost overrun. There may be some debt service of the loan and such service will be guaranteed along with guarantees regarding maintenance of current assets during any period of project non-activity. As the key players during this phase of the financing will be the project vehicle entity, any guarantors and the lender(s), the dispute resolution procedure(s) will have to reflect the relative status of the players at this stage and their interests.

The role of the guarantor during this phase, particularly in international financing of large projects wholly or partly is crucial. Often in the new era of privatisation of utilities, the project company will be wholly or partly privately owned, but in many cases the guarantees for the project will be supplied by the state or state entities. The guarantors may have direct obligations similar to direct agreements between the lender and the project company and will therefore have some leverage in participating in any procedures and resolving disputes arising regarding the financing during the construction phase.

It is during this phase of the financing that there is the most scope for the utilisation of

¹² For a detailed description of environmental liability in project finance see Chapter 9, Vinter, *supra* n.8.

alternative forms of dispute resolution, particularly with regard to renegotiation of the debt. The lender will have preserved its traditional rights regarding enforcement under the loan agreement, probably choosing its own law for those agreements and possibly its own courts or at least its chosen courts, for the purposes of enforcement. However, enforcement - the cut and run option - may not be in the lender's best long-term interests and extreme options such as acceleration and appointment of workout vehicles under the direct agreements to complete the project or sell it off by part may not be the cheapest and certainly the least hassle-free solution for the big institutional lender.

First, there is much to be said for writing into international loan agreements mechanisms for obligatory conciliation and mediation when looking at possible renegotiations of the strict legal terms of the loan contracts. An experienced mediator in this field would be able not only to examine the strategic rights of the parties, but would also be able, with the assistance of experts to advise where necessary, to comment on and give sensible directions as to the parties' best and worse cases and suggested terms of ways forward. Where there are guarantors, these entities should be brought into the contract arrangements for dispute resolution and again their interests assessed during any period of mediation.

Where the underlying reasons for the payment or delayed payment appear to be entwined with the project itself, the degree of management responsibility given to the lender in the loan agreements becomes of even greater significance. Careful consideration should be given to the use of expert panels for the reference of certain issues regarding disputes, for example, as to the interpretation of the nature of the technical advances made in the project. Such a mechanism would be particularly useful to the borrower, fearful that the lender will exercise management powers on an uninformed basis. The reference of technical matters to an expert panel to determine certain issues arising between the lender as manager, and the project company, will only serve to benefit the project where the accompanying procedures are speedy and flexible. The use of staged interim awards in an arbitral procedure on specific technical issues can be of enormous benefit to the ongoing success of the project. The ability of experienced arbitrators to "hive off" issues and timetable their resolution, with binding effect, is a mechanism being used more and more.

Speed, cost and flexibility will be driving influences on the choice and design of any contractual arrangement designed to prevent any enforcement in the event of default during

construction. Above all the project must not be delayed. Nonetheless, drafting consideration should be given to whether or not the lender or indeed the borrower is happy to place all disputes under the auspices of a first step conciliation/mediation contractual arrangement. It may be that the lender will want to preserve the immediate route to arbitration or litigation for certain disputes arising out of, for example, the collapse of the project company. Further, with regard to effective management by the lender, there may be rights and remedies which the lender will want to enforce through more traditional routes. Where the lender is potentially exposed under direct agreement(s) it will be important for the lender to preserve, throughout the construction period, rights of access to site documentation and records in order to be able to properly defend third party claims at some distant time in the future. The remedies under local law for the provision and preservation of the relevant documentation may serve the lender better than enforcement of an arbitration award.

Dispute resolution and financial risk during the start-up/testing phase

A major issue in every project is whether it will succeed. That is the real risk for all involved. At the beginning of this phase the risks of the lender are extremely high. It may be that the lender has loaned an enormous amount of money to finance a project which in fact does not or may never work. Unlike the construction phase, where an over-riding concern of all parties will in most circumstances be the resolution of any dispute to further the continuance of the project, during this stage the lender is increasingly in a position where its overriding consideration will be enforcement.

Nonetheless, there may still be a role for expert review panels to determine key issues with regard to technology and possible ways forward flowing from the findings of independent or party experts. Any procedure adopted with regard to such panels must be quick. It is therefore not surprising that in large projects it is now becoming increasingly common to set out procedure using expert review panels to determine off-spec. disputes arising out of the building. Consumer confidence is an extremely important factor during the near completion and completion of large projects, particularly where any financing through sales contracts is on the basis of take and pay rather than take or pay contracts. So confidentiality of any dispute resolution procedure will be a key factor. This is one major advantage, of course, of

arbitration over litigation which at least sets out to be confidential from the very beginning of the issuing of notices¹³.

Dispute resolution and financial risk during the operational phase

During the operational phase the risk for the lender will have reduced considerably. The project is presumably working and the debt being serviced. Any disputes regarding the service of the debt under the loan agreement typically will fall into the more traditional pattern, now that the status and position of the parties is relatively simple. Further, the guarantor as a factor in any dispute resolution, may have fallen away. However, because of the complex nature of financing, in order to mitigate risk, there may still be special considerations with regard to the position of the lender that ought to be considered when assessing the most suitable and practical form of dispute resolution.

In an international financing there may be international sales. Where there are international sales there will be international parties and variance of currency. Enforcement of debt servicing may involve, depending on the actual contractual rights of any lender, enforcement against the consumers of the project, products or services under any assignment that may be part of the lender's security or bank accounts containing international sales revenue from take and/or pay contracts. In this regard, serious thought must be given to a transnational solution. The obvious answer would seem to be to consider the transportability of arbitration awards over international judgments. Another factor which may influence the choice of dispute resolution favouring arbitration over litigation during this phase may be the participation of the debtor(s) on the international level.

Global issues regarding enforcement in international project finance: arbitration or litigation?

More than any other factor, particularly for international projects, enforcement is the main reason to favour arbitration rather than litigation¹⁴. Where the project is involved in international trade in order to service the debt, the lender may in any event find itself a party

¹³ See generally on confidentiality in arbitration: Patrick Neill QC "Confidentiality in Arbitration", Vol. 12(3), 287 *Arbitration International* (1996).

¹⁴ See William, *supra* n.3 at pages 217-219; Ruiz del Rio, *supra* n.4 at page 51; Otto Sandrock: "Is International Arbitration Inept to Solve Disputes Arising Out of International Loan Agreements", 11 (No. 3) *J. of Int'l Arb.* 33 (1994) at page 57.

by assignment of any take and/or pay contracts to arbitration clauses. In the financial agreements themselves, there is a lot to be said for choosing an international arbitration institution familiar with issues concerning international finance and enforcement. Institutions such as the ICC have been involved for many years in the development of international trade terms including sales applicable to the financing of international trade. It is no surprise therefore that arbitrators appointed to their panels will have expertise in determining and unravelling the various forms of enforcement rights available to lenders under complex international financial agreements. This is of particular importance where the financing of the project is essentially dependant on sales.

Any arbitration award must not only be enforceable within the forum state of the debtor (i.e. the project company) against its assets but also, particularly during the early years of the debt servicing, against the assets that will be servicing the debt (for example, the revenue rights to an international sales contract). In this regard, preservation of assets and other interim measures available on the international level through arbitration may prove to be more "transportable" and internationally recognised than forum shopping for such measures before national courts.

Unlike arbitration, court judgments do not benefit from the equivalent of the New York Convention. Further, although a high degree of care must be taken when obtaining arbitration awards in default, they are still an enforceable option in many states. In large projects where the debtor may be a consortium of various parties, starting arbitrations and completing them may prove to be easier than multi-forum or indeed single-forum but multi-party litigation. Here, the time it can take to appoint a tribunal has often been heralded as a major reason why litigation is preferable to arbitration. One solution may be the prior appointment of panels with the requisite expertise and knowledge. Special provision could be made for where an arbitrator, appointed for some time in the future, turns out to be conflicted or has had an unacceptable degree of prior contact with a party.

The involvement of states in project finance

A common feature of international project finance is the involvement of the state of the forum in the project. There may be state sponsorship of the project vehicle or direct participation in a joint venture. Further, where there will be an identifiable state benefit, for example in the building of a power station, it is most often expected that the state, through the organs of its

central bank or other entity set up specially for the enterprise, will act as guarantor of the project. The role of the sovereign state as either a participant in the project vehicle or as a guarantor of the project cannot be ignored in any dispute resolution procedure. Here, arbitration will have certain advantages over litigation in national courts.

On the face of it, arbitration can be made "state neutral". The place of the arbitration could be in a country neutral to all parties. Moreover, in the forum state of enforcement of any award, the sovereign holder of those assets will often be denied immunity. The same loss of immunity before the courts concerning issues related to arbitration may well apply in the chosen supervisory jurisdiction¹⁵.

In providing for arbitration where the seat is in a third state, the parties have gone some way towards "internationalising" their dispute. The chosen method for appointment of the tribunal should also be reviewed by the parties wishing to distance the decision making authority from the sovereign identity of the parties involved in the dispute. Often the chairman of a panel of three will be selected from a neutral state and in fact many of the arbitration provisions of the global institutions provide for this situation¹⁶.

In addition, the parties, in making the contracts as international as possible, may have chosen the proper law of a third state. The exercise of this choice of law would have been influenced by the relative dominant positions of the parties, with the lender preferring its own proper law. However, in the event that no proper law has been chosen, institutional rules aimed specifically at disputes where one of the parties to an investment contract is a state can provide an answer. Article 42(1) of the ICSID Rules provides that the tribunal shall decide a dispute in accordance with such rules of law as may be agreed by the parties. In the absence of such agreement, the tribunal shall apply the laws of the contracting state party to the

¹⁵ Section 9 of the State Immunity Act 1978, reflects the European Convention on State Immunity of 1972. Article 12 of the Convention provides that where a state agreed in writing to submit the dispute to arbitration it is not immune in respect of proceedings which relate to that arbitration. Note this exception to state immunity does not apply to arbitration agreements between two or more states - section 9(2) of the 1978 Act; See for useful overview of sovereign immunity generally in this context:- Philip Wood: "Project Finance, Sub-Ordinated Debt and State Loans", Chapter 13 at page 103; See also Nigel Rawding: "Protecting Investment Under State Contracts: Some Legal and Ethical Issues", *Arbitration International* Vol. 11(4) (1995) at page 241. Although case law is not consistent, it is fair to put forward a proposition that a waiver of immunity will be effective in most forums. See William Park, *supra* n. 3 at pages 226-227.

¹⁶ See arbitration provisions in the European Bank for Reconstruction and Development loans - ad hoc arbitration provision provides for 3 arbitrators. In default of appointment, the appointing authority is the President of the ICJ. See generally Augenblick & Ridgway, *supra* n.9 at page 75.

dispute (including its rules on the conflicts of laws) and such rules of international law that may be applicable. The ability of international arbitrators to apply international law, internationally generally recognised principles of law or *lex mercatoria* or law which is divorced from any national forum i.e. of a transnational character, is an expertise which carries value in the resolution of disputes between parties where at least one of the parties is either a state or a multi-national corporation¹⁷.

Multi-party issues

It would be wrong to consider dispute resolution and arbitration of project finance disputes without looking at the multi-party aspects of such disputes where they arise. Joinder provisions, subrogated rights and assignment may all give rise to complex, multi-party and multiple arbitrations requiring consideration of effective consolidation.

There are five key issues with regard to international multi-party arbitrations all which must be overcome with an eye both on practicality and fairness. The first is the selection of the applicable law. As mentioned above, this may solely depend on which of the parties is in the most dominant position, most commonly the lender. Secondly, the place of arbitration. This should not automatically be assumed to be the lender's forum state. Thought must be given not only to the independence and neutrality of the place of the arbitration, but also the powers of the supervisory jurisdiction over an arbitration which may be multi-party and involve states. Thirdly, language is often overlooked in the drafting of multi-party arbitration clauses but is of paramount importance where speed of resolution is a key factor. It is not practical or sensible to have a tribunal where translations are needed constantly of either the arbitral proceedings or the core documentation. There is a substantial amount of time to be lost, legal costs to be had and risks involved in proceeding with an arbitration in a different language to the core documents upon which the parties rely. Fourthly, an arbitral institution chosen by the parties must be able to cope with multi-party disputes, not only its rules but also its administration. Fifthly, and in some ways most importantly, the clause or the institutional rules must make provision for appointment of arbitrators with preservation of the rule of procedural equality.

¹⁷ Some knowledge of public international law may also be useful with regard to any Act of State defences put forward in the arbitration. Such knowledge is not guaranteed before state courts, whereas a panel can be chosen for their expertise.

To be able to consider the above key issues in drafting the multi-party clause may well prove to be a luxury. Interesting situations arise where arbitrations between the parties involved in projects are consolidated either by choice or by order. It is now possible in England and Wales to enforce an agreement of the parties to consolidate hearings or agree that concurrent hearings shall be held¹⁸. However, a question of validity arises where the multi-party arbitration agreements are subsequently "agreed to" by the parties. The involvement of third parties may be achieved through a provision in the loan documentation, such as the right of the guarantor to appoint an arbitrator or a co-arbitrator. This occurs in the case of World Bank loans where a co-arbitrator is appointed by the borrower and the guarantor or, if they cannot agree, by the guarantor alone. Such provisions must be considered carefully with a view to equality of parties in the procedure¹⁹.

Nonetheless, consolidated or concurrent proceedings are achievable in arbitration proceedings, particularly in large construction projects. The risk of separate awards or judgments being made which concern the same or similar issues being "passed down or indeed up the line" is mitigated. It is often quicker if all parties are aware of the dispute resolution procedures and are informed and equal. In theory this should also be more cost effective. Consolidated or concurrent hearings may be particularly useful where there are many parties spread over several jurisdictions all wishing, in the absence of any arbitration clause, to initiate suits on the basis of improperly drafted submissions to jurisdiction or mandatory submissions pursuant to local law. Obviously, in entering into any multi-party arbitration clause, consideration must be given to the potential loss of privacy and the effect this may have on commercial interests. This will apply equally to the lender's position on the financing and the contractor's position with regard to its sub-contractors.

An examination of the role of the national supervisory jurisdiction, (i.e. the *lex arbitri*), must also be made if the proposed multi-party arbitration clause is to contain a discretion to involve other parties or consolidate arbitrations. Composition of the arbitration tribunal or the nature of the arbitration procedure, whether in accordance with the agreement of the parties or

¹⁸ Section 35 of the Arbitration Act 1996.

¹⁹ See generally, *Siemens AG and BML Industriean Lagen GmbH -v- Duto Construction Co (Cour de Cassation Civ Div Jan 7 1992)* and commentary thereon, for example: Serge Gravel: "Multiparty Arbitration and Multiple Arbitrations", Vol. 7 No. 2 ICC Int'l Court of Arbitration Bulletin (1996) 45 at page 47.

alternatively the *lex arbitri*, may prove to be a ground for the refusal of the arbitration award under Article V(1)(d) of the New York Convention in the state of enforcement²⁰.

Conclusions

New trends in international project financing involving private and public parties has demanded an international response to dispute resolution. The natural choice for this response is arbitration, where enforcement of both final and interim measures can be guaranteed with more certainty than through the exportation from one state to another of national court judgments. This internationalisation requires adjudicator expertise in matters concerning transnational law and international business. In respect of dispute resolution of issues more relevant to the mechanisms of the project itself rather than its financing, specialist expertise has always been a well sought-after commodity. The use of expert panels, technical know-how mediators etc. during the construction phase of projects, where the lender's interests are heavily linked to the success of the project, through direct agreements and/or management control has gained established recognition over recent years.

The relative position(s) of the parties in any contract must be examined in any choice of a dispute resolution mechanism. This is particularly the case in project finance where the relative strength(s) and bargaining powers of the parties will alter throughout the phases of what is essentially a long-term commercial investment by all. Only good drafting and a firm but flexible approach to dispute resolution will be able to anticipate successful procedure to resolve all disputes that may arise in the life of a project. It is for this reason, if none other, that alternative forms of dispute resolution should be drafted into and used regularly in the contracts supporting the financing of these complex and often international arrangements.

Julian D M Lew
London, March 1999

²⁰ Isaak Dore in his book "Theory and Practice of Multi-Party Commercial Arbitration" (1990) suggests at pages 156-157 that a tactic the party wishing consolidation may utilise in order to induce others to join an arbitration, could be to stipulate that it will not raise an Article V(1)(d) challenge against the award; see also the operation of waiver provisions regarding procedural irregularity under Section 73 of the 1976 Arbitration Act.

A U.S. Perspective on Securities Arbitration

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Conference
Non-Judicial Dispute Settlement in International Financial Transactions

Law Centre for European and International Cooperation (R.I.Z)

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Conference on International Financial Dispute Resolution

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A U.S. PERSPECTIVE ON SECURITIES ARBITRATION

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1. INTRODUCTORY REMARKS

Nearly a decade has passed since the U.S. Supreme Court handed down its decision in *McMahon*,¹ upholding the validity of pre-dispute arbitration agreements under the Securities Exchange Act of 1934 between brokerage firms and their customers.² Shortly thereafter, the high court in *Rodriguez*³ gave its approbation to the validity of such agreements under the Securities Act of 1933.⁴

These decisions generated hurrahs from the brokerage industry⁵ and anguish from public investors (and, of course, their legal counsel).⁶ Arbitration between brokerage firms and their public customers, epitomized by the unsophisticated individual investor, was seen by many as stacked in the industry's favor.⁷ Indeed, this perception prevails today as evidenced by a relatively recent front-page Wall Street Journal article highlighting the pitfalls of arbitration for investors.⁸

This perception was (and continues) to be based on the apparent unfairness of the customer-broker arbitration process. Many brokerage firms compel their clients even in cash accounts, to execute arbitration agreements as a condition to doing business.⁹ The presence of

¹*Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220 (1987).

²15 U.S.C. ' 78a et seq. The Court in *McMahon* also upheld the validity of such pre-dispute arbitration provisions with respect to claims brought under the Racketeer Influenced and Corrupt Organizations Act (RICO). For further discussion, *see infra* notes ___ and accompanying text.

³*Rodriguez De Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477 (1989).

⁴15 U.S.C. ' 77a et seq. For further discussion, *see infra* notes ___ and accompanying text. *See generally* M. Cane & P. Shub, *Securities Arbitration: Law and Procedure* (1991); C.E. Fletcher, *Arbitrating Securities Disputes* (1992).

⁵*See, e.g.*, Bedell & Bosch, The Rodriguez Decision: A New Tradition in the Arbitration of Securities Disputes, 18 Sec. Reg. L.J. 53 (1990).

⁶*See, e.g.*, Arbitration: It's Mandatory But It Ain't Fair, 19 Sec. Reg. L.J. 181 (1991). *See also*, Brown, Shell & Tyson, Arbitration of Customer-Broker Disputes Under the Federal Securities Laws and RICO, 15 Sec. Reg. L.J. 3 (1987); Comment, Predispute Arbitration Agreements Between Brokers and Investors: The Extension of Wilko to Section 10(b) Claims, 46 Md. L. Rev. 339 (1987).

⁷*See, e.g.*, Gregory, *supra* note 6, at 184 (asserting that "arbitration as currently conducted by the NASD, NYSE or . . . AMEX is not fair"). *See also*, authorities cited *infra* notes 42-47.

⁸*See* Jacobs & Siconolfi, *Investors Fare Poorly Fighting Wall Street - and May Do Worse*, Wall St.J., Feb. 8, 1995, at A1 (stating that "arbitration has earned a reputation for being stacked squarely against brokerage-firm customers").

⁹*See* Fienberg & Yeo, *The NASD Securities Arbitration Report: A View from the Inside*, 10 Insights No. 10, at 7, 8 (April 1996) (stating that "[s]ince *McMahon*, broker-dealers

industry representatives as well as others who may favor brokerage firms (and their employees),¹⁰ the inconsistency in the quality of arbitrators,¹¹ the lack of a written decision justifying the award,¹² the near impossibility of persuading a court to overturn an arbitration decision under the "manifest disregard" standard,¹³ and the lack of investor success when pursuing seemingly meritorious claims¹⁴ all contribute to the belief that public investors receive callous treatment in this process.¹⁵

Nonetheless, mounting evidence shows that many investors emerge victorious from arbitration, even recovering punitive damages in appropriate cases.¹⁶ The lack of intensive

have required almost all individual investors who open margin or option accounts to sign a predispute arbitration agreement, and most broker-dealers require it for all customer accounts"). *See also*, Comment, *Arbitration Clauses in Consumer Contracts of Adhesion: Fair Play or Trap for the Weak and Unwary?* 21 J. Corp. L. 331 (1996).

¹⁰*See* Gregory, *supra* note 7, at 184-185. A majority of the arbitration panel must be comprised of public arbitrators. Generally, an industry arbitrator is an individual who:

1. Is currently associated with a broker dealer, municipal securities dealer or has been associated with on in the last three years;
2. Is retired, but continues to receive compensation from such an entity;
3. Has a spouse or other household member associated with a securities entity; or
4. Is a professional outside of the securities industry who has devoted 20% or more of his or her individual work effort to securities industry clients within the industry during the previous two years.

Securities Industry Conference on Arbitration (SICA), Uniform Code of Arbitration (UCA) ' 8(a)(2). *See* National Association of Securities Dealers, Inc. (NASD) Code of Arbitration Procedure ' 19(c)-(d).

¹¹*See* Report of the Arbitration Policy Task Force To the Board of Governors, National Association of Securities Dealers, Inc., [1995-1996 Transfer Binder] Fed. Sec. L. Rep. (CCH) & 85,735, at 87,475 (1996) (stating that "it is essential for the NASD to improve the overall quality, training, and effectiveness of NASD arbitrators").

¹²*See* NASD Arbitration Code, *supra* note 10, at ' 42. Accord, New York Stock Exchange Rule (NYSE) 627; American Stock Exchange Rule (AMEX) 618. For further discussion, *see infra* notes _____ and accompanying text.

¹³*See* M. Cane & P. Shub, *supra* note 4, at 336-338.

¹⁴*See* Jacobs & Siconolfi, *supra* note 8, at A1.

¹⁵*See generally* Poser, *When ADR Eclipses Litigation: The Brave New World of Securities Arbitration*, 59 Brook. L. Rev. 1095 (1993).

¹⁶*See, e.g.*, *Mastrobuano v. Shearson Lehman Hutton, Inc.*, 115 S.Ct. 1212 (1995) (holding that an arbitration clause containing a New York choice of law provision was not designed to incorporate that state's prohibition of punitive damages in arbitrations); *Seamons, Punitive Damages in Securities Arbitration: Jokers, Deuces, and One-Eyed Jaks Are Wild!* 21 Sec. Reg. L.J. 387 (1994) (stating that in securities arbitration "[p]unitive damages during 1992 were significant, ranging from \$250,000 to \$3.5 million"); Siconolfi, *Stock Investors Win*

pre-trial discovery (at least as compared to the court setting)¹⁷ and the more expeditious time frame in which arbitration proceeds may favor the public investor who cannot match the brokerage firm's litigation resources.¹⁸ Moreover, the inapplicability of strict pleading rules, along with the informality of the arbitration, may result in the arbitrators seeking to be "fair" whereas such claims may have been dismissed by a court on technical grounds.¹⁹

These reflections are particularly poignant in view of relatively recent federal court decisions, including in the Second Circuit,²⁰ that significantly restrict the viability of investors' claims.²¹ Enactment of The Private Securities Litigation Reform Act of 1995 (PSLRA)²² also spells "gloom" for uninitiated investors.²³ These developments portend that the availability of a federal court forum may be particularly unattractive to public investors today. Hence,

More Punitive Awards in Arbitration Cases, Wall St.J., June 11, 1990, at A1 (stating that "the clearest sign of trouble for Wall Street is a surge in punitive-damage awards").

¹⁷Historically, securities arbitration was "a model of informal, expeditious, and inexpensive dispute resolution." Task Force Report, *supra* note 11, at 87,433. Today, [t]he increasingly litigious nature of securities arbitration has gradually eroded [its] advantages [and there now is] concern that SRO arbitration has incorporated too many characteristics of civil litigation. . . ." *Id.* Nonetheless, the Task Force "believe[s] it is essential that securities arbitration continue to provide clear and significant advantages over the civil litigation system it has replaced." *Id.*

¹⁸See Masucci, *Securities Arbitration - A Success Story: What Does the Future Hold?* 31 Wake Forest L. Rev 183, 188-189 (1996) (stating that during 1994 the average length of time a case took was 10.4 months, with the average hearing lasting 2.5 days, thereby prompting the author to assert "[t]hese are remarkable figures when compared to the time for resolution in crowded court dockets nationwide").

¹⁹See *infra* notes ___ and accompanying text. See also, Comment, *Arbitration in the Securities Field: Does the Present System of Arbitration Between Small Investors and Brokerage Firms Really Protect Anyone?* 21 J. Corp. L. 363, 369 (1996) (stating that qualitative analysis therein "denies the existence of bias in arbitration").

