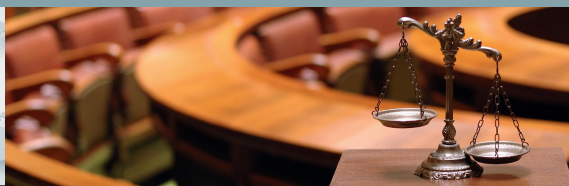

COMPENDIUM | 2012

DISPUTE RESOLUTION & LITIGATION

in association with:

FINANCIER WORLDWIDE corporatefinanceintelligence

VON WOBESER Y SIERRA

VON WOBESER Y SIERRA

Law firm ranking agencies confirm that **Wobeser y Sierra, S.C. (VWyS)** is the leading firm for dispute resolution services in Mexico and one of the most prominent in the field in the Latin American region. VWyS is the only firm in Mexico ranked by *Global Arbitration Review* among the best 100 law firms worldwide and *Chambers & Partners* has ranked its dispute resolution team in the top tier.

The dispute resolution practice of VWyS is domestic and international, and its **clients include many Fortune 500 companies**. Over the past 25 years, the firm has successfully represented several companies and foreign governments in a wide variety of disputes of different sizes and complexities, ranging from a fully successful defense of a 2.5 billion dollar commercial arbitration claim between two shareholders of a beer company, to a 900 million dollar infrastructure related claim against a state owned company in the oil industry, and a 130 million dollar judicial claim involving the malfunctioning of a satellite in outer space, just to mention some representative examples.

As to the arbitration practice, members of the firm have acted as counsel to parties, arbitrators, experts on Mexican law and secretaries to tribunals, and are frequent speakers on arbitration conferences all over the world. The added experience of the practice group members sums well above **150 complex proceedings** involving commercial, construction and investment disputes of different natures. All the practice group members are very familiar with the implementation of the arbitration rules of many international institutions, such as the ICC, AAA, ICDR, ICSID and LCIA, and many domestic institutions, such as CANACO and CAM.

The dispute resolution practice group of the firm is co-headed by Claus von Wobeser and Marco Tulio Venegas, who lead a team of 15 attorneys, all graduates with honors from the top law schools in Mexico, U.S. and Europe, and many of them trained in New York, Washington D.C., Paris and Beijing. Some of the team members have even been trained at the most prestigious international arbitration institutions, and others have been clerks at judicial courts dealing with award enforcements. The level of sophistication of this practice group is unparalleled in Mexico and highly competitive worldwide.

For more information on the dispute resolution practice of WVyS please contact Marco Tulio Venegas at: mtvenegas@vwys.com.mx.

C O M P E N D I U M | 2 0 1 2

DISPUTE RESOLUTION & LITIGATION

A selection of articles on Dispute Resolution & Litigation published by Financier Worldwide in 2011

Published by
Financier Worldwide
23rd Floor, Alpha Tower
Suffolk Street, Queensway
Birmingham B1 1TT
United Kingdom

Telephone: +44 (0)845 345 0456
Fax: +44 (0)121 600 5911
Email: info@financierworldwide.com

www.financierworldwide.com

First edition

Compendium 2012
DISPUTE RESOLUTION & LITIGATION

CONTENTS

CHAPTER 8

Marco Tulio Venegas, Von Wobeser y Sierra, S.C.

Introduction

Recent trends and developments in the Mexican arbitration practice

During 2011, arbitration in Mexico evolved based on legislative reforms and court decisions. In the legislative field, the Commerce Code, which regulates commercial arbitration, was updated in order to clarify and include some legal institutions that will certainly have a beneficial impact on arbitration.

The most important elements of the legal reform were as follows: (i) more detailed regulation of the obligation of the Mexican Courts to remit the parties to arbitration when a dispute subject to an arbitration clause is submitted to them; (ii) the option to request from a Court its assistance in ordering or enforcing a preliminary measure for an arbitration, without the limitations which existed previously in connection with the type and nature of such measures; (iii) more equitable treatment for the defendant in a procedure to nullify or enforce an award; and (iv) detailed regulation of the subsidiary judicial procedure for the appointment of arbitrators, when the parties do not agree on a specific procedure. A provision of particular importance was also included, which makes arbitrators responsible for the preliminary or precautionary measures they may take in an arbitration. This controversial provision has provoked mixed reactions from scholars and practitioners regarding its impact and the possibility of agreeing to exclude this liability beforehand.

In addition to the modifications to the Commerce Code, it is also important to note that during 2011

a negative precedent was set by Mexican courts regarding the inarbitrability of an administrative rescission issued by a public company or entity in a public work contract. In this regard, it is important to note that with the alleged intention to incorporate arbitration as an alternative method of resolution for all public entities which are subjected to the Law of Public Works and Related Services, a provision was included in said law establishing that arbitration clauses may be included in public contracts but that the administrative rescission, notwithstanding, could not be subjected to arbitration.

After this provision entered into force, no dispute regarding its application arose until 2011. This year, a dispute related to the arbitrability of the administrative rescission was brought before Mexican courts. The case involved a public work contract which was subject to arbitration but which was later administratively rescinded by the defendant of the arbitration that was a public entity. In this regard, Mexican courts have only recently decided that the administrative rescission of a public contract prevents an arbitral tribunal from rendering its award, even if it does not nullify the rescission, but only makes reference to its contractual causes or consequences. Based on this conclusion, an important arbitral award was nullified. The legal basis for this decision is that, according to the Court, the administrative rescission of a contract by a public entity should be deemed as a governmental act (act of authority), which may be challenged before a Federal Court through an amparo action. In this line of argument, Mexican courts deemed that the power to unilaterally rescind an agreement placed the public entity in a position of superiority before the contractor, which implied that the public entity would be enforcing the public policy of the Mexican government. Therefore, the public entity would be acting as a 'governmental authority' as is expressly confirmed by the Law of Public Works and Related Services in force.

The negative impact of this decision is clear, since pursuant to this approach, an administrative rescission of a public work contract could not be subject to arbitration and would leave the arbitration clause agreed by the parties ineffective. Indeed, this precedent, which is interpreting the Law of Public Works and Related Services, will have a negative impact on all public works contracts subject to arbitration, since it will have the practical effect of rendering the arbitration clause ineffective or at least to provoke parallel litigation. The practical scenario that a private

contractor may face is that when it enters into a dispute with a public company, and the latter opts to attribute the former a contractual breach and rescinds the contract, the private contractor would be forced to challenge the legality of the rescission before Mexican courts and not through arbitration. At the same time, the additional contractual claims that the private contractor may have should be brought in arbitration. In this regard, it is not clear the manner in which the challenge of the administrative rescission before Mexican courts would interact with a parallel arbitration, since it is clear that the decision on the legality of the rescission would certainly impact the arbitration. This would obviously impose a dilemma on the private contractor to bring the arbitration immediately or wait until the judicial challenge of the rescission is ruled by Mexican courts with the consequent delays, uncertainty and cost increase.

For this reason, scholars and practitioners have begun to coordinate efforts to convince the Mexican Congress and Executive Branch of the need to amend the Law of Public Works and Related services in order to eliminate the restriction on the arbitrability of the administrative rescission. However, the last word, as always, will reside with the Mexican government and its intention to modernise its legal system, allowing the arbitration of public contracts without restrictions which constitute clear impediments for the attraction of investment in the infrastructure sector.

Finally, during 2011, other important precedents were set by Mexican courts in connection with the enforceability of arbitral awards. In particular, two judicial decisions refused to enforce arbitration awards based on clear violations of due process. The first involved a case in which the sole arbitrator (who was an engineer and not an experienced lawyer) conducted arbitration without giving the parties the opportunity to review the claims of the other and respond to them. In addition, no hearing took place and the arbitrator practically decided the dispute based only on one set of initial briefs, which he requested from the parties. Due to these irregularities, the losing party as that the defendant was never properly summoned to the procedure. There was no evidence that the defendant was formally informed of the arbitration procedure in its domicile in Mexico. The only notification was made to a foreign office no longer occupied by the defendant. Therefore, based on this irregularity, the Mexican courts refused to enforce the resulting arbitral award, since that would constitute a breach of the fundamental rights of defence of the respondent.

Marco Tulio Venegas is a partner at Von Wobeser y Sierra, S.C.

SPONSOR PROFILE

VON WOBESER Y SIERRA, S.C.

The law firm is one of the leading firms in dispute resolution not only in Mexico but also in Latin America. Von Wobeser y Sierra S.C. has been ranked as one of the Mexican leading firms in Dispute Resolution: in Arbitration and Litigation by Chambers & Global 2007, 2008, 2009, 2010 and 2011. Von Wobeser y Sierra, S.C. is also the only Latin American law firm ranked in the Global Arbitration Review. The litigation practice of the firm includes the following areas: (i) complex commercial litigations; (ii) industrial and intellectual property; (iii) constitutional (amparo litigations); (iv) tax law; (v) administrative law; and (vi) consumer protection and advertising law. The firm is an active member of all the relevant national and international arbitration institutions (International Chamber of Commerce, American Arbitration Association, CANACO, London Court of International Arbitration, CAM, etc.). The experience of our law firm in arbitration includes all aspects of an arbitration procedure. We have acted as arbitrators, counsel, expert witnesses and even in exercises of mock arbitrations. We have also been actively involved in enforcing before State Courts arbitral awards and challenging them, when they are affected by substantive defects.