²⁰See, e.g., *Dodds v. Cigna Securities, Inc.*, 12 F.3d 346 (2d Cir. 1993) (interpreting 1934 Act ' 10(b) statute of limitations); *Brown v. E.F. Hutton Group, Inc.*, 991 F.2d 1020 (2d Cir. 1991) (construing plaintiff justifiable reliance requirement under ' 10(b)); *Wexner v. First Manhattan Co.*, 902 F.2d 169 (2d Cir. 1990) (interpreting Federal Rule of Civil Procedure 9(b) in context of ' 10(b) pleading requirements).

²¹See Steinberg, *The Ramifications of Recent U.S. Supreme Court Decisions on Federal and State Securities Regulation*, 70 Notre Dame L. Rev. 489 (1995).

²²See *Senate Overrides President's Veto; Securities Litigation Reform Bill Now Law*, 28 Sec. Reg. & L. Rep. (BNA) 3 (1996).

²³See Steinberg, *Litigation Reform Act Will Have Major Impact*, 24 Sec. Reg. L.J. 115 (1996).

investors may well be in a better position today bringing their claims in arbitration rather than in federal court.²⁴

Depending on the particular state, however, public investors are in a worse position after McMahon. In states such as California and Texas, whose statutes provide for broad relief,²⁵ investors lose a favorable forum to bring their grievances. On the other hand, in a state such as New York which declines to provide a private remedy for violation of its securities laws,²⁶ investors may well be content to proceed in arbitration.²⁷

This article will expand on the concepts set forth above. After discussing McMahon, Rodriguez and their aftermath, the article examines the arbitration process today. Thereafter, both the federal and state court forums will be analyzed from the perspective of the prospective investor-litigant. The article concludes by addressing whether investors in the brokerage firm setting are in a better (or worse) position by being relegated to arbitration rather than the courts.

II. A LOOK AT MCMAHON AND RODRIGUEZ

In *Shearson/American Express, Inc. v. McMahon*,²⁸ the Supreme Court held that predispute arbitration agreements between brokerage firms and their customers did not contravene the Exchange Act and the Racketeer Influenced and Corrupt Organizations Act (RICO). Hence, such claims ordinarily are arbitrable consistent with the terms of the applicable arbitration agreement. The following discussion focuses on the validity of such predispute arbitration agreements under the securities laws.

In McMahon, the Supreme Court relied in large part on the Federal Arbitration Act (FAA)²⁹ which establishes a "federal policy favoring arbitration."³⁰ This policy applies even when a claim is based on a federal statutory right. As a consequence, the burden is on the party opposing the validity of the arbitration agreement to show that Congress intended to preserve the availability of a judicial forum, irrespective of the terms of an arbitration agreement.³¹ Accordingly, to preclude application of the FAA, according to the Court, the

²⁴See *infra* notes ____ and accompanying text.

²⁵See Steinberg, *supra* note 21, at 509-516; discussion *infra* notes ____ and accompanying text.

²⁶See *CPC Int'l v. McKesson Corp.*, 514 N.E.2d 116 (N.Y. 1987).

²⁷See *infra* notes ____ and accompanying text.

²⁸482 U.S. 220 (1987). The discussion herein, notes 28-47, and accompanying text, is from my student reference text. M. Steinberg, *Understanding Securities Law* ____ (2d ed. 1996).

²⁹9 U.S.C. ' 1 et seq.

³⁰*Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, 460 U.S. 1, 24 (1983).

³¹482 U.S. at 227, *relying on*, *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614 (1985); *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213 (1985); *Scherk v. Alberto-Culber Co.*, 417 U.S. 506 (1974).

party seeking to avoid arbitration "must demonstrate that Congress intended to make an exception to the Arbitration Act for claims arising under . . . the Exchange Act, an intention discernible from the text, history, or purposes of the statute."³²

Upon examining Section 29(a) of the Exchange Act, which renders void any stipulation whereby a person waives compliance with any 1934 Act provision, the Court opined that Section 29(a) only proscribes waiver of the Exchange Act's substantive obligations. By contrast, Section 29(a) does not preclude parties from waiving a judicial forum in favor of an arbitral tribunal.³³

The Court's holding in *McMahon* takes a far different view of arbitration than its 1953 decision in *Wilko v. Swan*.³⁴ In holding that predispute arbitration agreements were not enforceable in actions brought pursuant to Section 12(2) of the Securities Act, the *Wilko* Court invoked the antiwaiver provision of the Securities Act, Section 14, which is Section 29(a)'s counterpart. Underlying the *Wilko* Court's holding was its hostility to the arbitration process. Succinctly put, the Court believed that arbitration would fail to protect the investor's substantive rights. As a consequence, a judicial forum was necessary to ensure that the statutory rights created by Section 12(2) would be adequately protected.³⁵

Although declining to overrule *Wilko* at that time,³⁶ the Supreme Court in *McMahon* asserted that, in view of the increased regulatory oversight of arbitration since *Wilko* was handed down, a party's 1934 Act substantive rights are not waived by enforcing a predispute arbitration agreement. Pursuant to the 1975 amendments to the 1934 Act, the SEC now "has broad authority to oversee and to regulate the rules adopted by the [self-regulatory organizations] relating to customer disputes, including the power to mandate the adoption of any rules it deems necessary to ensure that arbitration procedures adequately protect statutory rights."³⁷ Accordingly, the *McMahon* Court held:

We conclude, therefore, that Congress did not intend for ' 29(a) to bar enforcement of all predispute arbitration agreements. In this case, where the SEC has sufficient statutory authority to ensure that arbitration is adequate to vindicate Exchange Act rights, enforcement does not effect a waiver of "compliance with any provision" of the Exchange Act under ' 29(a).³⁸

³²482 U.S. at 227.

³³*Id.* at 228-38.

³⁴346 U.S. 427 (1953).

³⁵*Id.* at 432-37.

³⁶482 U.S. at 234 ("[S]tare decisis concerns may counsel against upsetting *Wilko*'s contrary compulsion under the Securities Act").

³⁷*Id.* at 233-34.

³⁸*Id.* at 238. But *see id.* at 252-68 (Blackmun, J., concurring in part and dissenting in part).

Subsequently, in *Rodriguez De Quijas v. Shearson/American Express, Inc.*,³⁹ the Supreme Court overruled *Wilko*. Holding that predispute agreements to arbitration claims under the Securities Act are enforceable, the court stated

[I]n *McMahon* the Court declined to read ' 29(a) of the Securities Exchange Act of 1934, the language of which is in every respect the same as that in ' 14 of the 1933 Act, to prohibit enforcement of predispute agreements to arbitrate. The Only conceivable distinction in this regard between the Securities Act and the Securities Exchange Act is that the former statute allows concurrent federal-state jurisdiction over causes of action and the latter statute provides for exclusive federal jurisdiction. But even if this distinction were thought to make any difference at all, it would suggest that arbitration agreements, which are "in effect, a specialized kind of forum-selection clause," . . . should not be prohibited under the Securities Act, since they, like the provision for concurrent jurisdiction, serve to advance the objective of allowing buyers of securities a broader right to select the forum for resolving disputes, whether it be judicial or otherwise. And in *McMahon* we explained at length why we rejected the *Wilko* Court's aversion to arbitration as a forum for resolving disputes over securities transactions, especially in light of the relatively recent expansion of the Securities and Exchange Commission's authority to oversee and to regulate those arbitration procedures. . . .⁴⁰

III. AFTERMATH OF McMAHON AND RODRIGUEZ

In the aftermath of *McMahon* and *Rodriguez*, many believed that securities arbitration favored the industry.⁴¹ As stated in a 1987 *New York Times* article, "The [brokerage] houses basically like the current system because they own the stacked deck."⁴² A

³⁹490 U.S. 477 (1989).

⁴⁰*Id.* at 482-83. Also, the Court in *Rodriguez* relied on the "strong language of the Arbitration Act" under which "the party opposing arbitration carries the burden of showing that Congress intended in a separate statute to preclude a waiver of judicial remedies, or that such a waiver of judicial remedies inherently conflicts with the underlying purposes of that other statute." *Id.* at 483.

Recently, the Supreme Court has decided a number of cases in the securities arbitration area. *See, e.g.*, *First Options of Chicago, Inc. v. Kaplan*, 115 S Ct. 1920 (1995) (holding that (1) issue of whether parties agreed to arbitrate a certain matter is a question for the court to decide and (2) standard that court of appeals should apply when reviewing district court decision confirming an arbitration award "should proceed like review of any other district court decision . . ., i.e., accepting findings of fact that are not 'clearly erroneous' but deciding questions of law de novo"); *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 115 S. Ct. 1212 (1995) (holding that award of punitive damages in arbitration proceeding not precluded by terms of broker firm-client agreement where agreement did not expressly refer to punitive damages and was ambiguous in this regard, resulting in such ambiguity being construed against the drafter of the agreement, the brokerage firm); authorities cited *supra* note 16.

⁴¹*See, e.g.*, Gregory, *supra* note 6, at 184-186.

⁴²Galbertson, *When the Investor Has a Gripe*, *New York Times*, March 29, 1987, at

1992 U.S. General Accounting Office Report on Securities Arbitration, however, does not agree: "GAO's analysis of statistical results of decisions in arbitration cases at both industry-sponsored and independent forums showed no indication of a pro-industry bias in decisions at industry-sponsored forums."⁴³ Nonetheless, as Professor Perry Wallace points out, "Given the prominence that securities arbitration enjoy[s], probing questions must be asked regarding the effectiveness [and] basic fairness of the procedures that effectuate it."⁴⁴

Even though not finding a pro-industry bias, the GAO report nonetheless was critical of the current process, stating that "GAO's review of arbitration procedures showed that arbitration forums lacked internal controls to provide a reasonable level of assurance regarding either the independence of the arbitrators or their competence in arbitrating disputes."⁴⁵ Needless to say, such lack of internal controls, as found by the GAO, bring into question the integrity of the arbitration process.

Fortunately, certain improvements have been made since 1987. For example, in cases involving public customers, an arbitration panel consists of a majority of public arbitrators. The new rules more rigorously define those who qualify as public arbitrators to exclude, for instance, securities industry retirees. Such individuals may serve only as industry arbitrators comprising a minority of the panel.⁴⁶ The rules also call for preservation of a record of the proceeding, disclosure to the parties of certain past or existing affiliations of the arbitrators that are likely to affect their impartiality, and providing in the statement of award the arbitrators' and parties' names, a summary of the relevant issues in controversy, the damages and/or other relief sought and awarded, a statement of any other issues resolved, and the signatures of the arbitrators who concurred in the award.⁴⁷

1, 8. A 1995 Wall Street Journal article reached a similar conclusion. See Jacobs & Siconofi, *supra* note 8, at A1.

⁴³General Accounting Office (GAO), Report on Securities Arbitration ____ (1992).

⁴⁴Wallace, *Securities Arbitration After McMahon, Rodriguez, and the New Rules: Can Investors' Rights Really Be Protected?* 43 Vand. L. Rev. 1199, 1202 (1990).

⁴⁵GAO Report, *supra* note 43, at ____.

⁴⁶See *supra* note 10; see also NASD Task Force Report, *supra* note 11, at 87,468-87,479.

⁴⁷See Securities Exchange Act Release No. 26805 (1989). See generally Fletcher, *Learning to Live with the Federal Arbitration Act - Securities Litigation in a Post-McMahon World*, 37 Emory L.J. 99 (1988); Frankhauser & Gardner, *An Up-to-Date Review of Judicial, Legislative, and Regulatory Developments in Arbitration with Financial Institutions*, 46 Wash. & Lee L. Rev. 583 (1989); Gregory & Schneider, *Securities Arbitration: A Need for Continued Reform*, 17 Nova L. Rev. 1223 (1993); Katsoris, *Securities Arbitration after McMahon*, 16 Fordham Urb. L.J. 361 (1987-1988); Poser, *supra* note 15. Shell, *Arbitration and Corporate Governance*, 67 N.C.L. Rev. 517 (1989); Wallace, *supra* note 44.

IV. ARBITRATION TODAY

Arbitration today, although more complex than in yesteryear,⁴⁸ remains a relatively informal process. Rather than burdensome pleading requirements as mandated by federal law,⁴⁹ a complainant in arbitration "shall specify the relevant facts and the remedies sought."⁵⁰

⁴⁸See NASD Task Force Report, *supra* note 11, at 87,463-87,468; *supra* note 17.

⁴⁹See, e.g., Rule 9(b) of the Federal Rules of Civil Procedure (requirement of pleading fraud with particularity). Moreover, pursuant to the PSLRA, new Section 21D(b) of the Exchange Act sets forth:

- (1) A requirement that a plaintiff in the complaint in any private securities fraud action alleging material misstatements and/or omissions "specify each statement alleged to have been misleading; the reason or reasons why the statement is misleading; and if an allegation regarding the statement or omission is made on information and belief, the complaint shall state with particularity all facts on which that belief is formed."
2. A requirement that in any private action under the 1934 Act in which the plaintiff "may recover money damages only on proof that the defendant acted with a particular state of mind, the complaint shall, with respect to each such act or omission alleged to violate [the 1934 Act], state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind."

See Private Securities Litigation Reform Act of 1995, Joint Explanatory Statement of the Committee on Conference (1995) (observing that the language contained in ' 21D(b) derives "in part" from the Second Circuit's pleading requirement which is "regarded as the most stringent pleading standard" but also stating that "the Conference Committee intends to strengthen existing pleading requirements").

⁵⁰UCA, *supra* note 10, at ' 13. This provision is included in the NASD, NYSE, and AMEX arbitration rules (except that the NYSE replaces "shall" with "should"). See NASD ' ____; NYSE ' ____; AMEX ' _____. Moreover, the American Arbitration Association's (AAA) Securities Arbitration Rules similarly requires that the Demand for Arbitration "shall contain a statement setting forth the nature of the dispute, the amount involved, if any, the remedy sought, and the hearing local requested." AAA Rule 5. See also, SICA, *Arbitration Procedures* at p.6 (booklet designed to assist prospective parties and their counsel) (The Statement of Claim "should set forth the details of the dispute, including all relevant dates and names, in a clear, concise, and chronological fashion and should conclude by indicating what relief (e.g., money damages in a specific amount, performance of a particular interest, etc.) is requested. The claimant should attach copies of documents and supporting materials as exhibits to the Statement of Claim."); Robbins, *Securities Arbitration from the Arbitrators' Perspective*, 23 Rev. Sec. & Comm. Reg. 171, 171-172 (1990) (stating that "[m]ost arbitrators just glance at the statement of claim after being appointed, and, unless they are chairmen and have to rule on pre-hearing discovery issues, arbitrators only read the pleadings carefully shortly before the first hearing

[, that] "[c]omplaint-like drafting rarely elicits an emotional response from arbitrators, . . . [and that] [i]n the claim, arbitrators do not like reading every possible cause of action").

Although discovery is permitted to an increasing extent,⁵¹ including written requests for information⁵² and document requests,⁵³ a number of the more costly and time-consuming aspects of discovery found in federal and state court litigation usually are not present.⁵⁴ Hence, depositions are rarely permitted⁵⁵ and dispositive motions prior to the formal hearing are not encouraged.⁵⁶

⁵¹See NASD Task Force Report, *supra* note 11, at 87,463 (referring to concerns that "NASD arbitration has become too litigious [along with] the proliferation of discovery requests and disputes").

⁵²See UCA, *supra* note 10, at ' 20(a)-(c); NASD ' ____.

⁵³Sources cited note 52 *supra*. Generally, "discovery disputes are resolved either on written submission to the arbitrators or at the pre-hearing conference, which is conducted by one or more of the arbitrators selected for the case." NASD Task Force Report, *supra* note 11, at 87,464.

⁵⁴For example, depositions are rarely allowed and motion practice is not as complex. See *infra* notes 55-56 and accompanying text. Nonetheless, as the NASD Task Force observed, "[p]arties frequently abuse the present NASD discovery rules." NASD Task Force Report, *supra* note 11, at 87,464.

⁵⁵NASD Task Force Report, *supra* note 11, at 87,463 ("Although the [Arbitration] Code does not set forth criteria for deciding requests for depositions, the Arbitrator's Manual suggests that depositions should be permitted only under fairly narrow circumstances."); SICA, The Arbitrator's Manual, at 10 ("Access to depositions should be granted to preserve the testimony of ill or dying witnesses, or of persons who are unable or unwilling to travel long distances for a hearing and may not otherwise be required to attend the hearing, as well as to expedite large or complex cases, and in other situations as deemed appropriate by the arbitrator. . . ."). Note, however, the view of one authoritative source: "It has generally been recognized . . . that the absence of deposition usually works to the advantage of brokerage firm respondents who have most of the information necessary to prove a claim in their possession (often in a form that is not comprehensible to the ordinary claimant or his counsel) and who do not have to bear the burden of proof in establishing a claim." Lowenfels & Bromberg, *Securities Industry Arbitrations: An Examination and Analysis*, 53 Albany L. Rev. 755, 811 (1989).

⁵⁶See Cane & Shub, *supra* note 4, at 114 (stating that generally there is no opportunity "to raise a motion to dismiss for failure to state a cause of action or a motion for summary judgment in arbitration"). Nonetheless, several pre-hearing motions are permitted, including "(1) a request for more definite statement of claim; (2) motion to consolidate; (3) motion to sever; (4) motion for lack of timeliness; (5) motion to decline jurisdiction; (6) motion to bar certain facts or defenses when a respondent only pleads a general denial or when it fails to answer; and (7) motion to bar certain facts or defenses when not raised in the answer." Robbins, *supra* note 50, at 175, citing, Arbitrator's Manual, *supra* note 55, at 2. Note, moreover, that with respect to particular legal issues, the Arbitrator's Manual allows "the submission of briefs in reference to a particular legal issue setting forth a law or statute and how it applies to the facts of the case." Cane & Shub, *supra* note 4, at 115, citing,

At the formal hearing, the panel is comprised of a majority of "public" arbitrators.⁵⁷ Unlike a judicial proceeding, formal rules of evidence do not apply,⁵⁸ thereby allowing for the introduction of "hearsay."⁵⁹ Relevance and materiality are key criteria in the arbitrators' determination relating to the weight given to evidence proffered.⁶⁰

Arbitrators, not being bound by precise legal standards in their determinations⁶¹ may render awards premised on the standards of applicable self-regulatory organizations (SROs), industry custom, or even concepts of equity and fairness.⁶² Indeed, damages may be awarded to claimants for violations of SRO rules where no remedy is provided for such misconduct under federal or state securities law.⁶³

Arbitrator's Manual, *supra* note 55, at 6. *See also*, Discovery Panel, New York Stock Exchange, Inc. Symposium on Arbitration in the Securities Industry, 63 Fordham L. Rev. 1553 (1995).

⁵⁷*See supra* note 10 and accompanying text.

⁵⁸*See UCA, supra* note 10, at ' 21; S. Jaffee, *Broker-Dealers and Securities Markets: A Guide to the Regulatory Process* (stating that arbitrators "do not rigidly adhere to the rules of evidence and allow the introduction of documentary and other evidence, if, in a general sense, it appears reliable").

⁵⁹*See Cane and Shub, supra* note 4, at 37 (stating that arbitrators routinely consider hearsay and other testimony not admissible in a court of law and give it whatever weight they feel it deserves under the circumstances").

⁶⁰*See UCA supra* note 10, at ' 21; A. Bromberg & L. Lowenfels, *Securities Fraud and Commodities Fraud* " 16.01-16.05 (300) (1994 & Supp.); sources cited *supra* notes 58-59.

⁶¹*See Arbitrators Manual, supra* note 55, at i (stating that arbitrators "keeps equity in view"); S. Jaffee, *supra* note 58, at 338 (stating that "arbitrators are not bound to precise legal standards in their decisions"); Lowenfels & Bromberg, *supra* note 55, at 784 (stating that "arbitration panels are not bound by precise legal standards in their decisions"); Sullivan, *The Scope of Modern Arbitral Awards*, 62 Tulane L. Rev. 1113 (1988) (stating that arbitrators are not strictly required to apply substantive law).

⁶²*See Lowenfels & Bromberg, supra* note 55, at 784. *See also*, sources cited *supra* notes 60-61.

⁶³*See Lowenfels & Bromberg, supra* note 55, at 784-788. Examples include claims relating to unsuitability, unauthorized trading, proper execution of customer orders, and margin deficiencies. Generally, these claims are actionable under Section 10(b) of the Exchange Act only if scienter is proven. *See Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976). As stated in *Merrill, Lynch, Pierce, Fenner & Smith, Inc. v. Goldman*, 592 F.2d 129, 134 (8th Cir. 1979) (stating that "the courts have typically found no private right of action exists for violation of exchange or dealer rules in the absence of a finding of fraud"). Moreover, courts have held that no private right of action exists on behalf of investors for violation of the margin requirements. *See, e.g., Bennett v. United States Trust Co. of New York*, 770 F.2d 308 (2d Cir. 1985). For further discussion, *see* M. Steinberg, Securities

Moreover, many arbitrators, however, are not attorneys and, even for those who are lawyers, they may not have expertise in securities law.⁶⁴ No written decision is required by the arbitration rules,⁶⁵ only the names of the parties, a summary of the issues presented, the relief sought and awarded, statement of other issues resolved (i.e. jurisdictional rulings), the names of the arbitrators, and the signatures of the arbitrators who concur in the award is necessary.⁶⁶ The rationale frequently provided for not requiring written opinions is that mandating such opinions would contravene the policies underlying arbitration which is to provide an expeditious, efficient, and informal forum of alternative dispute resolution.⁶⁷ Another argument advanced is that requiring written opinions would be time consuming and burdensome, thereby deterring many qualified individuals from agreeing to serve as arbitrators.⁶⁸ Nonetheless, there may well be another key reason why arbitrators are loathe to write opinions: Because the panel's decision can be overturned by a federal court only on narrow grounds, such as bias, misconduct, or manifest disregard of the law,⁶⁹ the writing of an

Regulation: Liabilities and Remedies ' 9.03 (1996).

⁶⁴See NASD Task Force Report, *supra* note 11, at 87,468-87,479.

⁶⁵See NASD Code ' 41. *See also*, Masucci, *supra* note 18, at 190-191. Note, however, that for large and complex cases, upon a party's request, a written decision must be provided that will be made public. Upon refusal by the arbitrators to produce written findings of fact and conclusions of law, such arbitrators will be replaced. *See Rules Changed to Make Written Findings Easier to Obtain in Larger Arbitrations*, 22 Sec. Reg. & L. Rep. (BNA) 816 (1990). Cases that qualify for large and complex status are determined on a case by case basis. Such cases may include "class actions, cases involving multiple parties, cases dealing with a novel legal theory, and disputes involving potentially large sums of money." Comment, Should Mandatory Written Opinions Be Required in All Securities Arbitrations?: The Practical and Legal Implications to the Securities Industry, 45 Am. U.L. Rev. 151, 167 (1995), relying on _____ Urges Rules to Allow Arbitrator to Refer Complex Cases to Court System, 20 Sec. Reg. & L. Rep. (BNA) 1087 (1988). *See also*, Arbitration Reforms Hearing Before the Subcomm. on Telecomm. and Finance of the House Comm. on Energy and Commerce, 100th Cong., 2d Sess. 99-100 (1988) (Statement of Theodore Krebsbach) (stating that the vast majority of arbitrations are typical broker-customer disputes).

⁶⁶*See, e.g.*, NASD Code ' 41.

⁶⁷*See, e.g.*, Raiford v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 903 F.2d 1410, _____ (11th Cir. 1990); Sargent v. Paine Webber Jackson & Curtis, Inc., _____ F.2d _____, _____ (D.C. Cir. 1989); Sobel v. Hertz, Warner & Co., 469 F.2d 1211, 1214 (2d Cir. 1972); Quick & Reilly, Inc. v. Jacobson, 126 F.R.D. 24, 26 (S.D.N.Y. 1989).

⁶⁸*See* Comment, *supra* note 65, at 164 n.92, citing, Securities Arbitration Group Opposes Mandatory Written Opinions in All Cases, 19 Sec. Reg. & L. Rep. (BNA) 1952, 1953 (1987) (asserting that requiring written opinions "could very well hinder, rather than enhance, the administration of arbitration proceedings in that it would be time consuming and burdensome and thus may discourage many qualified individuals from serving as an arbitrator").

⁶⁹Section 10 of the Federal Arbitration Act (FAA), 9 U.S.C. ' 10, allows for

opinion draws a "road map" by which the disgruntled party will have greater likelihood of upsetting the arbitral award. Moreover, being pressed for time, inadequately paid, and not accomplished in authoring written opinions (particularly in a complex area like securities law), any written decision incurs the risk as being viewed with disfavor by a learned federal court. Because arbitrators perceive that they act in good faith, follow the spirit if not the letter of the applicable law, and seek to do justice, they thus are reluctant to explain their rationale in a written opinion. The end product is one that reaches a defined result with no reasoning provided to support such result and with the losing party having little likelihood of overturning such result.⁷⁰

V. FEDERAL LAW: TO THE LIKING OF THE INDUSTRY

In the era prior to the Supreme Court's decision, in *McMahon*, disgruntled investors eagerly sought protection in the federal courts.⁷¹ The principal provision invoked was Section

vacating an arbitral award based only on:

1. The procurement of the award by corruption, fraud, or undue means;
2. The evident partiality or corruption of the arbitrators;
3. The misconduct of the arbitrators in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear pertinent and material evidence; or of any other misbehavior by which the rights of any party has been prejudiced;
4. Where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the matter submitted was not made.

Although error of law is not provided as a basis for vacating an award pursuant to Section 10, several courts have embraced a standard focusing on "manifest disregard of the law" by the arbitrators as a ground for vacating an award. *See M. Cane & P. Shub, supra* note 4, at 326-339 (citing cases). Nonetheless, the burden to show "manifest disregard" is a high one for aggrieved parties. *See, e.g., Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Jaros, ___ F.3d ___, ___ (6th Cir. 1995); Advest, Inc. v. McCarthy, 914 F.2d 6, 10 (1st Cir. 1990); Merrill Lynch, Pierce, Fenner & Smith v. Bobker, 808 F.2d 930, 934 (2d Cir. 1986)*. Succinctly stated, "[c]hallenging an arbitration award is usually fruitless." *Lowenfels & Bromberg, supra* note 55, at 864. On occasion, however, a number of courts have vacated arbitration awards, even under the "manifest disregard of the law" standard. *See, e.g., Ainsworth v. Skuunick, 409 F.2d 456 (11th Cir. 1990)*. *See also*, Section 11(a) of the FAA, 9 U.S.C. ' 11(a) ("evident material miscalculation basis for modifying or correcting arbitral award). *See generally* Lipton, The Standard on Which Arbitrators Base Decisions, 16 *Sec. Reg. L.J.* 3 (1988).

⁷⁰*See* S. Jaffee, *supra* note 58, at 339 (stating that "[w]here the facts are in dispute, testimony contradictory, and blame not entirely one-sided, arbitration forums have been known to compromise verdicts [and that] [s]uch verdicts . . . often represent a sense of justice which fits the facts of the case"); authorities cited *supra* notes 64-69. *See also*, *McIray v. PaineWebber, Inc., ___ F.2d ___, ___ (arbitral award of \$40,000 where more than \$1 million sought not "evident material miscalculation" under FAA ' 11(a), therefore denying investors request that court modify award)*.

⁷¹*See* Ferrara & Steinberg, A Reappraisal of Santa Fe: Rule 10b-5 and the New

10(b) of the Exchange Act. Due to that the Exchange Act (unlike the Securities Act)⁷² provides for exclusive federal jurisdiction, these actions were instituted in federal court.⁷³ Key Securities Act provisions asserted in this context included Section 12⁷⁴ and 17(a).⁷⁵ In addition, secondary liability doctrines seeking to hold brokerage firms and supervisory personnel liable encompassed aiding and abetting,⁷⁶ controlling person,⁷⁷ and respondeat superior.⁷⁸

Beginning with the mid 1970s and continuing to the present, investors generally have fared progressively worse under federal law.⁷⁹ This observation, particularly when compared to the expansionist decisions of the 1960s and early 1970s,⁸⁰ may well signify that

Federalism, 129 U. Pa. L. Rev. 263 (1980).

⁷²Section 22(a) of the Securities Act, 15 U.S.C. ' 77v(a).

⁷³Section 27 of the Exchange Act, 15 U.S.C. ' 78aa.

⁷⁴15 U.S.C. ' 772. *See, e.g.,* Davis v. Avco Financial Services, Inc., 739 F.2d 1057 (6th Cir. 1984).

⁷⁵15 U.S.C. ' 77q(a). Prior to the late 1970s, several courts recognized an implied private right of action for damages under Section 17(a). *See, eg.,* Newmar v. Prior, 518 F.2d 97, 99 (4th Cir. 1975); Steinberg, Section 17(a) of the Securities Act of 1933 After Naftalin and Redington, 68 Geo. L.J. 163, 172-182 (1979).

⁷⁶*See, e.g.,* Rolf v. Blyth, Eastman Dillon & Co., Inc., 570 F.2d 38 (2d Cir. 1978).

⁷⁷Section 15 of the Securities Act, 15 U.S.C. ' 77o; Section 22(a) of the Exchange Act, 15 U.S.C. ' 78t(a). *See, e.g.,* Haynes v. Anderson & Struderick, Inc., 508 F. Supp. 1303 (E.D. Va. 1981).

⁷⁸*See, e.g.,* Marbury Management, Inc. v. Kohn, 629 F.2d 705 (2d Cir. 1980). *See generally* Ferrara & Sanger, Derivative Liability in Securities Law: Controlling Person Liability, Respondeat Superior, and Aiding and Abetting, 40 Wash. & Lee L. Rev. 1007 (1983). But *see infra* notes ____ and accompanying text.

⁷⁹*See, e.g.,* Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson, 501 U.S. 350, 359-61 (1991) (adopting statute of limitations of one year after discovery and no longer than three years after the violation for ' 10(b) actions); Chiarella v. United States, 445 U.S. 222, 235 (1980) (holding that absent a duty to disclose based on a fiduciary or similar relationship, silence does not give rise to liability); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 (1976) (requiring that scienter be shown in ' 10(b) private actions. *See generally* Lowenfels, Recent Supreme Court Decisions Under the Federal Securities Laws: The Pendulum Swings, 65 Geo. L.J. 891 (1977). But *see* Basic, Inc. v. Levinson, 485 U.S. 224 (1988) (approving use of fraud-and-market theory for purposes of establishing presumption of reliance in ' 10(b) actions).

⁸⁰*See, e.g.,* Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6, 12, 13 n.9 (1971) (implied private cause of action for damages under ' 10(b) of Securities Exchange Act of 1934 and rule 10b-5); SEC v. National Sec., Inc., 393 U.S. 453, 460-61 (1969) (recognizing SEC's authority to regulate securities activities of insurance companies); J.I. Case

uninitiated investors would prefer arbitration today, even if they could elect to proceed in federal court. The following discussion, highlighting restrictions that investors today face in federal court, emphasizes this point.

1. Pleading Requirements

Federal Rule of Civil Procedure 9(b) requires that fraud "be stated with particularity."⁸¹ In construing whether complaints alleging securities fraud pass muster under Rule 9(b), the Second Circuit mandates that specific facts be set forth supporting a "strong inference of fraud."⁸² This standard, for example, was applied in *Wexner v. First Manhattan Co.*⁸³ There, Susan Wexner, wife of The Limited, Inc., founder _____ Wexner, brought suit under Section 10(b) against the brokerage firm. She alleged that the firm had perpetrated a deceptive scheme in the sale of her limited stock, resulting in damages of several million dollars. Although she detailed the alleged scheme and underlying motive and was not entitled to discovery at the pleading stage, the Second Circuit upheld the dismissal of her complaint for failing to satisfy Rule 9(b).⁸⁴

The Second Circuit's strict pleading requirement generally has been codified by Congress in the PSLRA.⁸⁵ Hence, facts giving rise to a strong inference of fraud must be alleged with particularity in Section 10(b) litigation.⁸⁶ Moreover, no discovery during the pleading stage generally is allowed under the PSLRA,⁸⁷ and sanctions under Rule 11 of the

Co. v. Borak, 377 U.S. 426, 432 (1964) (implied private right of action under '14(a) of Securities Exchange Act of 1934); *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 197 (1963) (requiring under Investment Adviser Act of 1940 that registered investment adviser disclose personal financial interest in securities recommended to clients).

⁸¹Rule 4(b) provides: "In all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity. Malice, intent, knowledge, and other condition of mind or a person may be averred generally."

⁸²*See, e.g., Wexner v. First Manhattan Co.*, 902 F.2d 169, 172 (2d Cir. 1990) ("Where pleading is permitted on information and belief, a complaint must allege specific facts supporting a strong inference of fraud or it will not satisfy even a relaxed pleading standard."). Accord, *In re Time Warner Securities Litigation*, 9 F.3d 259 (2d Cir. 1993).

⁸³902 F.2d 164 (2d Cir. 1990).

⁸⁴*Id.* at ____ (holding that Wexner's allegations were "conclusory" and "unsupported"). For a more relaxed interpretation of Rule 9(b) prior to the 1995 legislation, *see e.g., Shapiro v. UJB Financial Corp.*, 964 F.2d 272 (3d Cir. 1992). See generally Himelrock, *Pleading Securities Fraud*, 43 Md. L. Rev. 342 (1984); Richmond, *Lively & Mell, The Pleading of Fraud: Rhymes Without Reason*, 60 So. Calif. L. Rev. 959 (1987); Note, *Pleading Securities Fraud With Particularity Under Rule 9(b)*, 97 Harv. L. Rev. 1432 (1984).

⁸⁵Section 21D(b) of the Exchange Act, *quoted in supra* note 49. See Joint Explanatory Statement, *supra* note 49, stating that standard adopted in PSLRA is stronger than Second Circuit test.

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Federal Rules of Civil Procedure are more likely to be assessed against losing parties (and their attorneys)⁸⁸

2 Limitations on the Shingle Theory

Traditionally, the federal courts have recognized the applicability of the "shingle" theory.⁸⁹ The theory posits that by "hanging out its shingle," a broker-dealer impliedly represents that its conduct and the behavior of its employees will be fair and will comport with professional norms.⁹⁰ As the Second Circuit stated in *Hanly v. SEC*,⁹¹ "A securities dealer occupies a special relationship to the buyer of securities in that by his position he impliedly represents he has an adequate basis for the opinions he renders."⁹² One aspect of this duty, labeled the suitability theory, recognizes an implied representation by the broker that it will recommend only those securities suitable for each customer's investment objectives and economic status.⁹³

A number of other implied representations have been recognized as coming within the shingle theory, including

- (1) An implied representation of fair pricing, including any markup or markdown;
- (2) An implied representation that the broker-dealer will execute only authorized transactions for its customers;
- (3) An implied representation to disclose any special consideration that influences the broker-dealer's recommendation;
- (4) An implied representation to execute promptly customers' orders; and
- (5) An implied representation that any recommendation made by a broker-dealer to a customer has a reasonable basis.⁹⁴

One may inquire, however, whether aspects of the shingle theory still provide the basis for a Section 10(b) right of action in light of the Supreme Court's holding in *Santa Fe* that deception or manipulation must be shown.⁹⁵ A number of courts have taken the position that certain components of the shingle theory no longer are viable.⁹⁶ For example, in *Pross v. Baird, Patrick & Co., Inc.*,⁹⁷ a Section 10(b) claim based on unauthorized trading by a broker

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was dismissed. The court reasoned that the claim was in actuality one for breach of fiduciary duty not involving the element of deception necessary to invoke Section 10(b).⁹⁸

Moreover, courts allow brokers to engage in certain nonactionable puffery. Such statements as "This deal will make you rich" and "I'm the best broker in Kansas City" are not actionable due to lack of materiality and lack of justifiable reliance.⁹⁹ On the other hand, where specific and realistic percentages are communicated to the investor, such as "your return will be 15 percent annually," many courts will find such a statement to constitute actionable misrepresentation.¹⁰⁰

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MATERIALS

Annex / Materials

- China Chamber of International Commerce (CIETAC), Arbitration Rules (10th May 1998)
- Russia: Law of the Russian Federation on International Commercial Arbitration (14th August 1993)
- Chamber of Commerce and Industry of the Russian Federation, Rules of the International Commercial Arbitration Court (1st May 1995)
- North American Free Trade Agreement (NAFTA), Chapter Eleven: Investment
- UNCITRAL Model Law on International Commercial Arbitration (1994)

Arbitration Rules

(Revised and Adopted by China Chamber of International Commerce
on May 6, 1998. Effective as from May 10, 1998.)

Chapter I General Provisions Section 1 Jurisdiction

Article 1 These Rules are formulated in accordance with the Arbitration Law of the People's Republic of China and the provisions of the relevant laws and pursuant to the Decision of the former Government Administration Council of the Central People's Government and the Notice and Official Reply of the State Council.

Article 2 China International Economic and Trade Arbitration Commission (originally named Foreign Trade Arbitration Commission of the China Council for the Promotion of International Trade, later renamed as Foreign Economic and Trade Arbitration Commission of the China Council for the Promotion of International Trade, and presently called China International Economic and Trade Arbitration Commission, hereinafter referred to as the Arbitration Commission) independently and impartially resolves, by means of arbitration, disputes arising from economic and trade transactions, contractual or non-contractual.

The disputes stated in the preceding paragraph include:

- (1) international or foreign-related disputes;
- (2) disputes related to the Hong Kong SAR, Macao or Taiwan regions;
- (3) disputes between the enterprises with foreign investment and disputes between an enterprise with foreign investment and another Chinese legal person, physical person and/or economic organization;
- (4) disputes arising from project financing, invitation for tender, bidding, construction and other activities conducted by Chinese legal persons, physical persons and/or other economic organization through utilizing the capital, technology or service from foreign countries, international organizations or from the Hong Kong SAR, Macao and Taiwan regions; and
- (5) disputes that may be taken cognizance of by the Arbitration Commission in accordance with special provisions of or upon special authorization from the law or administrative regulations of the People's Republic of China.

Article 3 The Arbitration Commission takes cognizance of cases in accordance with an arbitration agreement between the parties concluded before or after the occurrence of the dispute to refer their dispute to the Arbitration Commission for arbitration and upon the written application by one of the parties.

An arbitration agreement means an arbitration clause stipulated by the parties in their contract or a written agreement concluded by the parties in other forms to submit their dispute for arbitration.

Article 4 The Arbitration Commission has the power to decide on the existence and validity of an arbitration agreement and the jurisdiction over an arbitration case. If a party challenges the validity of the arbitration agreement and requests the Arbitration Commission to make a decision thereupon and the other party applies to the People's Court for a ruling, the Court's ruling shall prevail.

Article 5 An arbitration clause contained in a contract shall be regarded as existing independently and separately from the other clauses of the contract, and an arbitration agreement attached to a contract shall be treated as a part of the contract existing independently and separately from the other parties of the contract. The validity of an arbitration clause or an arbitration agreement shall not be affected by the modification, rescission, termination, invalidity, revocation or non-existence of the contract.

Article 6 Any objections to an arbitration agreement and/or jurisdiction over an arbitration case shall be raised before the first hearing conducted by the arbitration tribunal. Where a case is examined on the basis of documents only, the objections to jurisdiction should be raised before submission of the first substantive defense.

Article 7 Once the parties agree to submit their dispute to the Arbitration Commission for arbitration, it shall be deemed that they have agreed to conduct the arbitration under these Rules. In case the parties have agreed otherwise which is also agreed by the Arbitration Commission, the parties agreement shall prevail.

Section 2 Organization

Article 8 The Arbitration Commission has one honorary Chairman and several advisers.

Article 9 The Arbitration Commission is composed of one Chairman, several Vice-Chairmen and a number of Commission members. The Chairman performs the functions and duties vested in him by these Rules and the Vice-Chairmen may perform the Chairman's functions and duties with the Chairman's authorization. The Arbitration Commission has a secretariat to handle its day-to-day work under the leadership of the Secretary-General of the Arbitration Commission.

Article 10 The Arbitration Commission maintains a Panel of Arbitrators. The arbitrators are selected and appointed by the Arbitration Commission from among Chinese and foreign personages with special knowledge and practical experience in the fields of law, economics and trade, science and technology, and other fields.

Article 11 The Arbitration Commission is located in Beijing. The Arbitration Commission has a Shenzhen Sub-Commission in

Shenzhen Special Economic Zone and a Shanghai Sub-Commission in Shanghai. The Sub-Commissions are an integral part of the Arbitration Commission.

The Sub-Commission have their own secretariats to handle their day-to-day work under the leadership of the Secretaries-General of the Sub-Commission.

These Rules uniformly apply to the Arbitration Commission and its Sub-Commissions. When arbitration proceedings are conducted in the Sub-Commissions, the functions and duties under these Rules to be carried out by the Chairman, the secretariat and the Secretary-General of the Arbitration Commission shall be performed by the Vice-Chairman authorized by the Chairman, the secretariats and the Secretaries-General of the Sub-Commissions respectively and accordingly.

Article 12 The Parties may agree to have their dispute submitted for arbitration conducted by the Arbitration Commission in Beijing or by its Shenzhen Sub-Commission in Shenzhen or by its Shanghai Sub-Commission in Shanghai. In the absence of such an agreement, the Claimant may opt to have the arbitration conducted by the Arbitration Commission in Beijing or by its Shenzhen Sub-Commission in Shenzhen or by its Shanghai Sub-Commission in Shanghai. When exercising such option, the option first made shall prevail. If a dispute arises over the option, it shall be decided by the Arbitration Commission.

Chapter Arbitration Proceedings

Section 1 Application for Arbitration, Defense and Counter-claim

Article 13 The arbitration proceedings shall commence from the date on which the Notice of Arbitration is sent out by the Arbitration Commission or its Sub-Commissions.

Article 14 The Claimant shall satisfy the following requirements when submitting his Application for Arbitration.

(1) an Application for Arbitration in writing shall be submitted and the following shall be specified in the Application for Arbitration.

- (a) the name and address of the Claimant and those of the Respondent, including the zip code, telephone number, telex number, fax number, cable number or other telecommunication means, if any;
- (b) the arbitration agreement relied upon by the Claimant;
- (c) the facts of the case and the main points of dispute;
- (d) the Claimant's claim and the facts and reasons on which his claim is based.

The Application for Arbitration shall be signed and/or stamped by the Claimant and/or the attorney authorized by the Claimant.

(2) When an Application for Arbitration is submitted to the Arbitration Commission, the relevant documentary evidence on which the Claimant's claim is based shall accompany the Application for Arbitration.

(3) The Claimant shall pay an arbitration fee in advance to the Arbitration Commission according to the Arbitration Fee Schedule of the Arbitration Commission.

Article 15 After receipt of the Application for Arbitration and its attachments and when the secretariat of the Arbitration Commission, after examination, deems that the Claimant has not completed the formalities required for arbitration, the secretariat shall demand the Claimant to complete them, and when the secretariat deems that the Claimant has completed the formalities, the secretariat shall immediately send to the Respondent a Notice of Arbitration together with one copy each of the Claimant's Application for Arbitration and its attachments as well as the Arbitration Rules, the Panel of Arbitrators and the Arbitration Fee Schedule of the Arbitration Commission, and shall simultaneously send to the Claimant one copy each of the Notice of Arbitration, the Arbitration Rules, the Panel of Arbitrators and Arbitration Fee Schedule.

The secretariat of the Arbitration Commission, after sending the Notice of Arbitration to the Claimant and Respondent, shall appoint one of its staff-members to take charge of procedural administration of the case.

Article 16 The Claimant and the Respondent shall, within 20 days as from the date of receipt of the Notice of Arbitration, appoint an arbitrator from among the Panel of Arbitrators of the Arbitration Commission or authorize the Chairman of the Arbitration Commission to make such appointment.

Article 17 The Respondent shall, within 45 days from the date of receipt of the Notice of Arbitration, submit his written defense and relevant documentary evidence to the secretariat of the Arbitration Commission.

Article 18 The Respondent shall, at the latest within 60 days from the date of receipt of the Notice of Arbitration, lodge with the secretariat of the Arbitration Commission his counterclaim in writing, if any. The arbitration tribunal may extend that time limit if it deems that there are justified reasons.

When lodging a counterclaim, the Respondent must state in his written statement of counterclaim his specific claim, the facts and reasons upon which his claim is based, and attach to his written statement of counterclaim the relevant documentary evidence.

When lodging a counterclaim, the Respondent shall pay an arbitration fee in advance according to the Arbitration Fee Schedule of the Arbitration Commission.

Article 19 The Claimant may request to amend his claim and the Respondent may request to amend his counterclaim; but the arbitration tribunal may refuse such an amendment if it considers that it is too late raise the request and the amendment may affect the arbitration proceedings.

Article 20 When submitting application for arbitration written defense, statement of counterclaim, documentary evidence and other documents, the party/parties shall submit them in quintuplicate. If the number of the parties exceeds two, additional copies shall be submitted accordingly; if the number of arbitrator of the arbitration tribunal is one, two copies may be reduced.

Article 21 The arbitration proceedings shall not be affected in case the Respondent fails to file his defense in writing or the Claimant fails to submit his written defense against the Respondent's counterclaim.

Article 22 The parties may authorize arbitration agents to deal with the matters relating to arbitration, the authorized attorney must produce a Power of Attorney to the Arbitration Commission.

Article 23 When a party applies for property preservative measures, the Arbitration Commission shall transmit the party's application for a ruling to the against whom the property preservative measures are sought is located or in the place where the property of the said is located.

When a party applies for taking interim measures of protection of evidence, the Arbitration Commission shall transmit the party's application for a ruling to the people's court in the place where the evidence is located.

Section 2 Formation of Arbitration Tribunal

Article 24 Each of the parties shall appoint one arbitrator from among the Panel of Arbitrators of the Arbitration Commission or entrust the Chairman of the Arbitration Commission to make such appointment. The third arbitrator shall be jointly appointed by the parties or appointed by the Chairman of the Arbitration Commission upon the parties joint authorization. In case the parties fail to jointly entrust the Chairman of the Arbitration Commission to appoint the third arbitrator within 20 days from the date on which the Respondent receives the Notice of Arbitration, the third arbitrator shall be appointed by the Chairman of the Arbitration Commission. The third arbitrator shall act as the presiding arbitrator. The presiding arbitrator and the two appointed arbitrators shall jointly form an arbitration tribunal to jointly hear the case.

Article 25 Both parties may jointly appoint or jointly authorize the Chairman of the Arbitration Commission to appoint a sole arbitrator to form an arbitration tribunal to hear the case alone.

If both parties have agreed on the appointment of a sole arbitrator to hear their case alone but have failed to agree on the choice of such a sole arbitrator within 20 days from the date on which the Respondent receives the Notice of Arbitration, the Chairman of the Arbitration Commission shall make such appointment.

Article 26 If the Claimant or the Respondent fails to appoint or authorize the Chairman of the Arbitration Commission to appoint an arbitrator according to Article 16 of these Rules, the Chairman of the Arbitration Commission shall appoint an arbitrator for the Claimant or the Respondent.

Article 27 When there are two or more Claimants and/or Respondents in an arbitration case, the Claimant's side and/or the Respondent's side each shall, through consultation, appoint or entrust the Chairman of the Arbitration Commission to appoint one arbitrator from among the Panel of Arbitrators of the Arbitration Commission.

If the Claimant's side or the Respondent's side fails to make such appointment or entrustment within 20 days as from the date on which the Respondent's side receives the Notice of Arbitration, the appointment shall be made by the chairman of the Arbitration Commission.

Article 28 Any appointed arbitrator having a personal interest in the case shall himself disclose such circumstances to the Arbitration Commission and request a withdrawal from his office.

Article 29 A party may make a request in writing to the Arbitration Commission for the removal of an appointed arbitrator from his office, if the party has justified reasons to suspect the impartiality and independence of the appointed arbitrator. In the request, the facts and reasons on which the request is based and evidence thereof must be given.

A Challenge against an arbitrator for a removal from his office must be put forward in writing no later than the first oral hearing. If the grounds for the challenge come out or are made known after the first oral hearing, the challenge may be raised after the first hearing but before the end of the last hearing.

Article 30 The Chairman of the Arbitration Commission shall decide on the challenge.

Article 31 If an arbitrator cannot perform his duty owing to withdrawal, demise, removal or other reasons, a substitute arbitrator shall be appointed in accordance with the procedure pursuant to which the original arbitrator was appointed.

After the appointment of the substitute arbitrator, the arbitration tribunal has discretion to decide whether the whole or part of the previous hearings shall be started again.

Section 3 Hearing

Article 32 The arbitrator tribunal shall hold oral hearings when examining a case. At the request of the parties or with their consent, oral hearings may be omitted if the arbitration tribunal also deems that oral hearings are unnecessary, and then the arbitration tribunal may examine the case the make an award on the basis of documents only.

Article 33 The date of the first oral hearing shall be fixed by the arbitration tribunal in consultation with the secretariat of the Arbitration Commission.

The notice of the date of the hearing shall be communicated by the secretariat of the Arbitration Commission to the parties 30 days before the date of the hearing. A party having justified reasons may request a postponement of the date of the hearing.

His request must be communicated to the secretariat of the Arbitration Commission 12 days before the date of the hearing and the arbitration tribunal shall decide whether to postpone the hearing or not

Article 34 The notice of the date of hearing subsequent to the first hearing is not subject to the 30-day limit.

Article 35 In case the parties have agreed the place of arbitration, the hearing of the case shall be conducted in the place of arbitration. Unless otherwise agreed by the parties, the cases taken cognizance of by the Arbitration Commission shall be heard in Beijing, or in other places with the approval of the Secretary-General of the Arbitration Commission. The cases taken cognizance of by a Sub-Commission of the Arbitration Commission shall be heard in the place where the Sub-Commission is located, or in other places with the approval of the Secretary-General of the Sub-Commission.

Article 36 The arbitration tribunal shall not hear cases in open session. If both parties request a hearing to be held in open session, the arbitration tribunal shall decide whether to hold the hearing in open session or not.