VON WOBESER Y SIERRA

Marco Tulio Venegas
Partner
Von Wobeser y Sierra, S.C.
T: +52 (55) 52581034
E: mtvenegas@vwys.com.mx
www.vonwobeserysierra.com

Marco Tulio Venegas is the partner in charge of the litigation practice at Von Wobeser y Sierra, S.C. As responsible partner he is in charge of acting as counsel in international commercial arbitration and investment arbitration cases, as well as administrative and intellectual property litigation; civil and commercial litigation; and constitutional (amparo) litigation.

VON WOBESER Y SIERRA

CHAPTER 1

COMMERCIAL DISPUTES

in association with:

JANUARY 2011

M. P. Bharucha, Sanjeev Kapoor and Vikram Nankani

TALKINGPOINT: RESOLVING COMMERCIAL DISPUTES IN INDIA

FW moderates a discussion between M. P. Bharucha at Bharucha & Partners, Sanjeev Kapoor at Khaitan & Co LLP and Vikram Nankani at the Economic Laws Practice, on Indian commercial disputes.

FW: Have you seen an increase in commercial disputes in India over the last 12 months or so? What types of disputes seem to be most prevalent?

Bharucha: We have not seen a significant increase in commercial disputes. With globalisation, the trend, if it can be so termed, is that a greater number of non-Indian commercial entities are involved in disputes. A number of regulators, including the securities regulator SEBI, the telecommunications regulator TRAI, and the Electricity Regulatory Commissions, often enough deal with commercial issues couched as regulatory issues and in that sense the scope of commercial disputes has expanded.

Nankani: There has been a considerable increase in the number of commercial disputes in India, particularly relating to infrastructure projects and the construction industry. Some disputes relating to sale-purchase contracts, which could not be amicably resolved during the global recession of 2008-09, have gone to arbitration in 2009-10. A spurt of disputes has also arisen from M&A deals entered into prior to September 2008. There has also been an increased activity on IPR disputes with corporates and individuals getting more conscious of the commercial value of their intellectual

property. Similar trends have been observed in the oil and gas sector, offshore services sector and the telecom and power sectors.

Kapoor: India has seen an increase in disputes arising out of increased business activity and the last 12 months were no exception to this general trend. There are disputes which arise out of contentious interpretations of shareholder rights in newly formed joint ventures, disputes arising out of rescission or cancellation of contracts, issues arising out of enforcement of foreign judgements and awards in India. There are also multifaceted disputes with the government which may arise as a result of denial of requisite clearances by the government or actions initiated by the government which have a direct bearing on the commercial activities of a company.

FW: To what extent are companies in India embracing alternative dispute resolution methods?

Kapoor: Increasingly, there is a growing dependence of companies on the alternate dispute redressal mechanism. In the context of international commercial transactions, our experience has shown that parties generally rely on established arbitral institutions such as the ICC, LCIA or SIAC, to name a few. In the context of domestic arbitrations, the Indian Arbitration and Conciliation Act, 1996 has provided a good framework, and the inclination therefore is to resolve domestic disputes through alternative dispute resolution methods with arbitration generally being preceded by an informal mediation process.

Bharucha: As the justice delivery system struggles to keep pace with the growing economy, ADR is the preferred alternative except in situations where delay favours a litigant. Arbitration has been long established and is the preferred ADR route. While concerted efforts are ongoing to promote conciliation, these are yet to bear fruit, at least in serious commercial disputes. Perhaps one of the reasons for this is the absence of conciliators with credentials. While one does see international arbitrators adjudicating disputes, we have yet to see a conciliator with international practice being engaged.

Nankani: Almost all cross-border transactional contracts contain exhaustive dispute resolution clauses, which typically provide for resolving disputes outside of the Court system, most commonly through institutional arbitration. Domestic companies are also now increasingly referring their disputes to arbitration rather than resolve them through civil courts. There is also an increasing trend to provide for Multi-Tier Dispute Resolution Mechanisms. Furthermore, expert determination,

adjudication, early neutral evaluation (ENE) and mediation are now being adopted as a precursor to arbitration, though these ADR methods are more common in certain sectors such as infrastructure and construction, than in the others.