Article 37 When a case is heard in closed session, the parties, their attorneys, witnesses, arbitrators, experts consulted by the arbitration tribunal, appraisers appointed by the arbitration tribunal and the relevant staff-members of the secretariat of the Arbitration Commission shall not disclose to outsiders the substantive or procedural matters of the case.

Article 38 The parties shall produce evidence for the facts on which their claim, defense or counterclaim is based. The arbitration tribunal may undertake investigations and collect evidence on its own initiative, if it deems it necessary. If the arbitration tribunal investigates and collects evidence on its own initiative, it shall timely inform the parties to be present on the spot if it deems it necessary. Should one party or both parties fail to appear on the spot, the investigation and collection of evidence shall be no means be affected.

Article 39 The arbitration tribunal may consult an expert or appoint an appraiser for the clarification of special questions relating to the case. Such an expert or appraiser can be an organization or a citizen, Chinese or foreign. The arbitration tribunal has the power to order the parties and the parties are also obliged to submit or produce to the expert or appraiser any materials, documents, properties or goods related to the case for check-up, inspection and/or appraisal.

Article 40 The expert's report and the appraiser's report shall be copied to the parties so that the parties may have the opportunity to give their opinions thereon. At the request of any party to the case and with the approval of the arbitration tribunal, the expert and appraiser may be present at the hearing and give explanations of their reports when the arbitration tribunal deems it necessary and appropriate.

Article 41 The evidence submitted by the parties shall be examined and decided by the arbitration tribunal. The adoption of the expert's report and the appraiser's report shall be determined by the arbitration tribunal.

Article 42 Should one of the parties fail to appear at the hearing, the arbitration tribunal may proceed with the hearing and make an award by default.

Article 43 During the hearing, the arbitration tribunal may make a record in writing and/or by tape-recording. The arbitration tribunal may, when it deems it necessary, make a minute stating the main points of the hearing and ask the parties and/or their attorneys, witnesses and/or other person involved to sign their names on it and/or affix their seals to it. The record in writing or by tape-recording is only for the use and reference of the arbitration tribunal.

Article 44 If the parties reach an amicable settlement agreement by themselves, they may either request the arbitration tribunal to make an award in accordance with the contents of their amicable settlement agreement to end the case or request a dismissal of the case.

The Secretary-General of the Arbitration Commission shall decide on the dismissal of an arbitration case if the decision on dismissal is made before the formation of the arbitration tribunal, and the arbitration tribunal shall decide thereon if the decision on dismissal is made after the formation of the arbitration tribunal.

If the party or the parties refer the dismissed case again to the Arbitration Commission for arbitration, the Chairman of the Arbitration Commission shall decide whether to accept the reference or not.

Article 45 If both parties have a desire for conciliation or one party so desires and the other party agrees to it when consulted by the arbitration tribunal, the arbitration tribunal may conciliate the case under its cognizance in the process of arbitration.

Article 46 The arbitration tribunal may conciliate cases in the manner it deems appropriate.

Article 47 The arbitration tribunal shall terminate conciliation and continue the arbitration proceedings when one of the parties requests a termination of conciliation or when the arbitration tribunal believes that further efforts to conciliate will be futile.

Article 48 If the parties have reached an amicable settlement outside the arbitration tribunal in the course of conciliation conducted by the arbitration tribunal, such settlement shall be deemed as one which has been reached through the arbitration tribunal's conciliation.

Article 49 The parties shall sign a settlement agreement in writing when an amicable settlement is reached through conciliation conducted by the arbitration tribunal, and the arbitration tribunal shall end the case by making an arbitration award in accordance with the contents of the settlement agreement unless otherwise agreed by the parties.

Article 50 Should conciliation fail, any statement, opinion, view or proposal which has been made, raised, put forward, acknowledged, accepted or rejected by either party or by the arbitration tribunal in the process of conciliation shall not be invoked as grounds for any claim, defense and/or counterclaim in the subsequent arbitration proceedings, judicial proceedings or any other proceedings.

Article 51 A party who knows or should have known that any provision or requirement of these Rules has not been complied with and yet proceeds with the arbitration proceedings without explicitly raising in writing his objection to non-compliance in a timely manner shall be deemed to have waived his right to object

Section 4 Award

Article 52 The arbitration tribunal shall render an arbitral award within 9 months as from the date on which the arbitration tribunal is formed. The Secretary-General of the Arbitration Commission may extend this time limit at the request of the arbitration tribunal if the Secretary-General of the Arbitration Commission considers that it is really necessary and the reasons for extension are truly justified.

Article 53 The arbitration tribunal shall independently and impartially make its arbitral award on the basis of the facts, in accordance with the law and the terms of the contracts, with reference to international practices and in compliance with the principle of fairness and reasonableness.

Article 54 Where a case is heard by an arbitration tribunal composed of three arbitrators, the arbitral award shall be decided by the majority of the arbitrators and the minority opinion may be written in the record and docketed into the file. When the arbitration tribunal cannot attain a majority opinion, the arbitral award shall be decided in accordance with the presiding arbitrator's opinion.

Article 55 The arbitration tribunal shall state in the arbitral award the claims, the facts of the dispute, the reasons on which the arbitral award is based, the facts of the dispute and the reasons on which the arbitral award is based may not be stated in the arbitral award if the parties have agreed not to state them in the arbitral award if the parties have agreed not to state them in the arbitral award, or the arbitral award is made in accordance with the contents of the settlement agreement reached between the parties.

Article 56 Unless the arbitral award is made in accordance with the opinion of the presiding arbitrator or the sole arbitrator, the arbitral award shall be signed by all the arbitrators or the majority arbitrators sitting on the arbitration tribunal. An arbitrator who has a dissenting opinion may sign or not sign his name on the arbitral award. The arbitrator shall submit his draft arbitral award to the Arbitration Commission before signing the award. The Arbitration Commission may remind the arbitrator of any issue related to the form of the arbitral award on condition that the arbitrator's independence of decision is not affected. The Arbitration Commission's stamp shall be affixed to the arbitral award. The date on which the arbitral award is made is the date on which the arbitral award comes into legal effect.

Article 57 The arbitration tribunal may, if it deems it necessary or the parties so request and the arbitration tribunal agree, make an interlocutory award or partial award on any issue of the case at any time in the course of arbitration before the final award is made. Either party's failure to perform the interlocutory award does not affect the continuation of the arbitration proceedings and the making of the final award by the arbitration tribunal.

Article 58 The arbitration tribunal has the power to determine in the arbitral award the arbitration fee and other expenses to be eventually paid by the parties to the Arbitration Commission.

Article 59 The arbitration tribunal has the power to decide in the arbitral award that the losing party shall pay the winning party as compensation a proportion of the expenses reasonably incurred by the winning party in dealing with the case. The amount of such compensation shall not in any case exceed 10% of the total amount awarded to the winning party.

Article 60 The arbitral award is final and binding upon both disputing parties. Neither party may bring a suit before a law court or make a request to any other organization for revising the arbitral award.

Article 61 Either party may request in writing that a correction be made to the writing, typing, calculating and similar errors contained in the arbitral award within 30 days from the date of receipt of the arbitral award; if there is really an error in the arbitral award, the arbitration tribunal shall make a correction in writing within 30 days from the date on receipt of the written request for correction, and the arbitration tribunal may by itself make a correction in writing within 30 days from the date on which the arbitral award is issued. The correction in writing forms a part of the arbitral award.

Article 62 If anything that should be awarded has been omitted in the arbitral award, either of the parties may make a request in writing to the arbitration tribunal for an additional award within 30 days from the date on which the arbitral award is received.

If something which should be awarded is really omitted, the arbitration tribunal shall make an additional award within 30 days from the date of receipt of the request in writing for an additional award. The arbitration tribunal may also by itself make an additional award within 30 days from the date on which the arbitral award is issued. The additional award forms a part of the arbitral award which has been previously issued.

Article 63 The parties must automatically execute the arbitral award within the time limit specified in the arbitral award. If no time limit is specified in the arbitral award, the parties shall carry out the arbitral award immediately. In case one party fails to execute the arbitral award, the other party may apply to the Chinese court for enforcement of the arbitral award pursuant to Chinese law or apply to the competent foreign court for enforcement of the arbitral award according to the 1958 Convention on Recognition and Enforcement of Foreign Arbitral Awards or other international treaties that China has concluded or participated in.

Chapter Summary Procedure

Article 64 Unless otherwise agreed by the parties, this Summary Procedure shall apply to any case in dispute where the amount of the claim totals not more than RMB 500,000 yuan, and to any case in dispute where the amount of the claim totals more than RMB 500,000 yuan provided that one party applies for arbitration under this Summary Procedure and the other party agrees in writing.

Article 65 When an application for arbitration is submitted to the Arbitration Commission after examination and Summary Procedure is applicable, the secretariat of the Arbitration Commission shall immediately send a Notice of Arbitration to the parties.

Unless both parties have jointly appointed one sole arbitrator from among the Panel of Arbitrators of the Arbitration Commission, they shall jointly appoint or jointly entrust the Chairman of the Arbitration Commission to appoint one sole arbitrator within 15 days from the date on which the Notice of Arbitration is received by the Respondent. Should the parties fail to make such appointment or entrustment, the Chairman of the Arbitration Commission shall immediately appoint one sole arbitrator to form an arbitration tribunal to hear the case.

Article 66 The Respondent shall, within 30 days from the date of receipt of the Notice of Arbitration, submit his defense and relevant documentary evidence to the secretariat of the Arbitration Commission; a counterclaim, if any, shall be filed with documentary evidence within the said time limit.

Article 67 The arbitration tribunal may hear the case in the way it deems appropriate. The arbitration tribunal has discretion to hear the case only on the basis of the written materials and evidence submitted by the parties or to hold an oral hearing as well.

Article 68 The parties must hand in written materials and evidence needed for the arbitration in compliance with the requirements of the arbitration within the time limit given by the arbitration tribunal.

Article 69 For a case which needs an oral hearing, the secretariat of the Arbitration Commission shall, after the arbitration tribunal has fixed a date for hearing, inform the parties of the date of the hearing 15 days before the date of the hearing.

Article 70 If the arbitration tribunal decides to hear the case orally, only one oral hearing shall be held. However, the arbitration tribunal may hold two oral hearings if really necessary.

Article 71 Should one of the parties fail to act in compliance with this Summary Procedure during summary proceedings, such failure shall not affect the arbitration tribunal's conduct of the proceedings and the arbitration tribunal's power to render an arbitral award.

Article 72 The conduct of the summary proceedings shall not be affected by any amendment of the claim or by the lodging of a counterclaim, except that the dispute amount of the revised arbitration claim or counterclaim is in conflict with the provision of Article 64.

Article 73 Where a case is heard orally, the arbitration tribunal shall make an arbitral award within 30 days from the date of the oral hearing if one hearing is to be held, or from the date of the second oral hearing if two oral hearings are to be held. Where a case is examined on the basis of documents only, the arbitration tribunal shall render an arbitral award within 90 days from the date on which the arbitration tribunal is formed. The Secretary-General of the Arbitration Commission may extend the said time limit if such extension is necessary and justified.

Article 74 For matters not covered in this Chapter, the relevant provisions in the other Chapter of these Rules shall apply.

Chapter Supplementary Provisions

Article 75 The Chinese language is the official language of the Arbitration Commission. If the parties have agreed otherwise, their agreement shall prevail.

At the hearing, if the parties or their attorneys or witnesses require language interpretation, the secretariat of the Arbitration Commission may provide an interpreter for them or the parties may bring with them their own interpreter.

The arbitration tribunal and/or the secretariat of the Arbitration Commission may, if it deems it necessary, request the parties to hand in corresponding translation copies in Chinese language or other languages of the documents and evidential materials submitted by the parties.

Article 76 All the arbitration documents, notices and materials may be sent to the parties and/or their attorneys in person, or by registered letter or express airmail, telefax, telex, cable or by any other means which are deemed proper by the secretariat of the Arbitration Commission.

Article 77 Any written communication to the parties is deemed to have been properly served if it is delivered to the addressee or delivered at his place of business, habitual residence or mailing address; or if none of these can be found after making a reasonable inquiry, a written communication is deemed to have been properly served if it is sent to the addressee's

last known place of business, habitual residence or mailing address by registered letter or by any other means which provides a record of the attempt to deliver it.

Article 78 Apart from charging arbitration fees from the parties according to the Arbitration Fee Schedule of the Arbitration Commission, the Arbitration Commission may collect from the parties other extra, reasonable and actual expenses including arbitrator's special remuneration and their travel and boarding expenses for dealing with the case and the fees and expenses for experts, appraisers and interpreters appointed by the arbitration tribunal, etc.
If a case is withdrawn after the parties have reached between themselves an amicable settlement, the Arbitration Commission may charge a certain amount of fees from the parties in consideration of the quantity of work and the amount of the actual expenses incurred by the Arbitration Commission.

Article 79 Where an arbitration agreement or an arbitration clause contained in the contract provides for arbitration to be conducted by China International Economic and Trade Arbitration Commission or its Sub-Commissions or Foreign Economic and Trade Arbitration Commission of the China Council for the Promotion of International Trade, it shall be deemed that the parties have unanimously agreed that the arbitration shall be conducted by China International Economic and Trade Arbitration Commission or by its Sub-Commission.

Where an arbitration agreement or an arbitration clause contained in the contract provides for arbitration by China Council for the Promotion of International Trade/China Chamber of International Commerce or by the arbitration commission of China Council for the Promotion of International Trade/China Chamber of International Commerce, it shall be deemed that the parties have unanimously agreed that the arbitration shall be conducted by China International Economic and Trade Arbitration Commission.

Article 80 These Rules shall come into force as from May 10, 1998. For cases which have been taken cognizance of by the Arbitration Commission or by its Sub-Commissions before the date on which these Rules become effective, the Rules of Arbitration effective on the date when the cases were taken cognizance of shall apply. However, these Rules shall be applied if the parties so agree.

Article 81 The power to interpret these Rules is vested in the Arbitration Commission.

ANNEX I

LAW OF THE RUSSIAN FEDERATION ON INTERNATIONAL COMMERCIAL ARBITRATION*

In force 14 August 1993

The present Law:

- is based on the recognition of the value of arbitration (third-party tribunal) as a widely used method of settling disputes arising in international trade, as well as on the recognition of the need for a comprehensive regulation of international commercial arbitration by means of legislation;
- takes into account the provisions on such arbitration contained in international treaties of the Russian Federation as well as in the Model Law adopted in 1985 by the United Nations Commission on International Trade Law and approved by the United Nations General Assembly with a view to its possible use by states in their legislation.

CHAPTER I. GENERAL PROVISIONS

Article 1. Scope of Application

1. The present Law applies to international commercial arbitration if the place of arbitration is in the territory of the Russian Federation. However, the provisions of articles 8, 9, 35 and 36 apply also if the place of arbitration is abroad.

2. Pursuant to an agreement of the parties, the following may be referred to international commercial arbitration:

- disputes resulting from contractual and other civil law relationships arising in the course of foreign trade and other forms of international economic relations, provided that the place of business of at least one of the parties is situated abroad; as well as
- disputes arising between enterprises with foreign investment, international associations and organizations established in the territory of the Russian Federation; disputes between the participants of such entities; as well as disputes between such entities and other subjects of the Russian Federation law.

3. For the purposes of paragraph 2 of this article:

- if a party has more than one place of business, the place of business is that which has the closest relationship to the arbitration agreement;
- if a party does not have a place of business, reference is to be made to his permanent residence.

4. The present Law does not affect any other law of the Russian Federation by virtue of which certain disputes may not be submitted to arbitration or may be submitted to arbitration only according to provisions other than those of the present Law.

5. If an international treaty of the Russian Federation establishes rules other than those which are contained in the Russian legislation relating to arbitration (third-party tribunal), the rules of the international treaty shall be applied.

* English translation by the Parker School of Foreign and Comparative Law, Columbia University.

Article 2. Definitions and Rules of Interpretation

For the purposes of the present Law:

- “arbitration” means any arbitration (third-party tribunal) whether conducted by a tribunal set up specifically for a given case or administered by a permanent arbitral institution, in particular the Court of International Commercial Arbitration or the Maritime Arbitration Commission at the Chamber of Commerce and Industry of the Russian Federation (Appendices I and II to the present Law);
- “third-party tribunal” means a sole arbitrator or a panel of arbitrators (third-party judges);
- “court” means a respective organ of the judicial system of a state;
- where a provision of the present Law, except article 28, leaves the parties free to determine a certain issue, such freedom includes the right of the parties to authorize a third party, including an institution, to make that determination;
- where a provision of the present Law refers to the fact that the parties have agreed or that they may agree or in any other way refers to an agreement of the parties, such agreement includes any arbitration rules referred to in that agreement;
- where a provision of the present Law, except articles 25(1) and 32(2), refers to a claim, it also applies to a counter-claim, and where it refers to a defense, it also applies to a defence to such counter-claim.

Article 3. Receipt of Written Communications

1. Unless otherwise agreed by the parties:

- any written communication is deemed to have been received if it is delivered to the addressee personally or if it is delivered at his place of business, permanent residence or mailing address; if none of these can be found after making a reasonable inquiry, a written communication is deemed to have been received if it is sent to the addressee’s last-known place of business, permanent residence or mailing address by registered letter or any other means which provides a record of the attempt to deliver it;
 - the communication is deemed to have been received on the day it is so delivered.
2. The provisions of this article do not apply to communications in court proceedings.

Article 4. Waiver of Right to Object

A party who knows that any provision of the present Law from which the parties may derogate or any requirement under the arbitration agreement has not been complied with and yet proceeds with the arbitration without stating his objection to such non-compliance without undue delay or, if a time-limit is provided therefor, within such period of time, shall be deemed to have waived his right to object.

Article 5. Extent of Court Intervention

In matters governed by the present Law, no court shall intervene except where so provided in the present Law.

Article 6. Authority for Certain Functions of Arbitration Assistance and Control

1. The functions referred to in articles 11(3), 11(4), 13(3) and 14 shall be performed by the President of the Chamber of Commerce and Industry of the Russian Federation.

2. The functions referred to in articles 16(3) and 34(2) shall be performed by the Supreme Court of a republic forming part of the Russian Federation, the territorial, regional or city court, or the court of the autonomous region or autonomous area where the arbitration takes place.

CHAPTER II. ARBITRATION AGREEMENT

Article 7. Definition and Form of Arbitration Agreement

1. Arbitration agreement is an agreement by the parties to submit to arbitration all or certain disputes which have arisen or which may arise between them in respect of a defined legal relationship, whether contractual or not. An arbitration agreement may be in the form of an arbitration clause in a contract or in the form of a separate agreement.

2. The arbitration agreement shall be in writing. An agreement is in writing if it is contained in a document signed by the parties or in an exchange of letters, telex, telegrams or other means of telecommunication which provide a record of the agreement, or in an exchange of statements of claim and defense in which the existence of an agreement is alleged by one party and not denied by another. The reference in a contract to a document containing an arbitration clause constitutes an arbitration agreement provided that the contract is in writing and the reference is such as to make that clause part of the contract.

Article 8. Arbitration Agreement and Substantive Claim before Court

1. A court in which an action is brought in a matter which is the subject of an arbitration agreement shall, if any of the parties so requests not later than when submitting his first statement on the substance of the dispute, stay its proceedings and refer the parties to arbitration unless it finds that the agreement is null and void, inoperative or incapable of being performed.

2. Where an action referred to in paragraph 1 of this article has been brought, arbitral proceedings may nevertheless be commenced or continued, and an award may be made, while the issue of jurisdiction is pending before the court.

Article 9. Arbitration Agreement and Interim Measures by Court

It is not incompatible with an arbitration agreement for a party to request, before or during arbitral proceedings, a court to order interim measures of protection and for a court to take a decision granting such measures.

CHAPTER III. COMPOSITION OF THIRD-PARTY TRIBUNAL

Article 10. Number of Arbitrators

1. The parties are free to determine the number of arbitrators.
2. If the parties have not determined such number, three arbitrators shall be appointed.

Article 11. Appointment of Arbitrators

1. No person shall be precluded by reason of his nationality from acting as an arbitrator, unless otherwise agreed by the parties.

2. The parties are free to agree on a procedure of appointing the arbitrator or arbitrators, subject to the provisions of paragraphs 4 and 5 of this article.

3. Failing such agreement,
 - in an arbitration with three arbitrators, each party shall appoint one arbitrator, and the two arbitrators thus appointed shall appoint the third arbitrator; if a party fails to appoint the arbitrator within 30 days of receipt of a request to do so from the other party, or if the two arbitrators fail to agree on the third arbitrator within 30 days of their appointment, the appointment shall be made, upon request of a party, by the authority specified in article 6(1);
 - in an arbitration with a sole arbitrator, if the parties are unable to agree on the arbitrator, he shall be appointed, upon request of a party, by the authority specified in article 6(1).

4. Where, under an appointment procedure agreed upon by the parties,
 - a party fails to act as required under such procedure, or
 - the parties, or two arbitrators, are unable to reach an agreement expected of them under such procedure; or
 - a third party, including an institution, fails to perform any function entrusted to it under such procedure,

any party may request the authority specified in article 6(1) to take the necessary measures, unless the agreement on the appointment procedure provides other means for securing the appointment.

5. A decision on any matter entrusted by paragraph 3 or 4 of this article to the authority specified in article 6(1) shall be subject to no appeal. The authority, in appointing an arbitrator, shall have due regard to any qualifications required of the arbitrator by the agreement of the parties and to such considerations as are likely to secure the appointment of an independent and impartial arbitrator and, in the case of a sole or third arbitrator, shall take into account as well the advisability of appointing an arbitrator of a nationality other than those of the parties.

Article 12. Grounds for Challenge of Arbitrator

1. When a person is approached in connection with his possible appointment as an arbitrator, he shall disclose any circumstances which may give rise to justifiable doubts as to his impartiality or independence. An arbitrator, from the time of his appointment and throughout the arbitral proceedings, shall without delay disclose any such circumstances to the parties, unless they have already been informed of them by him.

2. An arbitrator may be challenged only if circumstances exist that give rise to justifiable doubts as to his impartiality or independence, or if he does not possess qualifications required by the agreement of the parties. A party may challenge an arbitrator appointed by him, or in whose appointment he has participated, only for reasons of which he becomes aware after the appointment has been made.

Article 13. Challenge Procedure

1. The parties are free to agree on a procedure for challenging an arbitrator, subject to the provisions of paragraph 3 of this article.

2. Failing such agreement, a party who intends to challenge an arbitrator shall, within 15 days after becoming aware of the constitution of the arbitral tribunal or after becoming aware of any circumstances referred to in article 12(2), communicate the reasons for the challenge in writing to the arbitral tribunal. Unless the challenged arbitrator withdraws from his office or the other party agrees to the challenge, the arbitral tribunal shall decide on the challenge.

3. If a challenge under any procedure agreed upon by the parties or under the procedure of paragraph 2 of this article is not successful, the challenging party may request, within 30 days after having received notice of the decision rejecting the challenge, the authority specified in article 6(1) to decide on the challenge; its decision shall be subject to no appeal. While such a request is pending, the arbitral tribunal, including the challenged arbitrator, may continue the arbitral proceedings and make an award.

Article 14. Termination of Authority (Mandate) of Arbitrator

1. If an arbitrator becomes *de jure* or *de facto* unable to perform his functions or for other reasons fails to act without undue delay, his authorization (mandate) terminates if he withdraws from his office or if the parties agree on the termination. Otherwise, if a controversy remains concerning any of these grounds, any party may request the

authority specified in article 6(1) to decide on the termination of the mandate; its decision shall be subject to no appeal.

2. If, under this article or article 13(2), an arbitrator withdraws from his office or a party agrees to the termination of the mandate of an arbitrator, this does not imply acceptance of the validity of any ground referred to in this article or article 12(2).

Article 15. Substitution of Arbitrator

Where the mandate of an arbitrator terminates under article 13 or 14 or because of his withdrawal from office for any other reason or because of the revocation of his mandate by agreement of the parties or in any other case of termination of his mandate, a substitute arbitrator shall be appointed according to the rules that were applicable to the appointment of the arbitrator being replaced.

CHAPTER IV. JURISDICTION OF ARBITRAL TRIBUNAL

Article 16. Competence of Arbitral Tribunal to Rule on Its Jurisdiction

1. The arbitral tribunal may rule on its own jurisdiction, including any objections with respect to the existence or validity of the arbitration agreement. For that purpose, an arbitration clause which forms part of a contract shall be treated as an agreement independent of the other terms of the contract. A decision by the arbitral tribunal that the contract is null and void shall not entail *ipso jure* the invalidity of the arbitration clause.

2. A plea that the arbitral tribunal does not have jurisdiction shall be raised not later than the submission of the statement of defense. A party is not precluded from raising such a plea by the fact that he has appointed, or participated in the appointment of, an arbitrator. A plea that the arbitral tribunal is exceeding the scope of its authority shall be raised as soon as the matter alleged to be beyond the scope of its authority is raised during the arbitral proceedings. The arbitral tribunal may, in either case, admit a later plea if it considers the delay justified.

3. The arbitral tribunal may rule on a plea referred to in paragraph 2 of this article either as a preliminary question or in an award on the merits. If the tribunal rules as a preliminary question that it has jurisdiction, any party may request, within 30 days after having received notice of that ruling, the court specified in article 6(2) to decide the matter; such a decision shall be subject to no appeal. While such a request is pending, the arbitral tribunal may continue the arbitral proceedings and make an award.

Article 17. Power of Arbitral Tribunal to Order Interim Measures

Unless otherwise agreed by the parties, the arbitral tribunal may, at the request of a party, order any party to take such interim measures of protection as the arbitral tribunal may consider necessary in respect of the subject-matter of the dispute. The arbitral tribunal may require any party to provide appropriate security in connection with such measures.

CHAPTER V. CONDUCT OF ARBITRAL PROCEEDINGS

Article 18. Equal Treatment of Parties

The parties shall be treated with equality and each party shall be given a full opportunity of presenting his case.

Article 19. Determination of Rules of Procedure

1. Subject to the provisions of the present Law, the parties are free to agree on the procedure to be followed by the arbitral tribunal in conducting the proceedings.

2. Failing such agreement, the arbitral tribunal may, subject to the provisions of the present Law, conduct the arbitration in such manner as it considers appropriate. The powers conferred upon the arbitral tribunal include the power to determine the admissibility, relevance, materiality and weight of any evidence.

Article 20. Place of Arbitration

1. The parties are free to agree on the place of arbitration. Failing such agreement, the place of arbitration shall be determined by the arbitral tribunal having regard to the circumstances of the case, including the convenience of the parties.

2. Notwithstanding the provisions of paragraph 1 of this article, the arbitral tribunal may, unless otherwise agreed by the parties, meet at any other place it considers appropriate for consultation among the arbitrators, for hearing witnesses, experts or the parties, or for consultation of goods, other property or documents.

Article 21. Commencement of Arbitral Proceedings

Unless otherwise agreed by the parties, the arbitral proceedings in respect of a particular dispute commence on the date on which a request for that dispute to be referred to arbitration is received by the respondent.

Article 22. Language

1. The parties are free to agree on the language or languages to be used in the arbitral proceedings. Failing such agreement, the arbitral tribunal shall determine the language or languages to be used in the proceedings. This agreement or determination, unless otherwise specified therein, shall apply to any written statement by a party, any hearing and any award, decision or other communication by the arbitral tribunal.

2. The arbitral tribunal may order that any documentary evidence shall be accompanied by a translation into the language or languages agreed upon by the parties or determined by the arbitral tribunal.

Article 23. Statements of Claim and Defense

1. Within the period of time agreed by the parties or determined by the arbitral tribunal, the claimant shall state the facts supporting his claim, the points at issue and the relief or remedy sought, and the respondent shall state his defense in respect of these particulars, unless the parties have otherwise agreed as to the required elements of such statements. The parties may submit with their statements all documents they consider to be relevant or may add a reference to the documents or other evidence they will submit.

2. Unless otherwise agreed by the parties, either party may amend or supplement his claim or defense during the course of the arbitral proceedings, unless the arbitral tribunal considers it inappropriate to allow such amendment having regard to the delay in making it.

Article 24. Hearings and Written Proceedings

1. Subject to any contrary agreement by the parties, the arbitral tribunal shall decide whether to hold oral hearings for the presentation of evidence or for oral argument, or whether the proceedings shall be conducted on the basis of documents and other materials. However, unless the parties have agreed that no hearings shall be held, the arbitral tribunal shall hold such hearings at an appropriate stage of the proceedings, if so requested by a party.

2. The parties shall be given sufficient advance notice of any hearing and of any meeting of the arbitral tribunal for the purposes of inspection of goods, other property or documents.

3. All statements, documents or other information supplied to the arbitral tribunal by one party shall be communicated to the other party. Also any expert report or evidentiary document on which the arbitral tribunal may rely in making its decision shall be communicated to the parties.

Article 25. Failure to Submit Documents or to Appear at Hearing

Unless otherwise agreed by the parties, if, without showing sufficient cause,

- the claimant fails to communicate his statement of claim in accordance with article 23(1), the arbitral tribunal shall terminate the proceedings;
- the respondent fails to communicate his statement of defense in accordance with article 23(1), the arbitral tribunal shall continue the proceedings without treating such failure in itself as an admission of the claimant's allegations;
- any party fails to appear at a hearing or to produce documentary evidence, the arbitral tribunal may continue the proceedings and make the award on the evidence before it.

Article 26. Expert Appointed by Arbitral Tribunal

1. Unless otherwise agreed by the parties, the arbitral tribunal

- may appoint one or more experts to report to it on specific issues to be determined by the arbitral tribunal;
- may require a party to give the expert any relevant information or to produce, or to provide access to, any relevant documents, goods or other property for his inspection.

2. Unless otherwise agreed by the parties, if a party so requests or if the arbitral tribunal considers it necessary, the expert shall, after delivery of his written or oral report, participate in a hearing where the parties have the opportunity to put questions to him and to present expert witnesses in order to testify on the points at issue.

Article 27. Court Assistance in Taking Evidence

The arbitral tribunal or a party with the approval of the arbitral tribunal may request from a competent court of the Russian Federation assistance in taking evidence. The court may execute the request, being guided by its rules on taking evidence, including those on letters rogatory.

CHAPTER VI. MAKING OF AWARD AND TERMINATION OF PROCEEDINGS

Article 28. Rules Applicable to Substance of Dispute

1. The arbitral tribunal shall decide the dispute in accordance with such rules of law as are chosen by the parties as applicable to the substance of the dispute. Any designation of the law or legal system of a given State shall be construed as directly referring to the substantive law of that State and not to its conflict of laws rules.

2. Failing any designation by the parties, the arbitral tribunal shall apply the law determined by the conflict of laws rules which it considers applicable.

3. In all cases, the arbitral tribunal shall decide in accordance with the terms of the contract and shall take into account the usages of the trade applicable to the transaction.

Article 29. Decision Making by Panel of Arbitrators

In arbitral proceedings with more than one arbitrator, any decision of the arbitral tribunal shall be made, unless otherwise agreed by the parties, by a majority of all its members. However, questions of procedure may be decided by a presiding arbitrator, if so authorized by the parties or all members of the arbitral tribunal.

Article 30. Settlement

1. If, during arbitral proceedings, the parties settle the dispute, the arbitral tribunal shall terminate the proceedings and, if requested by the parties and not objected to by the arbitral tribunal, record the settlement in the form of an arbitral award on agreed terms.

2. An award on agreed terms shall be made in accordance with the provisions of article 31 and shall state that it is an award. Such an award has the same status and effect as any other award on the merits of the case.

Article 31. Form and Contents of Award

1. The award shall be made in writing and shall be signed by the arbitrator or arbitrators. In arbitral proceedings with more than one arbitrator, the signatures of the majority of all members of the arbitral tribunal shall suffice, provided that the reason for any omitted signature is stated.

2. The award shall state the reasons upon which it is based, a resolution regarding satisfaction or rejection of the claim, the amount of the arbitration fee and costs, and their apportioning.

3. The award shall state its date and the place of arbitration as determined in accordance with article 20(1). The award shall be deemed to have been made at that place.

4. After the award is made, a copy signed by the arbitrators in accordance with paragraph (1) of this article shall be delivered to each party.

Article 32. Termination of Arbitral Proceedings

1. The arbitral proceedings are terminated by the final award or by an order of the arbitral tribunal in accordance with paragraph (2) of this article.

2. The arbitral tribunal shall issue an order for the termination of the arbitral proceedings when:

the claimant withdraws his claim, unless the respondent objects thereto and the arbitral tribunal recognizes a legitimate interest on his part in obtaining a final settlement of the dispute;

the parties agree on the termination of the proceedings;

the arbitral tribunal finds that the continuation of the proceedings has for any other reason become unnecessary or impossible.

3. The mandate of the arbitral tribunal terminates with the termination of the arbitral proceedings, subject to the provisions of articles 33 and 34(4).

Article 33. Correction and Interpretation of Award; Additional Award

1. Within 30 days of receipt of the award, unless another period of time has been agreed upon by the parties:

any of the parties, with notice to the other party, may request the arbitral tribunal to correct in the award any errors in computation, any clerical or typographical errors or any errors of similar nature;

if so agreed by the parties, a party, with notice to the other party, may request the arbitral tribunal to give an interpretation of a specific point or part of the award.

If the arbitral tribunal considers the request to be justified, it shall make the correction or give the interpretation within 30 days of receipt of the request. Such interpretation shall form part of the award.

2. The arbitral tribunal may correct any error of the type referred to in the second subparagraph of paragraph 1 of this article on its own initiative within 30 days of the date of the award.

3. Unless otherwise agreed by the parties, any of the parties, with notice to the other party, may request, within 30 days of receipt of the award, the arbitral tribunal to make

an additional award as to claims presented in the arbitral proceedings but omitted from the award. If the arbitral tribunal considers the request to be justified, it shall make the additional award within 60 days.

4. The arbitral tribunal may extend, if necessary, the period of time within which it shall make a correction, interpretation or an additional award under paragraph 1 or 3 of this article.

5. The provisions of article 31 shall apply to a correction or interpretation of the award or to an additional award.

CHAPTER VII. RECOURSE AGAINST AWARD

Article 34. Application for Setting Aside as Exclusive Recourse against Arbitral Award

1. Recourse to a court against an arbitral award may be made only by an application for setting aside in accordance with paragraphs 2 and 3 of this article.

2. An arbitral award may be set aside by the court specified in article 6(2) only if:

(1) the party making the application for setting aside furnishes proof that:

- a party to the arbitration agreement referred to in article 7 was under some incapacity, or the said agreement is not valid under the law to which the parties have subjected it or, failing any indication thereon, under the law of the Russian Federation; or
- he was not given proper notice of the appointment of an arbitrator or of the arbitral proceedings or was otherwise unable to present his case; or
- the award was made regarding a dispute not contemplated by or not falling within the terms of the submission to arbitration, or contains decisions on matters beyond the scope of the submission to arbitration, provided that, if the decisions on matters submitted to arbitration can be separated from those not so submitted, only that part of the award which contains decisions on matters not submitted to arbitration may be set aside; or
- the composition of the arbitral tribunal or the arbitral procedure was not in accordance with the agreement of the parties, unless such agreement was in conflict with a provision of this Law from which the parties cannot derogate, or, failing such agreement, was not in accordance with this Law; or

(2) the court finds that:

- the subject-matter of the dispute is not capable of settlement by arbitration under the law of the Russian Federation; or
- the award is in conflict with the public policy of the Russian Federation.

3. An application for setting aside may not be made after three months have elapsed from the date on which the party making that application had received the award and, if a request had been made under article 33, from the date on which that request had been disposed of by the arbitral tribunal.

4. The court, which has been asked to set aside an award, may, where appropriate and so requested by a party, suspend the setting aside proceedings for a period of time determined by it in order to give the arbitral tribunal an opportunity to resume the arbitral proceedings or to take such other action as in the arbitral tribunal's opinion will eliminate the grounds for setting aside.

CHAPTER VIII. RECOGNITION AND ENFORCEMENT OF AWARDS

Article 35. Recognition and Enforcement

1. An arbitral award, irrespective of the country in which it was made, shall be recognized as binding and, upon application in writing to the competent court, shall be enforced subject to the provisions of this article and of article 36.

2. The party relying on an award or applying for its enforcement shall supply the duly authenticated original award or a duly certified copy thereof, and the original arbitration agreement referred to in article 7 or a duly certified copy thereof. If the award or agreement is made in a foreign language, the party shall supply a duly certified translation thereof into the Russian language.

Article 36. Grounds for Refusing Recognition or Enforcement of Arbitral Award

1. Recognition or enforcement of an arbitral award, irrespective of the country in which it was made, may be refused only:

(1) at the request of the party against whom it is invoked, if that party furnishes to the competent court where recognition or enforcement is sought proof that:

- a party to the arbitration agreement referred to in article 7 was under some incapacity; or the said agreement is not valid under the law to which the parties have subjected it or, failing any indication thereon, under the law of the country where the award was made; or
- the party against whom the award was made was not given proper notice of the appointment of an arbitrator or of the arbitral proceedings or was otherwise unable to present his case; or
- the award was made regarding a dispute not contemplated by or not falling within the terms of the submission to arbitration, or it contains decisions on matters beyond the scope of the submission to arbitration, provided that, if the decisions on matters submitted to arbitration can be separated from those not so submitted, that part of the award which contains decisions on matters submitted to arbitration may be recognized and enforced; or
- the composition of the arbitral tribunal or the arbitral procedure was not in accordance with the agreement of the parties or, failing such agreement, was not in accordance with the law of the country where the arbitration took place; or
- the award has not yet become binding on the parties or has been set aside or suspended by a court of the country in which, or under the law of which, that award was made; or

(2) if the court finds that:

- the subject-matter of the dispute is not capable of settlement by arbitration under the law of the Russian Federation; or
- the recognition or enforcement of the award would be contrary to the public policy of the Russian Federation.

2. If an application for setting aside or suspension of an award has been made to a court referred to in the fifth point of subparagraph 1 of paragraph 1 of this article, the Court where recognition or enforcement is sought may, if it considers it proper, adjourn its decision and may also, on the application of the party claiming recognition or enforcement of the award, order the other party to provide appropriate security.

President of the Russian Federation

B. Yeltsin

Moscow

The House of the Soviets of Russia

July 7, 1993

No. 5338-I

CHAMBER OF COMMERCE AND INDUSTRY OF THE RUSSIAN FEDERATION

RULES OF THE INTERNATIONAL COMMERCIAL ARBITRATION COURT

*In force 1 May 1995**

I. GENERAL PROVISIONS

Paragraph 1 – Jurisdiction

1. The International Commercial Arbitration Court (ICAC) is an independent, permanently functioning arbitral institution (third-party tribunal) acting under the Law of the Russian Federation on International Commercial Arbitration of June 7, 1993.

2. Pursuant to an agreement of the Parties, the following may be referred to the ICAC: disputes arising from contractual or other civil-law relationships in the course of foreign trade and other forms of international economic affairs, provided that the place of business of at least one of the Parties is situated abroad; as well as disputes arising between enterprises with foreign investment, international associations and organizations set up in the territory of the Russian Federation, disputes between their participants and also their disputes with other subjects of law of the Russian Federation.

Civil-law relationships, resulting in disputes that may be referred to the ICAC, in particular, include the relationships arising from purchase and sale (delivery) of goods, contracts of service and labor, exchange of goods and/or services, carriage of goods and passengers, commercial representation or agency, leasing, scientific-technical exchange, exchange with other results of intellectual activity, construction of industrial and other objects, licensing operations,

* This translation of the Rules has been prepared in consultation with Prof. S. Lebedev and is hereby based on the translation made available by the Chamber of Commerce and Industry of the Russian Federation.

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investment, crediting and settlement operations, insurance, joint ventures and other forms of industrial and business co-operation.

3. The ICAC shall entertain disputes where the parties have agreed in writing to submit to its arbitration disputes which have arisen or which may arise between them.

4. The ICAC shall also entertain disputes subject to its jurisdiction by virtue of international agreements.

5. The question of the ICAC jurisdiction in a given case shall be decided by the arbitral tribunal considering the case. For that purpose the arbitration clause, which forms part of a contract, shall be treated as an agreement independent of the other terms of the contract. A decision by the ICAC that the contract is null and void shall not entail *ipso jure* the invalidity of the arbitration clause. The ICAC may rule on its jurisdiction either as a preliminary question or in its award on the merits.

6. In cases subject to the jurisdiction of the ICAC, the President of the ICAC may, at the request of a party, determine the amount and the form of the security for a claim. A decision to take any measures of protection in respect of the subject-matter of the dispute to be settled by the ICAC may be taken under the present Rules (para. 30) by the arbitral tribunal formed to consider the given case.

If a party has requested a competent court to order measures for the security of the claim which is either subject to the jurisdiction of the ICAC or has already been filed therewith when the court has ruled to take such measures, the party shall immediately notify the ICAC thereof.

II. ORGANIZATION AND WORK

Paragraph 2 – Arbitrators

1. The arbitrators under the present Rules shall be elected or appointed from the number of persons possessing adequate special knowledge in resolving disputes related to the ICAC jurisdiction. The arbitrators are independent and impartial in fulfilling their duties. They are not representatives of the parties. A person assuming functions of an arbitrator shall disclose to the ICAC any circumstances likely to give rise to justifiable doubts as to his impartiality or independence with regard to any dispute in the resolving of which he is supposed to participate. The arbitrator shall without delay inform the ICAC about any such circumstance, if it becomes known to him later in the course of the arbitral proceedings.

2. The Chamber of Commerce and Industry of the Russian Federation shall approve the List of Arbitrators (hereinafter referred to as “the List of

Arbitrators”) for a period of 5 years. The List of Arbitrators shall specify the full name of the arbitrator, his education and place of work, scientific degree and title, speciality. The List of Arbitrators may be issued by the Secretariate of the ICAC to any interested person at his request.

3. Persons not included in the List of Arbitrators may also act as the arbitrators, unless otherwise envisaged by the present Rules.

Paragraph 3 – The President and Vice-President of the ICAC

1. The President of the ICAC and the Vice-President shall be elected for a period of 5 years by the general meeting of the persons included in the List of Arbitrators.

2. The President of the ICAC shall represent the ICAC in its relations within the country and abroad.

3. The President of the ICAC shall perform the functions stipulated by the present Rules.

4. The functions of the Vice-Presidents of the ICAC shall be defined by the President of the ICAC. Functions of the President of the ICAC in his absence shall be performed by one of the Vice-Presidents appointed by the President of the ICAC.

Paragraph 4 – Presidium of the ICAC

1. The Presidium of the ICAC shall include *ex officio* the President and the Vice-Presidents of the ICAC, three members of the Presidium elected by the general meeting of the persons included in the List of Arbitrators, and a person appointed by the President of the Chamber of Commerce and Industry of the Russian Federation. The President of the ICAC shall serve as the Chairman of the Presidium.

2. The Presidium of the ICAC shall resolve all the matters within its competence defined by the present Rules, study arbitration practice, consider matters of disseminating information about the ICAC activities, international ties of the ICAC and other issues of the ICAC activities. The meetings of the ICAC Presidium shall be attended by the Executive Secretary of the ICAC with the right of a deliberative vote.

3. Resolutions of the Presidium shall be passed by a simple majority of votes provided that more than half of the Presidium members took part in the voting. The Executive Secretary of the ICAC shall perform the functions of the Presidium Secretary.

Paragraph 5 – Reporters

1. The President of the ICAC shall appoint a reporter for each case, in respect of which arbitral proceedings have been commenced, who shall keep the

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record of the hearing, be present at closed conferences of the tribunal and execute its orders. Before the tribunal is formed, the reporter shall execute orders of the President of the ICAC or the Executive Secretary of the ICAC that relate to the arbitral proceedings, and also other functions defined by the Regulations on the Reporters approved by the Presidium of the ICAC.

2. The List of the Reporters shall be approved by the Presidium of the ICAC for a period of 5 years. Included in the List of the Reporters are persons with higher juridical education and knowing, as a rule, a foreign language.

Paragraph 6 – The Secretariate

1. The Secretariate shall perform functions required to support the activities of the ICAC under the present Rules. The Secretariate shall be headed by the Executive Secretary appointed by the Chamber of Commerce and Industry of the Russian Federation in co-ordination with the President of the ICAC.

2. The Executive Secretary shall have a Deputy. Distribution of the responsibilities between the Executive Secretary and his Deputy, and also among other staff of the Secretariate is laid on the Executive Secretary.

3. When performing functions related to arbitral proceedings in the ICAC, the Secretariate shall be subordinated to the President of the ICAC.

Paragraph 7 – Seat of the ICAC and the Place of Hearings

1. The seat of the ICAC and the place of hearings shall be the city of Moscow.

2. The parties may agree to hold hearings in another place in the territory of the Russian Federation. In such case, all additional expenses incurred in connection with holding the hearings outside the city of Moscow shall be borne by the disputing parties. The ICAC may demand that the parties first provide an adequate guarantee that the expenses will be compensated.

3. In agreement with the President of the ICAC the arbitral tribunal, if necessary, may hold its hearings, outside the city of Moscow, in another place in the territory of the Russian Federation.

Paragraph 8 – Confidentiality

The arbitrators, the reporters and the staff of the Secretariate must ensure the confidentiality of information which has become known to them about the disputes examined by the ICAC which can impair interests of the parties.

Paragraph 9 – Presentation of Documents

1. All documents pertaining to the institution and carrying out of the arbitral proceedings shall be presented by the parties to the ICAC in five copies, or in three copies, if the case is to be considered by a sole arbitrator, unless

otherwise determined, in case of necessity, by the Executive Secretary of the ICAC.

2. The documents mentioned in sub-para. 1 of this paragraph, excluding written evidence (para. 34, sub-para. 2), shall be presented in the language of the contract, or in the language of the correspondence conducted by the parties between themselves, or in the Russian language. The ICAC may, at its own discretion or at a party's request, direct the other party to translate into Russian the documents presented by him or to secure such translation at that other party's expense.

Paragraph 10 – Language of the Hearing

The hearing shall be conducted in the Russian language. With the consent of the parties the ICAC may conduct the hearing in another language. If a party does not know the language in which the hearing is conducted, the ICAC shall, at the party's request and expense, provide him with the services of an interpreter.

Paragraph 11 – Duration of Proceedings in a Case

The ICAC shall take measures to secure, as far as possible, completion of the proceedings in a case within 180 days from the date of the formation of the arbitral tribunal (election or appointment of a sole arbitrator).

Paragraph 12 – Forwarding and Serving of Documents

1. The Secretariate of the ICAC shall see that all documents in a case are forwarded to the parties. They shall be sent to the addresses indicated by the parties. The parties shall immediately notify the ICAC about any changes in the earlier indicated addresses.

2. Statements of claim, statements of defence, notices of hearings, arbitral awards, orders and rulings shall be forwarded by registered letters with return receipt requested or by any other means which provides a record of the attempt to deliver the communication in question.

3. Other documents may be forwarded by registered or ordinary mail, notices and notifications may be also sent by cable, telex or telefax, numbers of which are indicated by the parties.

4. Any of the aforesaid documents may equally be delivered or served personally to a party against receipt.

5. Any written communication is deemed to have been received if it is delivered to the party personally or if it is delivered at his place of business, permanent residence or mailing address. If none of these can be found after making a reasonable inquiry, a written communication is deemed to have been received if it is sent to the last-known place of business, permanent residence

or mailing address of the party by registered letter or any other means which provides a record of the attempt to deliver it.

6. The communications is deemed to have been received on the date of the delivery accomplished under sub-para. 5 of this paragraph.

Paragraph 13 – Applicable Law

1. The ICAC shall settle disputes on the basis of the applicable rules of substantive law determined by an agreement of the parties. Failing any designation by the parties, the arbitral tribunal shall apply the law determined by the conflict of laws rules which it considers applicable. In all cases, the arbitral tribunal shall decide in accordance with the terms of the contract and shall take into account the usages of the trade applicable to the transaction.

2. The ICAC shall apply the provisions of the present Rules to the proceedings. When resolving questions regulated neither by the present Rules nor by the parties' agreement, the ICAC subject to the provisions of the Russian law relating to international commercial arbitration shall carry out the proceedings in such a manner as it thinks fit, subject to the condition that the parties shall be treated with equality and that each party shall have the opportunity to properly defend his interests.

III. ARBITRAL PROCEEDINGS

1. Institution of Proceedings

Paragraph 14 – Bringing of an Action

1. The arbitral proceedings shall be instituted by filing a statement of claim with the ICAC.

2. The date of filing of the statement of claim shall be the date of its delivery to the ICAC and, if the statement of claims is sent by post, the date of the stamp of the postoffice at the place of sending.

Paragraph 15 – Content of the Statement of Claim

1. The statement of claim shall include:

- (a) the names of the parties;
- (b) the claimant's demands;
- (c) substantiation of the ICAC jurisdiction;
- (d) circumstances of fact and law on which the claimant bases his claim and indication of evidence corroborating these circumstances;
- (e) the amount of the claim;

- (f) full names of the arbitrator and reserve arbitrator chosen by the claimant or the request for appointment of an arbitrator and reserve arbitrator by the President of the ICAC;
- (g) list of documents attached to the statement of claim;
- (h) the claimant's signature.

Paragraph 16 – Amount of the Claim

1. The amount of the claim shall be determined:

- (a) if the claim is for recovery of money, by the sum sought to be recovered;
- (b) if the claim is for vindication of property, by the value of the property sought to be vindicated;
- (c) if the claim is for recognition or transformation of a legal relationship, by the value of the subject-matter of the relationship at the moment of bringing the action;
- (d) if the claim is for an act to be done or forborne from, on the basis of the available information as to the property interests of the claimant.

The claimant has also to indicate the amount of the claim in the cases when his statement of claim or any part of the claim is of non-pecuniary nature.

2. If the claim consists of several demands, the amount of each demand shall be indicated separately. In this case, the amount of the claim shall be the total amount of all demands.

3. If the claimant has failed to determine, or has incorrectly determined the amount of the claim, the ICAC shall, on its own initiative or at the request of the respondent, determine the amount of the claim on the basis of the available information.