FW: In your opinion, is the justice delivery system capable of dealing efficiently with the challenges posed by large commercial disputes?

Nankani: Currently, having regard to the prevalent judicial system and the large arrears, the courts in India are not equipped, administratively or technically, to deal with large commercial disputes expeditiously. This is something which has been noticed by the Legislature which is bringing in reforms to rectify the problem, particularly the proposal to set up the Commercial Division in the High Courts. A lot more can be done in terms of making the process more efficient through the use of technology. The Delhi High Court has also supported training and knowledge building exercises in specialised areas such as capital and finance markets involving complex products and transactions, IP disputes and the like.

Kapoor: India has a sound judicial system which is capable of dealing efficiently and effectively with the challenges posed by large commercial disputes. However, tending a backlog of approximately 30 million cases does present its share of difficulties to the courts dealing with such disputes, resulting in delays. Also there is some criticism of the Indian courts for adopting an interventionist approach by giving expansive interpretation to the provisions of the Arbitration and Conciliation Act, 1996 so as to increase the interference of the courts in the arbitration process.

Bharucha: In theory, the justice system is capable of dealing efficiently with disputes; in reality, it is not.

While the intellectual capabilities and forensic skills exist in the higher judiciary, the infrastructure, including sufficient numbers of judges with specialised domain knowledge, and properly controlled case management procedures, are absent. Even managing documents in a large commercial dispute is a challenge. The absence of a Court transcription system is a more serious challenge. Again, efforts are ongoing to improve the infrastructure – the Delhi High Court has set up an e-court with electronic filing and data – but more needs to be done.

FW: What measures have been implemented or suggested by the government to make

dispute resolution more efficient? Is there scope for further improvement?

Bharucha: The government now seems acutely conscious of the need to improve the justice delivery system. One proposal is the setting up of a commercial division for the High Court of every State to decide commercial disputes. Since what is 'commercial' is easy to perceive but difficult to define, the government proposes reserving to itself power to notify disputes as being 'commercial'. Another proposal is the revamping of the Arbitration & Conciliation Act, 1996 to restore the position originally intended by the Legislature: minimum court intervention in the arbitral process. The most significant initiative is the National Litigation Policy. The government is the single largest litigant. It is also the prime contributor to judicial delays, rarely being able to timely progress litigation. The Policy, recognising that the government and its panel of lawyers are all stakeholders, aims to set up committees, the apex committee being headed by the Attorney General, to review litigation and to make each stakeholder accountable. The Policy also aims at revamping the system of selecting lawyers for the government panels, such that only lawyers with requisite skill sets are empanelled.

Nankani: The Code of Civil Procedure has been amended to encourage courts to refer matters to arbitration. The government also plans to introduce the Commercial Courts Bill whereby each High Court shall have specially trained judges to handle commercial disputes. This Bill is likely to be introduced in Parliament in the next session. Further changes are proposed to the existing Arbitration and Conciliation Act, 1996 by way of an Arbitration and Conciliation Bill to make the law arbitration friendly and minimise judicial intervention. The same has currently been thrown open for public debate. There is further scope for improvement which can be achieved by incorporating the recent trends in international commercial arbitration including changes made to the Model Law. The State is also reviewing its litigation-happy past with the objective of minimising litigation where the State is one of the parties. All of this apart, the one biggest challenge for the Indian judicial system is the use of technology for making the process efficient. The Government also needs to create an institutionalised system of continuing professional development so that the global best practices can be introduced into the system. The Code of Civil Procedure is over a century old. It is time for a thorough review to bring it up to speed with the commercial realities of the day.

Kapoor: The government is taking steps to make the disputes resolution process more efficient. As a step towards this, the Commercial Division of High Courts Bill, 2009, has been introduced in parliament to create special divisions in high courts to deal exclusively with commercial disputes above a certain threshold value. Also, in June 2010 the government introduced the National

Litigation Policy 2010, which aims, inter alia, to reduce government litigation in courts and the average time of cases from fifteen years to three years. On the arbitration front, the Ministry of Law has released a Consultation Paper on the proposed amendments to the Indian Arbitration and Conciliation Act, 1996 with a view to resolving disputes in a speedy manner through the ADR route without much interference of the courts.

FW: How relevant is 'reciprocity' in the context of dispute resolution?

Nankani: Both for enforcement of foreign judgements as well as foreign awards, reciprocity is an important factor. The same is clear from S. 44A of the Code of Civil Procedure, 1908 and S. 44(b) of the Arbitration and Conciliation Act, 1996 wherein the reciprocal provisions are a prerequisite. India has notified several countries whose court judgements can be directly enforced as a decree and also, separately, those whose awards can be directly enforced, as India is itself a signatory to the New York Convention, 1958.