Paragraph 17 – Rectification of the Statement of Claim

1. On finding that the statement of claim has been filed in violation of the requirements of para. 15 of the present Rules, the Executive Secretary of the ICAC shall invite the claimant to rectify the defects so found. The period to rectify the defects shall not exceed two months from the date of the receipt of such invitation.

2. Where, despite the invitation to rectify the defects of the statement of claim, the claimant does not rectify them but insists on the case being examined, the ICAC shall either make an award or order to terminate the proceedings.

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Paragraph 18 – Arbitration Expenses

1. When filing a statement of claim or a request for the security of a claim, the claimant shall pay registration fee. The claim or the request shall be deemed to be not filed until the registration fee is paid. The registration fee is not refundable.

2. The claimant shall ensure the advance payment of the arbitration fee in respect of each claim filed. The registration fee paid by the claimant at the time of filing the statement of claim shall be counted towards the sum of advance.

The arbitral proceedings in respect of any given claim is not to be initiated and the case is to remain without progress until the advance payment of the arbitration fee is effected.

3. The amount of the registration fee and arbitration fee, the procedure for their payment and apportionment, and also the procedure for covering other arbitral proceedings costs are established by the Schedule on Arbitration Fees and Costs being an integral part of the present Rules.

2. Preparation of the Case for Examination

Paragraph 19 – Notification of the Respondent and Election of Arbitrator by the Respondent

1. Upon receipt of the statement of claim the Executive Secretary of the ICAC shall notify the respondent thereof and shall send him copies of the statement of claim and of the documents attached thereto.

2. At the same time the Executive Secretary shall invite the respondent to file his written explanations supported by relevant evidence within not more than 45 days after receiving the copy of the statement of claim.

3. Within 30 days after receiving the copy of the statement of claim the respondent shall indicate the full names of the arbitrator and reserve arbitrator chosen by him or request the appointment of an arbitrator and reserve arbitrator by the President of the ICAC.

Paragraph 20 – Formation of the Arbitral Tribunal

1. If the parties have not agreed that the case shall be considered by a sole arbitrator, the arbitral tribunal shall consist of three arbitrators. The functions of a tribunal, as specified in the Rules, shall equally apply to a sole arbitrator.

2. If the respondent fails to choose an arbitrator and reserve arbitrator within the time envisaged in para. 19, sub-para. 3, of the present Rules, the arbitrator and reserve arbitrator shall be appointed on his behalf by the President of the ICAC from the List of Arbitrators.

3. The arbitrators chosen by the parties or appointed by the President of the ICAC shall elect the chairman of the arbitral tribunal from the List of Arbitrators. Following the same procedure they may also elect a reserve chairman of the tribunal. If the arbitrators fail to elect the chairman of the tribunal within 30 days from the date of the election or appointment of the second arbitrator, the chairman of the arbitral tribunal shall be appointed by the President of the ICAC from the List of Arbitrators. Following the same procedure the President of the ICAC may also elect a reserve chairman of the tribunal.

4. Where there are two or more claimants or respondents, the claimants and the respondents shall choose one arbitrator and one reserve arbitrator on each side. They may also request the President of the ICAC to appoint an arbitrator and reserve arbitrator on their behalf.

If the claimants and the respondents fail to agree within 30 days, the arbitrator and reserve arbitrator shall be appointed by the President of the ICAC from the List of Arbitrators. The indicated term shall be counted from the date when the need was found to elect one arbitrator and one reserve arbitrator each by two and more claimants or respondents.

Paragraph 21 – Election or Appointment of a Sole Arbitrator

If, as agreed by the parties, the case is to be considered by a sole arbitrator, the sole arbitrator and reserve sole arbitrator shall be chosen by agreement of the parties. They may also request the President of the ICAC for appointment of a sole arbitrator and reserve sole arbitrator on their behalf. Failing such agreement, the sole arbitrator and reserve sole arbitrator shall be appointed by the President of the ICAC from the List of Arbitrators.

Paragraph 22 – Preparation of the Case for Examination

1. The arbitral tribunal shall check the state of preparation of the case of examination and, if it deems necessary, shall take further measures to prepare the case, particularly by obtaining written explanations, evidence, or other additional documents from the parties. If the tribunal decides to take further measures to prepare the case, it shall determine time limits within which such further measures shall be carried out.

2. The chairman of the arbitral tribunal may give instructions to the Executive Secretary of the ICAC in connection with the preparation and the conduct of the proceedings. He shall also direct the Executive Secretary to invite the parties to the hearing.

ARBITRATION RULES

Paragraph 23 – Notification of the Parties about the Hearing

1. The parties shall be notified of the time and place of a hearing by notices which shall be forwarded to them so as to enable each party to have at least 30 days at his disposal to prepare for and to appear at the hearing. Upon agreement of the parties this period may be reduced.

2. Should there be a need to conduct further hearings, their dates shall be set by the arbitral tribunal with consideration of particular circumstances.

Paragraph 24 – Challenge to Arbitrator, Expert, or Interpreter

1. Each party shall be entitled to challenge an arbitrator, the chairman of the arbitral tribunal, or a sole arbitrator, if circumstances exist that give rise to justifiable doubts as to their impartiality or independence, particularly if it can be supposed that they are personally, directly or indirectly interested in the outcome of the proceedings. The challenge request may also be submitted if an arbitrator does not possess the qualifications stipulated in the parties' agreement.

The party shall submit its written challenge request containing the reasons thereof not later than 15 days after becoming aware of the constitution of the arbitral tribunal or after becoming aware of any circumstances which may be a ground for the challenge. Such request submitted subsequently shall be considered only if the arbitral tribunal finds the delay justified.

2. The other members of the arbitral tribunal shall decide on the challenge. If they fail to come to an agreement, or if two arbitrators or a sole arbitrator are challenged, the challenge shall be decided by the Presidium of the ICAC.

The Presidium of the ICAC shall be entitled to take the initiative in resolving the question of challenge to any arbitrator, the chairman of the arbitral tribunal, or a sole arbitrator for the reasons stipulated in sub-para. 1 of the present paragraph.

3. Any arbitrator, the chairman of the arbitral tribunal, or any sole arbitrator may also withdraw on his own initiative.

4. Provisions of sub-paras. 1 through 3 of the present paragraph shall also apply to the arbitrator, chairman of the arbitral tribunal, or sole arbitrator elected or appointed as a reserve arbitrator, reserve chairman of the arbitral tribunal, or reserve sole arbitrator.

5. Experts and interpreters participating in the proceedings can be challenged for the same reasons mentioned in sub-para. 1 of the present paragraph. In this case, the question of challenge shall be decided by the arbitral tribunal.

Paragraph 25 – Termination of Arbitrator's Mandate

1. If an arbitrator, the chairman of the arbitral tribunal, or a sole arbitrator is legally or physically unable to perform his functions or does not perform his

functions without undue delay for any other reasons, the mandate of any of them can be terminated upon mutual agreement of the parties.

2. The mandate of an arbitrator, the chairman of the arbitral tribunal, or a sole arbitrator shall be also terminated in case of his statement of withdrawal.

3. In case there are causes stipulated in sub-para. 1 of the present paragraph, and in case the parties have failed to reach a relevant agreement, each of the parties shall be entitled to apply to the Presidium of the ICAC with the request to resolve the question of termination of the mandate of the arbitrator, chairman of the arbitral tribunal, or sole arbitrator.

The Presidium of the ICAC shall be entitled to take initiative in resolving the question of termination of the mandate of any arbitrator, the chairman of the arbitral tribunal, or any sole arbitrator provided there are causes stipulated in sub-para. 1 of the present paragraph.

Paragraph 26 – Substitutions in the Arbitral Tribunal

1. If the chairman of the arbitral tribunal, sole arbitrator, or arbitrator was challenged or is not able to participate in the consideration of the case for other reasons, his place shall be taken by the reserve chairman of the arbitral tribunal, reserve sole arbitrator, or reserve arbitrator, respectively. If such substitution is impossible, a new chairman of the arbitral tribunal, sole arbitrator, or arbitrator shall be elected or appointed in accordance with the Rules. If the chairman of the arbitral tribunal, sole arbitrator, or arbitrator was appointed by the President of the ICAC, the latter shall also make new appointments.

2. If necessary and with regard to the views of the parties the arbitral tribunal may examine afresh issues which have been already considered in the course of hearings preceding the substitution.

3. Examination of the Case

Paragraph 27 – Hearing

Any hearing is conducted to enable the parties to express their stands on the base of the presented evidence and for oral argument. The hearing of the case shall be conducted in private. With permission of the arbitral tribunal and with the consent of the parties, persons not participating in the proceedings may be present at the hearing.

ARBITRATION RULES

Paragraph 28 – Participation of the Parties

1. The parties may present their cases in the ICAC directly or through duly authorized representatives appointed by the parties at their discretion, including those appointed from among foreign citizens and organizations.

2. Failure to appear by a party who has been duly notified of the time and place of the hearing shall not prevent the case from being examined and the award from being made, unless the defaulting party has requested in writing to adjourn the proceedings for good reasons.

3. Either party may request the hearing of the case to be conducted in his absence.

Paragraph 29 – Communication of Documents

The Secretariate of the ICAC shall communicate all documents submitted to the ICAC by either party to the other party. The parties shall also receive any experts' report or any other evidentiary document on which the arbitral award may be based.

Paragraph 30 – Interim Measures of Protection

1. At the request of any party the arbitral tribunal may order any party to take such interim measures of protection in respect of the subject-matter of the dispute, as it may consider necessary. It may also require any party to provide appropriate security in connection with such measure.

2. The arbitral tribunal may order to take such measures of protection in the form of an interim award.

Paragraph 31 – Examination of the Case on the Basis of Written Materials

The parties may agree that the arbitral tribunal settle the dispute on the basis of documents and other materials only without holding any hearing. However, the tribunal may direct that a hearing be held, if the materials presented prove insufficient for the resolution of the dispute on the merits.

Paragraph 32 – Amendments or Supplements to Claim or Defence

1. Before the hearing is completed either party may, without undue delay, amend or supplement his claim or defence therein.

2. If the arbitral tribunal finds the delay caused by the party in amending or supplementing his claim or defence unjustified, it may charge that party with any additional costs of the ICAC and expenses of the other party resulting therefrom.

The arbitral tribunal may consider it inappropriate to allow such amendment or supplementation to the claim or defence having regard to the delay caused.

Paragraph 33 – Counterclaim and Claim for Set-Off

1. The respondent shall be entitled within the period of time specified in para. 19, sub-para. 2, to make a counterclaim arising out of the same contract or to rely on a claim arising out of the same contract for the purpose of a set-off.

If due to an unjustified delay on the part of the respondent in submitting his counterclaim or claim for the purpose of a set-off the proceedings are protracted, the arbitral tribunal may charge the respondent with any additional costs of the ICAC and expenses of the other party resulting therefrom. The arbitral tribunal may think it inappropriate to allow making of such counterclaim or claim for the purpose of a set-off having regard to the delay caused.

2. The counterclaim and claim for the purpose of a set-off shall meet the same requirements as the principal claim.

Paragraph 34 – Evidence

1. Each party shall have the burden of proving the facts relied on to support his claim or defence. The arbitral tribunal may require the parties to present other evidence. It also may, at its own discretion, direct that expert examination be conducted and obtain evidence from third parties as well as summon and hear witnesses.

2. Either party may present written evidence in the original or in the form of copies certified by him. The arbitral tribunal may require translation of such evidence into another language where it is necessary in the interests of the examination of the case.

3. Verification of evidence shall be effected as directed by the arbitral tribunal. The arbitral tribunal may entrust one of the arbitrators with conducting such verification.

4. The arbitrators shall evaluate the evidence according to their inner convictions.

5. Failure by either party to present adequate evidence does not prevent the arbitral tribunal from continuing the proceedings and making of an award on the basis of the evidence before it.

Paragraph 35 – Participation of Third Parties

Any third party may only join the arbitral proceedings with the consent of the parties in dispute. The invitation of any third party to the proceedings, apart from the consent of the parties in dispute, requires the consent of the invited person. The request for the invitation of any third party is allowed, before the term for submitting explanations to the statement of claim has expired. The consent of the third party to the invitation shall be expressed in writing.

ARBITRATION RULES

Paragraph 36 – Adjournment of Hearing and Stay of Proceedings

Where necessary, at the request of the parties or on the initiative of the arbitral tribunal, the hearing can be adjourned or the proceedings stayed. Adjournment or stay shall be directed by a ruling.

Paragraph 37 – Record of Hearing

1. The hearing of the case shall be recorded; the record to include the following data:

- the name of the ICAC;
- the number of the case;
- the place and date of the hearing;
- the names of the parties in dispute;
- information as to the participation of the parties' representatives in the hearing;
- the full names of the arbitrators, reporter, witnesses, experts, interpreters and other participants in the hearing;
- a short description of the course of the hearing;
- the parties' demands and an account of other important statements of the parties;
- the indication of reasons for adjournment or for termination of the proceedings;
- the signatures of the arbitrators.

2. The parties may examine the contents of the record.

The arbitral tribunal may, at the request of any party, make a ruling to amend or supplement the record provided that the request is found to be justified.

3. A copy of the record shall be given to a party at his request.

4. Termination of Arbitral Proceedings

Paragraph 38 – Final Arbitral Award

The arbitral proceedings are terminated by the final award.

Paragraph 39 – Making of the Award

1. On finding that all facts related to the dispute have been sufficiently clarified the arbitral tribunal shall declare the hearing of the case completed and shall proceed to making of the award.

2. The award shall be made at a closed session by the majority of votes of the arbitral tribunal. If the award cannot be made by the majority of votes, the chairman of the tribunal shall make it. The dissenting arbitrator can express in writing his particular opinion which shall be attached to the award

Paragraph 40 – Announcement of the Award

1. On making of the award the operative part of it shall be orally announced to the parties, and if the parties are absent, may be communicated to them in writing.

2. A motivated arbitral award shall be sent to the parties in writing within a period, not exceeding, as a rule, 30 days, determined by the arbitral tribunal.

3. Upon completion of the hearing the tribunal may rule that the arbitral award shall be sent to the parties in written form without oral announcement of its operative part, within a period not exceeding, as a rule, 30 days.

4. The arbitral tribunal may conduct additional proceedings, if that is required for proper resolution of the dispute, unless the operative part of the award has been announced to the parties.

5. The President of the ICAC may, if necessary, prolong the periods mentioned in sub-paras. 2 and 3 of this paragraph.

Paragraph 41 – Content of the Award

1. The award shall include, in particular:

- the name of the ICAC;
- the number of the case;
- the place and date of the delivery of the award;
- the full names of the arbitrators;
- the names of the parties in dispute and other participants in the proceedings;
- the subject-matter of the dispute and a summary of the circumstances of the case;
- the reasons for the decision;
- the conclusion accepting or rejecting the claim;
- the amounts of the arbitration costs and fees in the case, and their apportionment among the parties;
- the signatures of the arbitrators.

2. If one of the arbitrators is not able to sign the award, the President of the ICAC shall verify it by his signature with an indication of the reasons therefor.

ARBITRATION RULES

Paragraph 42 – Correction, Interpretation of and Additions to the Award

1. Either party, with notice to the other party, may, within 30 days of receipt by him of the arbitral award, request the arbitral tribunal to correct in the award any errors in computation, any clerical or typographical errors or any errors of similar nature.

If the arbitral tribunal considers the request to be justified, it shall, within 30 days of receipt of the request, make the relevant corrections.

The arbitral tribunal may make such corrections on its own initiative within 30 days counting from the date of sending the arbitral award to the parties.

2. If so agreed by the parties, either of them, with notice to the other party, may, within 30 days of receipt by him of the arbitral award, request the arbitral tribunal to give an interpretation of a specific point or part of the award.

If the arbitral tribunal considers the request to be justified, it shall, within 30 days of receipt of the request, give the required interpretation.

3. Either party, with notice to the other party, may, within 30 days of receipt by him of the arbitral award, request the arbitral tribunal to make an additional award as to the claims which were duly presented in the arbitral proceedings, but, omitted from the award.

If the arbitral tribunal considers the request to be justified, it shall, within 60 days of receipt of the request, make the additional arbitral award.

4. The President of the ICAC may, if necessary, extend the periods mentioned in indentation 2 of sub-para. 1, indentation 2 of sub-para. 2 and indentation 2 of sub-para. 3 of this paragraph.

5. Any ruling concerning correction or interpretation of the award, as well as the additional award, shall be an integral part of the arbitral award.

Paragraph 43 – Amicable Settlement

1. If, during arbitral proceedings, the parties settle their dispute, the proceedings shall be terminated. At the parties' request the arbitral tribunal may record the settlement in the form of an arbitral award on agreed terms.

2. The relevant provisions of para. 41 of the present Rules shall also apply to the making of the arbitral award stipulated in the previous sub-paragraph.

Paragraph 44 – Execution of the Award

The awards of the ICAC shall be executed by the parties voluntarily within the period specified in the arbitral award. If no period is indicated in the award, the latter shall be carried out immediately.

Awards not carried out voluntarily within the specified period shall be enforced according to the law and international agreements

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Paragraph 45 – Termination of Proceedings without Making Award

1. If no final award is made in a case, the arbitral proceedings shall be terminated by an order.

2. An order to terminate the proceedings shall be issued, in particular, when:

(a) the claimant withdraws his claim, unless the respondent within 30 days of receipt of the notice thereof objects to termination of the proceedings and the arbitral tribunal recognizes a legitimate interest on his part in obtaining a final settlement of the dispute;

(b) the parties agree on the termination of the proceedings;

(c) the tribunal finds that the continuation of the proceedings has for some reason become unnecessary or impossible, in particular, in the absence of prerequisites required for the case to be examined and resolved on its merits, including where owing to the claimant's inaction the case stays without progress for more than six months.

3. Paras. 38 through 44 of the present Rules, respectively, apply to an order to terminate the proceedings. The order to terminate the proceedings prior to the formation of an arbitral tribunal shall be issued by the President of the ICAC.

APPENDIX

to the Rules of the International Commercial Arbitration Court
at the Chamber of Commerce and Industry of the Russian Federation

SCHEDULE ON ARBITRATION FEES AND COSTS

Paragraph 1 – Definitions

1. “*Registration fee*” shall mean a fee paid at the time of filing a statement of claim or request for the security of a claim with the ICAC to cover expenses arising prior to institution of the arbitral proceedings.

2. “*Arbitration fee*” shall mean a fee charged in respect of each claim filed with the ICAC to cover general expenses connected with the work of the ICAC (particularly, arbitrators' fees, reporters' fees, remuneration of the Secretariate, expenses of organization of the arbitral proceedings, etc.).

3. “*Additional costs of the ICAC*” shall mean specific expenses incurred by the ICAC in connection with examination of a particular case (particularly, expenses of conducting expert examination, etc.).

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**PART FIVE—INVESTMENT, SERVICES AND
RELATED MATTERS**

Chapter Eleven—Investment

Section A—Investment

Article 1101: Scope and Coverage

1. This Chapter applies to measures adopted or maintained by a Party relating to:

- (a) investors of another Party;
- (b) investments of investors of another Party in the territory of the Party; and
- (c) with respect to Articles 1106 and 1114, all investments in the territory of the Party.

* * *

**Section B—Settlement of Disputes between a Party and an Investor of
Another Party**

Article 1115: Purpose

Without prejudice to the rights and obligations of the Parties under Chapter Twenty (Institutional Arrangements and Dispute Settlement Procedures), this Section establishes a mechanism for the settlement of investment disputes that assures both equal treatment among investors of the Parties in accordance with the principle of international reciprocity and due process before an impartial tribunal.

Article 1116: Claim by an Investor of a Party on Its Own Behalf

1. An investor of a Party may submit to arbitration under this Section a claim that another Party has breached an obligation under:

- (a) Section A or Article 1503(2) (State Enterprises), or
- (b) Article 1502(3)(a) (Monopolies and State Enterprises) where the monopoly has acted in a manner inconsistent with the Party's obligations under Section A,

and that the investor has incurred loss or damage by reason of, or arising out of, that breach.

2. An investor may not make a claim if more than three years have elapsed from the date on which the investor first acquired, or should have first acquired, knowledge of the alleged breach and knowledge that the investor has incurred loss or damage.

Article 1117: Claim by an Investor of a Party on Behalf of an Enterprise

1. An investor of a Party, on behalf of an enterprise of another Party that is a juridical person that the investor owns or controls directly or indirectly, may submit to arbitration under this Section a claim that the other Party has breached an obligation under:

- (a) Section A or Article 1503(2) (State Enterprises), or
- (b) Article 1502(3)(a) (Monopolies and State Enterprises) where the monopoly has acted in a manner inconsistent with the Party's obligations under Section A,

and that the enterprise has incurred loss or damage by reason of, or arising out of, that breach.

2. An investor may not make a claim on behalf of an enterprise described in paragraph 1 if more than three years have elapsed from the date on which the enterprise first acquired, or should have first acquired, knowledge of the alleged breach and knowledge that the enterprise has incurred loss or damage.

3. Where an investor makes a claim under this Article and the investor or a noncontrolling investor in the enterprise makes a claim under Article 1116 arising out of the same events that gave rise to the claim under this Article, and two or more of the claims are submitted to arbitration under Article 1120, the claims should be heard together by a Tribunal established under Article 1126, unless the Tribunal finds that the interests of a disputing party would be prejudiced thereby.

4. An investment may not make a claim under this Section.

Article 1118: Settlement of a Claim through Consultation and Negotiation

The disputing parties should first attempt to settle a claim through consultation or negotiation.

Article 1119: Notice of Intent to Submit a Claim to Arbitration

The disputing investor shall deliver to the disputing Party written notice of its intention to submit a claim to arbitration at least 90 days before the claim is submitted, which notice shall specify:

- (a) the name and address of the disputing investor and, where a claim is made under Article 1117, the name and address of the enterprise;
- (b) the provisions of this Agreement alleged to have been breached and any other relevant provisions;
- (c) the issues and the factual basis for the claim; and
- (d) the relief sought and the approximate amount of damages claimed.

Article 1120: Submission of a Claim to Arbitration

1. Except as provided in Annex 1120.1, and provided that six months have elapsed since the events giving rise to a claim, a disputing investor may submit the claim to arbitration under:

- (a) the ICSID Convention, provided that both the disputing Party and the Party of the investor are parties to the Convention;
- (b) the Additional Facility Rules of ICSID, provided that either the disputing Party or the Party of the investor, but not both, is a party to the ICSID Convention; or
- (c) the UNCITRAL Arbitration Rules.

2. The applicable arbitration rules shall govern the arbitration except to the extent modified by this Section.

Article 1121: Conditions Precedent to Submission of a Claim to Arbitration

1. A disputing investor may submit a claim under Article 1116 to arbitration only if:

- (a) the investor consents to arbitration in accordance with the procedures set out in this Agreement; and
- (b) the investor and, where the claim is for loss or damage to an interest in an enterprise of another Party that is a juridical person that the investor owns or controls directly or indirectly, the enterprise, waive their right to initiate or continue before any administrative tribunal or court under the law of any Party, or

other dispute settlement procedures, any proceedings with respect to the measure of the disputing Party that is alleged to be a breach referred to in Article 1116, except for proceedings for injunctive, declaratory or other extraordinary relief, not involving the payment of damages, before an administrative tribunal or court under the law of the disputing Party.

2. A disputing investor may submit a claim under Article 1117 to arbitration only if both the investor and the enterprise:
 - (a) consent to arbitration in accordance with the procedures set out in this Agreement; and
 - (b) waive their right to initiate or continue before any administrative tribunal or court under the law of any Party, or other dispute settlement procedures, any proceedings with respect to the measure of the disputing Party that is alleged to be a breach referred to in Article 1117, except for proceedings for injunctive, declaratory or other extraordinary relief, not involving the payment of damages, before an administrative tribunal or court under the law of the disputing Party.
3. A consent and waiver required by this Article shall be in writing, shall be delivered to the disputing Party and shall be included in the submission of a claim to arbitration.
4. Only where a disputing Party has deprived a disputing investor of control of an enterprise:
 - (a) a waiver from the enterprise under paragraph 1(b) or 2(b) shall not be required; and
 - (b) Annex 1120.1(b) shall not apply.

Article 1122: Consent to Arbitration

1. Each Party consents to the submission of a claim to arbitration in accordance with the procedures set out in this Agreement.
2. The consent given by paragraph 1 and the submission by a disputing investor of a claim to arbitration shall satisfy the requirement of:
 - (a) Chapter II of the ICSID Convention (Jurisdiction of the Centre) and the Additional Facility Rules for written consent of the parties;
 - (b) Article II of the New York Convention for an agreement in writing; and

(c) Article I of the Inter-American Convention for an agreement.

Article 1123: Number of Arbitrators and Method of Appointment

Except in respect of a Tribunal established under Article 1126, and unless the disputing parties otherwise agree, the Tribunal shall comprise three arbitrators, one arbitrator appointed by each of the disputing parties and the third, who shall be the presiding arbitrator, appointed by agreement of the disputing parties.

Article 1124: Constitution of a Tribunal When a Party Fails to Appoint an Arbitrator or the Disputing Parties Are Unable to Agree on a Presiding Arbitrator

1. The Secretary-General shall serve as appointing authority for an arbitration under this Section.

2. If a Tribunal, other than a Tribunal established under Article 1126, has not been constituted within 90 days from the date that a claim is submitted to arbitration, the Secretary-General, on the request of either disputing party, shall appoint, in his discretion, the arbitrator or arbitrators not yet appointed, except that the presiding arbitrator shall be appointed in accordance with paragraph 3.

3. The Secretary-General shall appoint the presiding arbitrator from the roster of presiding arbitrators referred to in paragraph 4, provided that the presiding arbitrator shall not be a national of the disputing Party or a national of the Party of the disputing investor. In the event that no such presiding arbitrator is available to serve, the Secretary-General shall appoint, from the ICSID Panel of Arbitrators, a presiding arbitrator who is not a national of any of the Parties.

4. On the date of entry into force of this Agreement, the Parties shall establish, and thereafter maintain, a roster of 45 presiding arbitrators meeting the qualifications of the Convention and rules referred to in Article 1120 and experienced in international law and investment matters. The roster members shall be appointed by consensus and without regard to nationality.

Article 1125: Agreement to Appointment of Arbitrators

For purposes of Article 39 of the ICSID Convention and Article 7 of Schedule C to the ICSID Additional Facility Rules, and without prejudice to an objection to an arbitrator based on Article 1124(3) or on a ground other than nationality:

-
- (a) the disputing Party agrees to the appointment of each individual member of a Tribunal established under the ICSID Convention or the ICSID Additional Facility Rules;
 - (b) a disputing investor referred to in Article 1116 may submit a claim to arbitration, or continue a claim, under the ICSID Convention or the ICSID Additional Facility Rules, only on condition that the disputing investor agrees in writing to the appointment of each individual member of the Tribunal; and
 - (c) a disputing investor referred to in Article 1117(1) may submit a claim to arbitration, or continue a claim, under the ICSID Convention or the ICSID Additional Facility Rules, only on condition that the disputing investor and the enterprise agree in writing to the appointment of each individual member of the Tribunal.

Article 1126: Consolidation

1. A Tribunal established under this Article shall be established under the UNCITRAL Arbitration Rules and shall conduct its proceedings in accordance with those Rules, except as modified by this Section.
2. Where a Tribunal established under this Article is satisfied that claims have been submitted to arbitration under Article 1120 that have a question of law or fact in common, the Tribunal may, in the interests of fair and efficient resolution of the claims, and after hearing the disputing parties, by order:
 - (a) assume jurisdiction over, and hear and determine together, all or part of the claims; or
 - (b) assume jurisdiction over, and hear and determine one or more of the claims, the determination of which it believes would assist in the resolution of the others.
3. A disputing party that seeks an order under paragraph 2 shall request the Secretary-General to establish a Tribunal and shall specify in the request:
 - (a) the name of the disputing Party or disputing investors against which the order is sought;
 - (b) the nature of the order sought, and
 - (c) the grounds on which the order is sought.

4. The disputing party shall deliver to the disputing Party or disputing investors against which the order is sought a copy of the request.

5. Within 60 days of receipt of the request, the Secretary-General shall establish a Tribunal comprising three arbitrators. The Secretary-General shall appoint the presiding arbitrator from the roster referred to in Article 1124(4). In the event that no such presiding arbitrator is available to serve, the Secretary-General shall appoint, from the ICSID Panel of Arbitrators, a presiding arbitrator who is not a national of any of the Parties. The Secretary-General shall appoint the two other members from the roster referred to in Article 1124(4), and to the extent not available from that roster, from the ICSID Panel of Arbitrators, and to the extent not available from that Panel, in the discretion of the Secretary-General. One member shall be a national of the disputing Party and one member shall be a national of a Party of the disputing investors.

6. Where a Tribunal has been established under this Article, a disputing investor that has submitted a claim to arbitration under Article 1116 or 1117 and that has not been named in a request made under paragraph 3 may make a written request to the Tribunal that it be included in an order made under paragraph 2, and shall specify in the request:

- (a) the name and address of the disputing investor;
- (b) the nature of the order sought; and
- (c) the grounds on which the order is sought.

7. A disputing investor referred to in paragraph 6 shall deliver a copy of its request to the disputing parties named in a request made under paragraph 3.

8. A Tribunal established under Article 1120 shall not have jurisdiction to decide a claim, or a part of a claim, over which a Tribunal established under this Article has assumed jurisdiction.

9. On application of a disputing party, a Tribunal established under this Article, pending its decision under paragraph 2, may order that the proceedings of a Tribunal established under Article 1120 be stayed, unless the latter Tribunal has already adjourned its proceedings.

10. A disputing Party shall deliver to the Secretariat, within 15 days of receipt by the disputing Party, a copy of:

- (a) a request for arbitration made under paragraph (1) of Article 36 of the ICSID Convention;
- (b) a notice of arbitration made under Article 2 of Schedule C of the ICSID Additional Facility Rules; or

- (c) a notice of arbitration given under the UNCITRAL Arbitration Rules.
11. A disputing Party shall deliver to the Secretariat a copy of a request made under paragraph 3:
- (a) within 15 days of receipt of the request, in the case of a request made by a disputing investor;
 - (b) within 15 days of making the request, in the case of a request made by the disputing Party.
12. A disputing Party shall deliver to the Secretariat a copy of a request made under paragraph 6 within 15 days of receipt of the request.
13. The Secretariat shall maintain a public register of the documents referred to in paragraphs 10, 11 and 12.

Article 1127: Notice

A disputing Party shall deliver to the other Parties:

- (a) written notice of a claim that has been submitted to arbitration no later than 30 days after the date that the claim is submitted; and
- (b) copies of all pleadings filed in the arbitration.

Article 1128: Participation by a Party

On written notice to the disputing parties, a Party may make submissions to a Tribunal on a question of interpretation of this Agreement.

Article 1129: Documents

1. A Party shall be entitled to receive from the disputing Party, at the cost of the requesting Party a copy of:
- (a) the evidence that has been tendered to the Tribunal; and
 - (b) the written argument of the disputing parties.
2. A Party receiving information pursuant to paragraph 1 shall treat the information as if it were a disputing Party.

Article 1130: Place of Arbitration

Unless the disputing parties agree otherwise, a Tribunal shall hold an arbitration in the territory of a Party that is a party to the New York Convention, selected in accordance with:

- (a) the ICSID Additional Facility Rules if the arbitration is under those Rules or the ICSID Convention; or
- (b) the UNCITRAL Arbitration Rules if the arbitration is under those Rules.

Article 1131: Governing Law

1. A Tribunal established under this Section shall decide the issues in dispute in accordance with this Agreement and applicable rules of international law.
2. An interpretation by the Commission of a provision of this Agreement shall be binding on a Tribunal established under this Section.

Article 1132: Interpretation of Annexes

1. Where a disputing Party asserts as a defense that the measure alleged to be a breach is within the scope of a reservation or exception set out in Annex I, Annex II, Annex III or Annex IV, on request of the disputing Party, the Tribunal shall request the interpretation of the Commission on the issue. The Commission, within 60 days of delivery of the request, shall submit in writing its interpretation to the Tribunal.
2. Further to Article 1131(2), a Commission interpretation submitted under paragraph 1 shall be binding on the Tribunal. If the Commission fails to submit an interpretation within 60 days, the Tribunal shall decide the issue.

Article 1133: Expert Reports

Without prejudice to the appointment of other kinds of experts where authorized by the applicable arbitration rules, a Tribunal, at the request of a disputing party or, unless the disputing parties disapprove, on its own initiative, may appoint one or more experts to report to it in writing on any factual issue concerning environmental, health, safety or other scientific matters raised by a disputing party in a proceeding, subject to such terms and conditions as the disputing parties may agree.

Article 1134: Interim Measures of Protection

A Tribunal may order an interim measure of protection to preserve the rights of a disputing party, or to ensure that the Tribunal's jurisdiction is made fully effective, including an order to preserve evidence in the possession or control of a disputing party or to protect the Tribunal's jurisdiction. A Tribunal may not order attachment or enjoin the application

of the measure alleged to constitute a breach referred to in Article 1116 or 1117. For purposes of this paragraph, an order includes a recommendation.

Article 1135: Final Award

1. Where a Tribunal makes a final award against a Party, the Tribunal may award, separately or in combination, only:

- (a) monetary damages and any applicable interest;
- (b) restitution of property, in which case the award shall provide that the disputing Party may pay monetary damages and any applicable interest in lieu of restitution.

A tribunal may also award costs in accordance with the applicable arbitration rules.

2. Subject to paragraph 1, where a claim is made under Article 1117(1):

- (a) an award of restitution of property shall provide that restitution be made to the enterprise;
- (b) an award of monetary damages and any applicable interest shall provide that the sum be paid to the enterprise; and
- (c) the award shall provide that it is made without prejudice to any right that any person may have in the relief under applicable domestic law.

3. A Tribunal may not order a Party to pay punitive damages.

Article 1136: Finality and Enforcement of an Award

1. An award made by a Tribunal shall have no binding force except between the disputing parties and in respect of the particular case.

2. Subject to paragraph 3 and the applicable review procedure for an interim award, a disputing party shall abide by and comply with an award without delay.

3. A disputing party may not seek enforcement of a final award until:

- (a) in the case of a final award made under the ICSID Convention
 - (i) 120 days have elapsed from the date the award was rendered and no disputing party has requested revision or annulment of the award, or
 - (ii) revision or annulment proceedings have been completed; and

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- (b) in the case of a final award under the ICSID Additional Facility Rules or the UNCITRAL Arbitration Rules
 - (i) three months have elapsed from the date the award was rendered and no disputing party has commenced a proceeding to revise, set aside or annul the award, or
 - (ii) a court has dismissed or allowed an application to revise, set aside or annul the award and there is no further appeal.
- 4. Each Party shall provide for the enforcement of an award in its territory.
- 5. If a disputing Party fails to abide by or comply with a final award, the Commission, on delivery of a request by a Party whose investor was a party to the arbitration, shall establish a panel under Article 2008 (Request for an Arbitral Panel). The requesting Party may seek in such proceedings:
 - (a) a determination that the failure to abide by or comply with the final award is inconsistent with the obligations of this Agreement; and
 - (b) a recommendation that the Party abide by or comply with the final award.
- 6. A disputing investor may seek enforcement of an arbitration award under the ICSID Convention, the New York Convention or the Inter-American Convention regardless of whether proceedings have been taken under paragraph 5.
- 7. A claim that is submitted to arbitration under this Section shall be considered to arise out of a commercial relationship or transaction for purposes of Article I of the New York Convention and Article I of the Inter-American Convention.

Article 1137: General

Time when a Claim is Submitted to Arbitration

- 1. A claim is submitted to arbitration under this Section when:
 - (a) the request for arbitration under paragraph (1) of Article 36 of the ICSID Convention has been received by the Secretary-General;
 - (b) the notice of arbitration under Article 2 of Schedule C of the ICSID Additional Facility Rules has been received by the Secretary-General; or

- (c) the notice of arbitration given under the UNCITRAL Arbitration Rules is received by the disputing Party.

Service of Documents

2. Delivery of notice and other documents on a Party shall be made to the place named for that Party in Annex 1137.2.

Receipts under Insurance or Guarantee Contracts

3. In an arbitration under this Section, a Party shall not assert, as a defense, counterclaim, right of setoff or otherwise, that the disputing investor has received or will receive, pursuant to an insurance or guarantee contract, indemnification or other compensation for all or part of its alleged damages.

Publication of an Award

4. Annex 1137.4 applies to the Parties specified in that Annex with respect to publication of an award.

Article 1138: Exclusions

1. Without prejudice to the applicability or non-applicability of the dispute settlement provisions of this Section or of Chapter Twenty (Institutional Arrangements and Dispute Settlement Procedures) to other actions taken by a Party pursuant to Article 2102 (National Security), a decision by a Party to prohibit or restrict the acquisition of an investment in its territory by an investor of another Party, or its investment, pursuant to that Article shall not be subject to such provisions.

2. The dispute settlement provisions of this Section and of Chapter Twenty shall not apply to the matters referred to in Annex 1138.2.

Section C—Definitions

Article 1139: Definitions

For purposes of this Chapter:

disputing investor means an investor that makes a claim under Section B;

disputing parties means the disputing investor and the disputing Party;

disputing party means the disputing investor or the disputing Party;

disputing Party means a Party against which a claim is made under Section B;

enterprise means an “enterprise” as defined in Article 201 Definitions of General Application), and a branch of an enterprise;

enterprise of a Party means an enterprise constituted or organized under the law of a Party, and a branch located in the territory of a Party and carrying out business activities there.

equity or debt securities includes voting and non-voting shares, bonds, convertible debentures, stock options and warrants;

G7 Currency means the currency of Canada, France, Germany, Italy, Japan, the United Kingdom of Great Britain and Northern Ireland or the United States;

ICSID means the International Centre for Settlement of Investment Disputes;

ICSID Convention means the *Convention on the Settlement of Investment Disputes between States and Nationals of other States*, done at Washington, March 18, 1965;

Inter-American Convention means the *Inter-American Convention on International Commercial Arbitration*, done at Panama, January 30, 1975;

investment means:

- (a) an enterprise;
- (b) an equity security of an enterprise;
- (c) a debt security of an enterprise
 - (i) where the enterprise is an affiliate of the investor, or
 - (ii) where the original maturity of the debt security is at least three years,
but does not include a debt security, regardless of original maturity, of a state enterprise;
- (d) a loan to an enterprise
 - (i) where the enterprise is an affiliate of the investor, or
 - (ii) where the original maturity of the loan is at least three years,
but does not include a loan, regardless of original maturity, to a state enterprise;

- (e) an interest in an enterprise that entitles the owner to share in income or profits of the enterprise;
- (f) an interest in an enterprise that entitles the owner to share in the assets of that enterprise on dissolution, other than a debt security or a loan excluded from subparagraph (c) or (d);
- (g) real estate or other property, tangible or intangible, acquired in the expectation or used for the purpose of economic benefit or other business purposes; and
- (h) interests arising from the commitment of capital or other resources in the territory of a Party to economic activity in such territory, such as under
 - (i) contracts involving the presence of an investor's property in the territory of the Party, including turnkey or construction contracts, or concessions, or
 - (ii) contracts where remuneration depends substantially on the production, revenues or profits of an enterprise;

but investment does not mean,

- (i) claims to money that arise solely from
 - (i) commercial contracts for the sale of goods or services by a national or enterprise in the territory of a Party to an enterprise in the territory of another Party, or
 - (ii) the extension of credit in connection with a commercial transaction, such as trade financing, other than a loan covered by subparagraph (d); or
- (j) any other claims to money,
 - that do not involve the kinds of interests set out in subparagraphs (a) through (h);

investment of an investor of a Party means an investment owned or controlled directly or indirectly by an investor of such Party;

investor of a Party means a Party or state enterprise thereof, or a national or an enterprise of such Party, that seeks to make, is making or has made an investment;

investor of a non-Party means an investor other than an investor of a Party, that seeks to make, is making or has made an investment;

New York Convention means the *United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards*, done at New York, June 10, 1958;

Secretary-General means the Secretary-General of ICSID;

transfers means transfers and international payments;

Tribunal means an arbitration tribunal established under Article 1120 or 1126, and

UNCITRAL Arbitration Rules means the arbitration rules of the United Nations Commission on International Trade Law, approved by the United Nations General Assembly on December 15, 1976.

Annex 1120.1

Submission of a Claim to Arbitration

Mexico

With respect to the submission of a claim to arbitration:

- (a) an investor of another Party may not allege that Mexico has breached an obligation under:
 - (i) Section A or Article 1503(2) (State Enterprises), or
 - (ii) Article 1502(3)(a) (Monopolies and State Enterprises) where the monopoly has acted in a manner inconsistent with the Party's obligations under Section A,
both in an arbitration under this Section and in proceedings before a Mexican court or administrative tribunal; and
- (b) where an enterprise of Mexico that is a juridical person that an investor of another Party owns or controls directly or indirectly alleges in proceedings before a Mexican court or administrative tribunal that Mexico has breached an obligation under:
 - (i) Section A or Article 1503(2) (State Enterprises), or
 - (ii) Article 1502(3)(a) (Monopolies and State Enterprises) where the monopoly has acted in a manner inconsistent with the Party's obligations under Section A,
the investor may not allege the breach in an arbitration under this Section.

Annex 1137.2
Service of Documents on a Party Under Section B

Each Party shall set out in this Annex and publish in its official journal by January 1, 1994, the place for delivery of notice and other documents under this Section.

Annex 1137.4
Publication of an Award

Canada

Where Canada is the disputing Party, either Canada or a disputing investor that is a party to the arbitration may make an award public.

Mexico

Where Mexico is the disputing Party, the applicable arbitration rules apply to the publication of an award.

United States

Where the United States is the disputing Party, either the United States or a disputing investor that is a party to the arbitration may make an award public.

Annex 1138.2
Exclusions from Dispute Settlement

Canada

A decision by Canada following a review under the *Investment Canada Act*, with respect to whether or not to permit an acquisition that is subject to review, shall not be subject to the dispute settlement provisions of Section B or of Chapter Twenty (Institutional Arrangements and Dispute Settlement Procedures).

Mexico

A decision by the National Commission on Foreign Investment ("Comision Nacional de Inversiones Extranjeras") following a review pursuant to Annex I, page I-M-4, with respect to whether or not to permit an acquisition that is subject to review, shall not be subject to the dispute settlement provisions of Section B or of Chapter Twenty.

Chapter Fourteen—Financial Services

Article 1401: Scope and Coverage

1. This Chapter applies to measures adopted or maintained by a Party relating to:

- (a) financial institutions of another Party;
- (b) investors of another Party, and investments of such investors, in financial institutions in the Party's territory; and
- (c) cross-border trade in financial services.

2. Articles 1109 through 1111, 1113, 1114 and 1211 are hereby incorporated into and made a part of this Chapter. Articles 1115 through 1138 are hereby incorporated into and made a part of this Chapter solely for breaches by a Party of Articles 1109 through 1111, 1113 and 1114, as incorporated into this Chapter.

3. Nothing in this Chapter shall be construed to prevent a Party, including its public entities, from exclusively conducting or providing in its territory:

- (a) activities or services forming part of a public retirement plan or statutory system of social security; or
- (b) activities or services for the account or with the guarantee or using the financial resources of the Party, including its public entities.

4. Annex 1401.4 applies to the Parties specified in that Annex.

* * *

Article 1412: Financial Services Committee

1. The Parties hereby establish the Financial Services Committee. The principal representative of each Party shall be an official of the Party's authority responsible for financial services set out in Annex 1412.1.

2. Subject to Article 2001(2)(d) (Free Trade Commission), the Committee shall:

- (a) supervise the implementation of this Chapter and its further elaboration;
- (b) consider issues regarding financial services that are referred to it by a Party; and
- (c) participate in the dispute settlement procedures in accordance with Article 1415.

3. The Committee shall meet annually to assess the functioning of this Agreement as it applies to financial services. The Committee shall inform the Commission of the results of each annual meeting.

Article 1413: Consultations

1. A Party may request consultations with another Party regarding any matter arising under this Agreement that affects financial services. The other Party shall give sympathetic consideration to the request. The consulting Parties shall report the results of their consultations to the Committee at its annual meeting.

2. Consultations under this Article shall include officials of the authorities specified in Annex 1412.1.

3. A Party may request that regulatory authorities of another Party participate in consultations under this Article regarding that other Party's measures of general application which may affect the operations of financial institutions or cross-border financial service providers in the requesting Party's territory.

4. Nothing in this Article shall be construed to require regulatory authorities participating in consultations under paragraph 3 to disclose information or take any action that would interfere with individual regulatory, supervisory, administrative or enforcement matters.

5. Where a Party requires information for supervisory purposes concerning a financial institution in another Party's territory or a cross-border financial service provider in another Party's territory, the Party may approach the competent regulatory authority in the other Party's territory to seek the information.

6. Annex 1413.6 shall apply to further consultations and arrangements.

Article 1414: Dispute Settlement

1. Section B of Chapter Twenty (Institutional Arrangements and Dispute Settlement Procedures) applies as modified by this Article to the settlement of disputes arising under this Chapter.

2. The Parties shall establish by January 1, 1994 and maintain a roster of up to 15 individuals who are willing and able to serve as financial services panelists. Financial services roster members shall be appointed by consensus for terms of three years, and may be reappointed.

3. Financial services roster members shall:

- (a) have expertise or experience in financial services law or practice, which may include the regulation of financial institutions.
 - (b) be chosen strictly on the basis of objectivity, reliability and sound judgment; and
 - (c) meet the qualifications set out in Article 2009(2)(b) and (c) (Roster).
4. Where a Party claims that a dispute arises under this Chapter, Article 2011 (Panel Selection) shall apply, except that:
- (a) where the disputing Parties so agree, the panel shall be composed entirely of panelists meeting the qualifications in paragraph 3; and
 - (b) in any other case,
 - (i) each disputing Party may select panelists meeting the qualifications set out in paragraph 3 or in Article 2010(1) (Qualifications of Panelists), and
 - (ii) if the party complained against invokes Article 1410, the chair of the panel shall meet the qualifications set out in paragraph 3.
5. In any dispute where a panel finds a measure to be inconsistent with the obligations of this Agreement and the measure affects:
- (a) only the financial services sector, the complaining Party may suspend benefits only in the financial services sector;
 - (b) the financial services sector and any other sector, the complaining Party may suspend benefits in the financial services sector that have an effect equivalent to the effect of the measure in the Party's financial services sector; or
 - (c) only a sector other than the financial services sector, the complaining Party may not suspend benefits in the financial services sector.

Article 1415: Investment Disputes in Financial Services

1. Where an investor of another Party submits a claim under Article 1116 or 1117 to arbitration under Section B of Chapter Eleven (Investment - Settlement of Disputes between a Party and an Investor of Another Party) against a Party and the disputing Party invokes Article 1410, on request of the disputing Party, the Tribunal shall refer the matter in writing to the Committee for a decision. The Tribunal may not proceed pending receipt of a decision or report under this Article.

2. In a referral pursuant to paragraph 1, the Committee shall decide the issue of whether and to what extent Article 1410 is a valid defense to the claim of the investor. The Committee shall transmit a copy of its decision to the Tribunal and to the Commission. The decision shall be binding on the Tribunal.

3. Where the Committee has not decided the issue within 60 days of the receipt of the referral under paragraph 1, the disputing Party or the Party of the disputing investor may request the establishment of an arbitral panel under Article 2008 (Request for an Arbitral Panel). The panel shall be constituted in accordance with Article 1414. Further to Article 2017 (Final Report), the panel shall transmit its final report to the Committee and to the Tribunal. The report shall be binding on the Tribunal.

4. Where no request for the establishment of a panel pursuant to paragraph 3 has been made within 10 days of the expiration of the 60-day period referred to in paragraph 3, the Tribunal may proceed to decide the matter.

* * *

Chapter Twenty—Institutional Arrangements and Dispute Settlement Procedures.

Section A—Institutions

Article 2001: The Free Trade Commission

* * *

Article 2002: The Secretariat

1. ...

2. ...

3. The Secretariat shall:

(a) provide assistance to the Commission;

(b) provide administrative assistance to

(i) panels and committees established under Chapter Nineteen (Review and Dispute Settlement in Antidumping and Countervailing Duty Matters), in accordance with the procedures established pursuant to Article 1908, and

(ii) panels established under this Chapter, in accordance with procedures established pursuant to Article 2012; and

- (c) as the Commission may direct
 - (i) support the work of other committees and groups established under this Agreement, and
 - (ii) otherwise facilitate the operation of the Agreement.

Section B—Dispute Settlement

* * *

Section C—Domestic Proceedings and Private Commercial Dispute Settlement

Article 2020: Referrals of Matters from Judicial or Administrative Proceedings

1. If an issue of interpretation or application of this Agreement arises in any domestic judicial or administrative proceeding of a Party that any Party considers would merit its intervention, or if a court or administrative body solicits the view of a Party, that Party shall notify the other Parties and its Section of the Secretariat. The Commission shall endeavor to agree on an appropriate response as expeditiously as possible.
2. The Party in whose territory the court or administrative body is located shall submit any agreed interpretation of the Commission to the court or administrative body in accordance with the rules of that forum.
3. If the Commission is unable to agree, any Party may submit its own view to the court or administrative body in accordance with the rules of that forum.

Article 2021: Private Rights

No Party may provide for a right of action under its domestic law against any other Party on the ground that a measure of another Party is inconsistent with this Agreement.

Article 2022: Alternative Dispute Resolution

1. Each Party shall, to the maximum extent possible, encourage and facilitate the use of arbitration and other means of alternative dispute resolution for the settlement of international commercial disputes between private parties in the free trade area.

-
2. To this end, each Party shall provide appropriate procedures to ensure observance of agreements to arbitrate and for the recognition and enforcement of arbitral awards in such disputes.
 3. A Party shall be deemed to be in compliance with paragraph 2 if it is a party to and is in compliance with the 1958 *United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards* or the 1975 *Inter-American Convention on International Commercial Arbitration*.
 4. The Commission shall establish an Advisory Committee on Private Commercial Disputes comprising persons with expertise or experience in the resolution of private international commercial disputes. The Committee shall report and provide recommendations to the Commission on general issues referred to it by the Commission respecting the availability, use and effectiveness of arbitration and other procedures for the resolution of such disputes in the free trade area.

UNITED NATIONS COMMISSION ON INTERNATIONAL TRADE
LAW
(UNCITRAL)

UNCITRAL MODEL LAW ON
INTERNATIONAL COMMERCIAL ARBITRATION

UNITED NATIONS 1994

(United Nations document A/40/17, Annex I)
(As adopted by the United Nations Commission on International
Trade Law on 21 June 1985)

CHAPTER I. GENERAL PROVISIONS

Article 1. Scope of application*

(1) This Law applies to international commercial** arbitration, subject to any agreement in force between this State and any other State or States.

(2) The provisions of this Law, except articles 8, 9, 35 and 36, apply only if the place of arbitration is in the territory of this State.

(3) An arbitration is international if:

(a) the parties to an arbitration agreement have, at the time of the conclusion of that agreement, their places of business in different States; or

(b) one of the following places is situated outside the State in which the parties have their places of business:

(i) the place of arbitration if determined in, or pursuant to, the arbitration agreement;

(ii) any place where a substantial part of the obligations of the commercial relationship is to be performed or the place with which the subject-matter of the dispute is most closely connected; or

(c) the parties have expressly agreed that the subject-matter of the arbitration agreement relates to more than one country.

* Article headings are for reference purposes only and are not to be used for purposes of interpretation.

** The term "commercial" should be given a wide interpretation so as to cover matters arising from all relationships of a commercial nature, whether contractual or not. Relationships of a commercial nature include, but are not limited to, the following transactions: any trade transaction for the supply or exchange of goods or services; distribution agreement; commercial representation or agency; factoring; leasing; construction of works; consulting; engineering; licensing; investment; financing; banking; insurance; exploitation agreement or concession; joint venture and other forms of industrial or business co-operation; carriage of goods or passengers by air, sea, rail or road.

(4) For the purposes of paragraph (3) of this article:

(a) if a party has more than one place of business, the place of business is that which has the closest relationship to the arbitration agreement;

(b) if a party does not have a place of business, reference is to be made to his habitual residence.

(5) This Law shall not affect any other law of this State by virtue of which certain disputes may not be submitted to arbitration or may be submitted to arbitration only according to provisions other than those of this Law.

Article 2.
Definitions and rules of interpretation

For the purposes of this Law:

(a) "arbitration" means any arbitration whether or not administered by a permanent arbitral institution;

(b) "arbitral tribunal" means a sole arbitrator or a panel of arbitrators;

(c) "court" means a body or organ of the judicial system of a State;

(d) where a provision of this Law, except article 28, leaves the parties free to determine a certain issue, such freedom includes the right of the parties to authorize a third party, including an institution, to make that determination;

(e) where a provision of this Law refers to the fact that the parties have agreed or that they may agree or in any other way refers to an agreement of the parties, such agreement includes any arbitration rules referred to in that agreement;

(f) where a provision of this Law, other than in articles 25(a) and 32(2)(a), refers to a claim, it also applies to a counter-claim, and where it refers to a defence, it also applies to a defence to such counter-claim.

Article 3.
Receipt of written communications

(1) Unless otherwise agreed by the parties:

(a) any written communication is deemed to have been received if it is delivered to the addressee personally or if it is delivered at his place of business, habitual residence or mailing address; if none of these can be found after making a reasonable inquiry, a written communication is deemed to have been received if it is sent to the addressee's last-known place of business, habitual residence or mailing address by registered letter or any other means which provides a record of the attempt to deliver it;

(b) the communication is deemed to have been received on the day it is so delivered.

(2) The provisions of this article do not apply to communications in court proceedings.

Article 4.
Waiver of right to object

A party who knows that any provision of this Law from which the parties may derogate or any requirement under the arbitration agreement has not been complied with and yet proceeds with the arbitration without stating his objection to such non-compliance without undue delay or, if a time-limit is provided therefor, within such period of time, shall be deemed to have waived his right to object.

Article 5.
Extent of court intervention

In matters governed by this Law, no court shall intervene except where so provided in this Law.

Article 6.
Court or other authority for certain functions of arbitration assistance and supervision

The functions referred to in articles 11(3), 11(4), 13(3), 14, 16(3) and 34(2) shall be performed by ... [Each State enacting this model law specifies the court, courts or, where referred to therein, other authority competent to perform these functions.]

CHAPTER II. ARBITRATION AGREEMENT

Article 7.

Definition and form of arbitration agreement

(1) "Arbitration agreement" is an agreement by the parties to submit to arbitration all or certain disputes which have arisen or which may arise between them in respect of a defined legal relationship, whether contractual or not. An arbitration agreement may be in the form of an arbitration clause in a contract or in the form of a separate agreement.

(2) The arbitration agreement shall be in writing. An agreement is in writing if it is contained in a document signed by the parties or in an exchange of letters, telex, telegrams or other means of telecommunication which provide a record of the agreement, or in an exchange of statements of claim and defence in which the existence of an agreement is alleged by one party and not denied by another. The reference in a contract to a document containing an arbitration clause constitutes an arbitration agreement provided that the contract is in writing and the reference is such as to make that clause part of the contract.

Article 8.

Arbitration agreement and substantive claim before court

(1) A court before which an action is brought in a matter which is the subject of an arbitration agreement shall, if a party so requests not later than when submitting his first statement on the substance of the dispute, refer the parties to arbitration unless it finds that the agreement is null and void, inoperative or incapable of being performed.

(2) Where an action referred to in paragraph (1) of this article has been brought, arbitral proceedings may nevertheless be commenced or continued, and an award may be made, while the issue is pending before the court.

Article 9.

Arbitration agreement and interim measures by court

It is not incompatible with an arbitration agreement for a party to request, before or during arbitral proceedings, from a court an interim measure of protection and for a court to grant such measure.

CHAPTER III. COMPOSITION OF ARBITRAL TRIBUNAL

Article 10.

Number of arbitrators

(1) The parties are free to determine the number of arbitrators.

(2) Failing such determination, the number of arbitrators shall be three.

Article 11.

Appointment of arbitrators

(1) No person shall be precluded by reason of his nationality from acting as an arbitrator, unless otherwise agreed by the parties.

(2) The parties are free to agree on a procedure of appointing the arbitrator or arbitrators, subject to the provisions of paragraphs (4) and (5) of this article.

(3) Failing such agreement,

(a) in an arbitration with three arbitrators, each party shall appoint one arbitrator, and the two arbitrators thus appointed shall appoint the third arbitrator; if a party fails to appoint the arbitrator within thirty days of receipt of a request to do so from the other party, or if the two arbitrators fail to agree on the third arbitrator within thirty days of

their appointment, the appointment shall be made, upon request of a party, by the court or other authority specified in article 6,

(b) in an arbitration with a sole arbitrator, if the parties are unable to agree on the arbitrator, he shall be appointed, upon request of a party, by the court or other authority specified in article 6.

(4) Where, under an appointment procedure agreed upon by the parties,

(a) a party fails to act as required under such procedure, or

(b) the parties, or two arbitrators, are unable to reach an agreement expected of them under such procedure, or

(c) a third party, including an institution, fails to perform any function entrusted to it under such procedure,

any party may request the court or other authority specified in article 6 to take the necessary measure, unless the agreement on the appointment procedure provides other means for securing the appointment.

(5) A decision on a matter entrusted by paragraph (3) or (4) of this article to the court or other authority specified in article 6 shall be subject to no appeal. The court or other authority, in appointing an arbitrator, shall have due regard to any qualifications required of the arbitrator by the agreement of the parties and to such considerations as are likely to secure the appointment of an independent and impartial arbitrator and, in the case of a sole or third arbitrator, shall take into account as well the advisability of appointing an arbitrator of a nationality other than those of the parties.

Article 12.

Grounds for challenge

(1) When a person is approached in connection with his possible appointment as an arbitrator, he shall disclose any circumstances likely to give rise to justifiable doubts as to his impartiality or independence. An arbitrator, from the time of his appointment and throughout the arbitral proceedings, shall without delay disclose any such circumstances to the parties unless they have already been informed of them by him.

(2) An arbitrator may be challenged only if circumstances exist that give rise to justifiable doubts as to his impartiality or independence, or if he does not possess qualifications agreed to by the parties. A party may challenge an arbitrator appointed by him, or in whose appointment he has participated, only for reasons of which he becomes aware after the appointment has been made.

Article 13.

Challenge procedure

(1) The parties are free to agree on a procedure for challenging an arbitrator, subject to the provisions of paragraph (3) of this article.

(2) Failing such agreement, a party who intends to challenge an arbitrator shall, within fifteen days after becoming aware of the constitution of the arbitral tribunal or after becoming aware of any circumstance referred to in article 12(2), send a written statement of the reasons for the challenge to the arbitral tribunal. Unless the challenged arbitrator withdraws from his office or the other party agrees to the challenge, the arbitral tribunal shall decide on the challenge.

(3) If a challenge under any procedure agreed upon by the parties or under the procedure of paragraph (2) of this article is not successful, the challenging party may request, within thirty days after having received notice of the decision rejecting the challenge, the court or other authority specified in article 6 to decide on the challenge, which decision shall be subject to no appeal; while such a request is pending, the arbitral tribunal, including the challenged arbitrator, may continue the arbitral proceedings and make an award.

Article 14.

Failure or impossibility to act

(1) If an arbitrator becomes de jure or de facto unable to perform his functions or for other reasons fails to act without undue delay, his mandate terminates if he withdraws from his office or if the parties agree on the termination. Otherwise, if a controversy remains concerning any of these grounds, any party may request the court or other authority specified in article 6 to decide on the termination of the mandate, which decision shall be subject to no appeal.

(2) If, under this article or article 13(2), an arbitrator withdraws from his office or a party agrees to the termination of the mandate of an arbitrator, this does not imply acceptance of the validity of any ground referred to in this article or article 12(2).

Article 15. Appointment of substitute arbitrator

Where the mandate of an arbitrator terminates under article 13 or 14 or because of his withdrawal from office for any other reason, or because of the revocation of his mandate by agreement of the parties or in any other case of termination of his mandate, a substitute arbitrator shall be appointed according to the rules that were applicable to the appointment of the arbitrator being replaced.

CHAPTER IV. JURISDICTION OF ARBITRAL TRIBUNAL

Article 16. Competence of arbitral tribunal to rule on its jurisdiction

(1) The arbitral tribunal may rule on its own jurisdiction, including any objections with respect to the existence or validity of the arbitration agreement. For that purpose, an arbitration clause which forms part of a contract shall be treated as an agreement independent of the other terms of the contract. A decision by the arbitral tribunal that the contract is null and void shall not entail ipso jure the invalidity of the arbitration clause.

(2) A plea that the arbitral tribunal does not have jurisdiction shall be raised not later than the submission of the statement of defence. A party is not precluded from raising such a plea by the fact that he has appointed, or participated in the appointment of, an arbitrator. A plea that the arbitral tribunal is exceeding the scope of its authority shall be raised as soon as the matter alleged to be beyond the scope of its authority is raised during the arbitral proceedings. The arbitral tribunal may, in either case, admit a later plea if it considers the delay justified.

(3) The arbitral tribunal may rule on a plea referred to in paragraph (2) of this article either as a preliminary question or in an award on the merits. If the arbitral tribunal rules as a preliminary question that it has jurisdiction, any party may request, within thirty days after having received notice of that ruling, the court specified in article 6 to decide the matter, which decision shall be subject to no appeal; while such a request is pending, the arbitral tribunal may continue the arbitral proceedings and make an award.

Article 17. Power of arbitral tribunal to order interim measures

Unless otherwise agreed by the parties, the arbitral tribunal may, at the request of a party, order any party to take such interim measure of protection as the arbitral tribunal may consider necessary in respect of the subject-matter of the dispute. The arbitral tribunal may require any party to provide appropriate security in connection with such measure.

CHAPTER V. CONDUCT OF ARBITRAL PROCEEDINGS

Article 18. Equal treatment of parties

The parties shall be treated with equality and each party shall be given a full opportunity of presenting his case.

Article 19. Determination of rules of procedure

(1) Subject to the provisions of this Law, the parties are free to agree on the procedure to be followed by the arbitral tribunal in conducting the proceedings.

(2) Failing such agreement, the arbitral tribunal may, subject to the provisions of this Law, conduct the arbitration in such manner as it considers appropriate. The power conferred upon the arbitral tribunal includes the power to determine the admissibility, relevance, materiality and weight of any evidence.

Article 20. Place of arbitration

(1) The parties are free to agree on the place of arbitration. Failing such agreement, the place of arbitration shall be determined by the arbitral tribunal having regard to the circumstances of the case, including the convenience of the parties.

(2) Notwithstanding the provisions of paragraph (1) of this article, the arbitral tribunal may, unless otherwise agreed by the parties, meet at any place it considers appropriate for consultation among its members, for hearing witnesses, experts or the parties, or for inspection of goods, other property or documents.

Article 21. Commencement of arbitral proceedings

Unless otherwise agreed by the parties, the arbitral proceedings in respect of a particular dispute commence on the date on which a request for that dispute to be referred to arbitration is received by the respondent.

Article 22. Language

(1) The parties are free to agree on the language or languages to be used in the arbitral proceedings. Failing such agreement, the arbitral tribunal shall determine the language or languages to be used in the proceedings. This agreement or determination, unless otherwise specified therein, shall apply to any written statement by a party, any hearing and any award, decision or other communication by the arbitral tribunal.

(2) The arbitral tribunal may order that any documentary evidence shall be accompanied by a translation into the language or languages agreed upon by the parties or determined by the arbitral tribunal.

Article 23. Statements of claim and defence

(1) Within the period of time agreed by the parties or determined by the arbitral tribunal, the claimant shall state the facts supporting his claim, the points at issue and the relief or remedy sought, and the respondent shall state his defence in respect of these particulars, unless the parties have otherwise agreed as to the required elements of such statements. The parties may submit with their statements all documents they consider to be relevant or may add a reference to the documents or other evidence they will submit.

(2) Unless otherwise agreed by the parties, either party may amend or supplement his claim or defence during the course of the arbitral proceedings, unless the arbitral tribunal considers it inappropriate to allow such amendment having regard to the delay in making it.

Article 24.

Hearings and written proceedings

(1) Subject to any contrary agreement by the parties, the arbitral tribunal shall decide whether to hold oral hearings for the presentation of evidence or for oral argument, or whether the proceedings shall be conducted on the basis of documents and other materials. However, unless the parties have agreed that no hearings shall be held, the arbitral tribunal shall hold such hearings at an appropriate stage of the proceedings, if so requested by a party.

(2) The parties shall be given sufficient advance notice of any hearing and of any meeting of the arbitral tribunal for the purposes of inspection of goods, other property or documents.

(3) All statements, documents or other information supplied to the arbitral tribunal by one party shall be communicated to the other party. Also any expert report or evidentiary document on which the arbitral tribunal may rely in making its decision shall be communicated to the parties.

Article 25.

Default of a party

Unless otherwise agreed by the parties, if, without showing sufficient cause,

(a) the claimant fails to communicate his statement of claim in accordance with article 23(1), the arbitral tribunal shall terminate the proceedings;

(b) the respondent fails to communicate his statement of defence in accordance with article 23(1), the arbitral tribunal shall continue the proceedings without treating such failure in itself as an admission of the claimant's allegations;

(c) any party fails to appear at a hearing or to produce documentary evidence, the arbitral tribunal may continue the proceedings and make the award on the evidence before it.

Article 26.

Expert appointed by arbitral tribunal

(1) Unless otherwise agreed by the parties, the arbitral tribunal

(a) may appoint one or more experts to report to it on specific issues to be determined by the arbitral tribunal;

(b) may require a party to give the expert any relevant information or to produce, or to provide access to, any relevant documents, goods or other property for his inspection.

(2) Unless otherwise agreed by the parties, if a party so requests or if the arbitral tribunal considers it necessary, the expert shall, after delivery of his written or oral report, participate in a hearing where the parties have the opportunity to put questions to him and to present expert witnesses in order to testify on the points at issue.

Article 27.

Court assistance in taking evidence

The arbitral tribunal or a party with the approval of the arbitral tribunal may request from a competent court of this State assistance in taking evidence. The court may execute the request within its competence and according to its rules on taking evidence.

CHAPTER VI. MAKING OF AWARD AND TERMINATION OF PROCEEDINGS

Article 28.

Rules applicable to substance of dispute

(1) The arbitral tribunal shall decide the dispute in accordance with such rules of law as are chosen by the parties as applicable to the substance of the dispute. Any designation of the law or legal system of a given State shall be construed, unless otherwise expressed, as

directly referring to the substantive law of that State and not to its conflict of laws rules.

(2) Failing any designation by the parties, the arbitral tribunal shall apply the law determined by the conflict of laws rules which it considers applicable.

(3) The arbitral tribunal shall decide *ex aequo et bono* or as *amiable compositeur* only if the parties have expressly authorized it to do so.

(4) In all cases, the arbitral tribunal shall decide in accordance with the terms of the contract and shall take into account the usages of the trade applicable to the transaction.

Article 29.

Decision making by panel of arbitrators

In arbitral proceedings with more than one arbitrator, any decision of the arbitral tribunal shall be made, unless otherwise agreed by the parties, by a majority of all its members. However, questions of procedure may be decided by a presiding arbitrator, if so authorized by the parties or all members of the arbitral tribunal.

Article 30.

Settlement

(1) If, during arbitral proceedings, the parties settle the dispute, the arbitral tribunal shall terminate the proceedings and, if requested by the parties and not objected to by the arbitral tribunal, record the settlement in the form of an arbitral award on agreed terms.

(2) An award on agreed terms shall be made in accordance with the provisions of article 31 and shall state that it is an award. Such an award has the same status and effect as any other award on the merits of the case.

Article 31.

Form and contents of award

(1) The award shall be made in writing and shall be signed by the arbitrator or arbitrators. In arbitral proceedings with more than one arbitrator, the signatures of the majority of all members of the arbitral tribunal shall suffice, provided that the reason for any omitted signature is stated.

(2) The award shall state the reasons upon which it is based, unless the parties have agreed that no reasons are to be given or the award is an award on agreed terms under article 30.

(3) The award shall state its date and the place of arbitration as determined in accordance with article 20(1). The award shall be deemed to have been made at that place.

(4) After the award is made, a copy signed by the arbitrators in accordance with paragraph (1) of this article shall be delivered to each party.

Article 32.

Termination of proceedings

(1) The arbitral proceedings are terminated by the final award or by an order of the arbitral tribunal in accordance with paragraph (2) of this article.

(2) The arbitral tribunal shall issue an order for the termination of the arbitral proceedings when:

(a) the claimant withdraws his claim, unless the respondent objects thereto and the arbitral tribunal recognizes a legitimate interest on his part in obtaining a final settlement of the dispute;

(b) the parties agree on the termination of the proceedings;

(c) the arbitral tribunal finds that the continuation of the proceedings has for any other reason become unnecessary or impossible.

(3) The mandate of the arbitral tribunal terminates with the termination of the arbitral proceedings, subject to the provisions of articles 33 and 34(4).

Article 33.

Correction and interpretation of award; additional award

(1) Within thirty days of receipt of the award, unless another period of time has been agreed upon by the parties:

(a) a party, with notice to the other party, may request the arbitral tribunal to correct in the award any errors in computation, any clerical or typographical errors or any errors of similar nature;

(b) if so agreed by the parties, a party, with notice to the other party, may request the arbitral tribunal to give an interpretation of a specific point or part of the award.

If the arbitral tribunal considers the request to be justified, it shall make the correction or give the interpretation within thirty days of receipt of the request. The interpretation shall form part of the award.

(2) The arbitral tribunal may correct any error of the type referred to in paragraph (1)(a) of this article on its own initiative within thirty days of the date of the award.

(3) Unless otherwise agreed by the parties, a party, with notice to the other party, may request, within thirty days of receipt of the award, the arbitral tribunal to make an additional award as to claims presented in the arbitral proceedings but omitted from the award. If the arbitral tribunal considers the request to be justified, it shall make the additional award within sixty days.

(4) The arbitral tribunal may extend, if necessary, the period of time within which it shall make a correction, interpretation or an additional award under paragraph (1) or (3) of this article.

(5) The provisions of article 31 shall apply to a correction or interpretation of the award or to an additional award.

CHAPTER VII. RECOURSE AGAINST AWARD

Article 34.

Application for setting aside as exclusive recourse against arbitral award

(1)

Recourse to a court against an arbitral award may be made only by an application for setting aside in accordance with paragraphs (2) and (3) of this article.

(2)

An arbitral award may be set aside by the court specified in article 6 only if:

(a) the party making the application furnishes proof that:

(i) a party to the arbitration agreement referred to in article 7 was under some incapacity; or the said agreement is not valid under the law to which the parties have subjected it or, failing any indication thereon, under the law of this State; or

(ii) the party making the application was not given proper notice of the appointment of an arbitrator or of the arbitral proceedings or was otherwise unable to present his case; or

(iii) the award deals with a dispute not contemplated by or not falling within the terms of the submission to arbitration, or contains decisions on matters beyond the scope of the submission to arbitration, provided that, if the decisions on matters submitted to arbitration can be separated from those not so submitted, only that part of the award which contains decisions on matters not submitted to arbitration may be set aside; or

(iv) the composition of the arbitral tribunal or the arbitral procedure was not in accordance with the agreement of the parties, unless such agreement was in conflict with a provision of this Law from which the parties cannot derogate, or, failing such agreement, was not in accordance with this Law; or

(b) the court finds that:

(i) the subject-matter of the dispute is not capable of settlement by arbitration under the law of this State; or

(ii) the award is in conflict with the public policy of this State.

(3) An application for setting aside may not be made after three months have elapsed from the date on which the party making that application had received the award or, if a request had been made under article 33, from the date on which that request had been disposed of by the arbitral tribunal.

(4) The court, when asked to set aside an award, may, where appropriate and so requested by a party, suspend the setting aside proceedings for a period of time determined by it in order to give the arbitral tribunal an opportunity to resume the arbitral proceedings or to take such other action as in the arbitral tribunal's opinion will eliminate the grounds for setting aside.

CHAPTER VIII. RECOGNITION AND ENFORCEMENT OF AWARDS

Article 35.

Recognition and enforcement

(1) An arbitral award, irrespective of the country in which it was made, shall be recognized as binding and, upon application in writing to the competent court, shall be enforced subject to the provisions of this article and of article 36.

(2) The party relying on an award or applying for its enforcement shall supply the duly authenticated original award or a duly certified copy thereof, and the original arbitration agreement referred to in article 7 or a duly certified copy thereof. If the award or agreement is not made in an official language of this State, the party shall supply a duly certified translation thereof into such language.***

Article 36.

Grounds for refusing recognition or enforcement

(1) Recognition or enforcement of an arbitral award, irrespective of the country in which it was made, may be refused only:

(a) at the request of the party against whom it is invoked, if that party furnishes to the competent court where recognition or enforcement is sought proof that:

(i) a party to the arbitration agreement referred to in article 7 was under some incapacity; or the said agreement is not valid under the law to which the parties have subjected it or, failing any indication thereon, under the law of the country where the award was made; or

(ii) the party against whom the award is invoked was not given proper notice of the appointment of an arbitrator or of the arbitral proceedings or was otherwise unable to present his case; or

*** The conditions set forth in this paragraph are intended to set maximum standards. It would, thus, not be contrary to the harmonization to be achieved by the model law if a State retained even less onerous conditions.

(iii) the award deals with a dispute not contemplated by or not falling within the terms of the submission to arbitration, or it contains decisions on matters beyond the scope of the submission to arbitration, provided that, if the decisions on matters submitted to

arbitration can be separated from those not so submitted, that part of the award which contains decisions on matters submitted to arbitration may be recognized and enforced; or

(iv) the composition of the arbitral tribunal or the arbitral procedure was not in accordance with the agreement of the parties or, failing such agreement, was not in accordance with the law of the country where the arbitration took place; or

(v) the award has not yet become binding on the parties or has been set aside or suspended by a court of the country in which, or under the law of which, that award was made; or

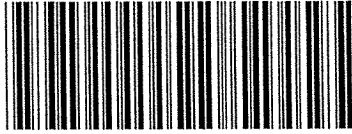
(b) if the court finds that:

(i) the subject-matter of the dispute is not capable of settlement by arbitration under the law of this State; or

(ii) the recognition or enforcement of the award would be contrary to the public policy of this State.

(2) If an application for setting aside or suspension of an award has been made to a court referred to in paragraph (1)(a)(v) of this article, the court where recognition or enforcement is sought may, if it considers it proper, adjourn its decision and may also, on the application of the party claiming recognition or enforcement of the award, order the other party to provide appropriate security.

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Non-judicial dispute