Kapoor: Reciprocity is relevant to ensure the enforcement of foreign court judgements as well as awards passed in international commercial arbitrations and is an accepted principle under the Arbitration and Conciliation Act, 1996. Under the Act only those awards which are passed in a convention country and which country is so notified by the Central Government as being a territory to which such convention applies, are enforceable in India. The awards not falling in convention could be enforced in India under the common law [(1964) 4 SCR 19] on grounds such as justice, equity and good conscience. A suit would be filed before the competent court and after proving conclusiveness of the foreign award, judgement thereon would be obtained. However, the observation of the Supreme Court in (2002) 4 SCC 105 that any award not passed under either Convention can also be considered a 'domestic award' and may lead to enforcement of an award passed in a non-convention country as per provisions of Part I of the Act.

Bharucha: Reciprocity is crucial in litigation as well as international arbitration. Under Section 44A of the Code of Civil Procedure, 1908 decrees of courts in reciprocating territories may be executed in India as if they were decrees of Indian courts. Decrees of other foreign courts can only be enforced by bringing a suit on the foreign judgment in India. The government has the power to declare, by notification, a foreign state to be a reciprocating country. That power has been sparsely exercised. As a result, enforcing a foreign judgment in India is a long process. India has subscribed to the New York Convention of 1958 on Recognition & Enforcement of foreign awards. However, a foreign state

only subscribing to the Convention is not enough to make an award rendered in that state a 'foreign award' enforceable as such in India. For enforcement purposes, the Indian government must notify that state as a reciprocating state. As a result, unless a foreign state is notified by India, an award rendered within that state can be enforced in India either by an action on the foreign award or by enforcing it as a domestic Indian award.

FW: How would you describe arbitration facilities and processes in India?

Kapoor: Arbitrations conducted in India are mostly ad hoc in nature. Such arbitrations tend to be procedurally cumbersome and time consuming as opposed to arbitrations which are conducted under institutional mechanisms. However the concept of institutional arbitration is gradually gaining a stronghold in the alternative dispute resolution sphere in India. Some of the arbitral institutions in India are the Chambers of Commerce (organised by either region or trade), the Indian Council of Arbitration (ICA), the FICCI Arbitration and Conciliation Tribunal and the International Centre for Alternate Dispute Resolution (ICADR). The launch of the London Court of International Arbitration India (LCIA India) also presents a credible dispute resolution option in India for corporate entities seeking to resolve their disputes in India which are administered by institutions.

Bharucha: While arbitration goes back a long way, the norm is non-institutional, or ad hoc, arbitration with retired judges being appointed to the arbitral tribunal. This has produced significant delays on two counts. Recourse must be had to the Chief Justice to constitute the tribunal if the parties do not cooperate in constituting the tribunal. This appointment process ought to be, but regrettably is not, an administrative process. As a result, particularly if jurisdictional issues arise, the appointing authority has to take on an adjudicatory role with concomitant delays. Secondly, with the preference for retired judges, the number of arbitrators available is insufficient, creating scheduling issues. Thirdly, the schedules are frequently not maintained. Lastly, but just as important, the litigating lawyers who take on arbitration hearings tend to give priority to court hearings accentuating scheduling problems and contracting arbitral hearings to a couple of hours outside the court timing.

Nankani: While a majority of arbitrations in India are ad-hoc, institutional arbitration is quickly catching up. Amongst others, the ICA, CNICA, CIAC, LCIA India, Permanent Court of Arbitration and the Nani Palkhiwala Arbitration Centre are well supported. Most of the local chambers of commerce have their own arbitration centres as well. The government is also promoting setting up

ADR centres. The Ministry of Finance has proposed to allocate INR one crore, around $220,000, per district to set up ADR centres. The Finance Commission has also recommended a major investment in reformation of the judicial system.

FW: Typically, what are the circumstances in which Courts may interfere in arbitral proceedings?

Nankani: The Indian law is based on the UNCITRAL Model law. The courts play a role in providing interim relief, in the appointment of arbitrators, in challenges to the appointment of arbitrators, in providing assistance with taking of evidence, in deciding the challenges to the award and in enforcement of the award. While court interference has grown due to certain decisions of the Apex Court, the same is being sought to be whittled down by the proposed amendments to the arbitration law in India. Increasingly, the Court, while dealing with applications for appointment of arbitrators, dealing with such applications as one in discharge of a judicial function, and in the light of the 7-judge bench decision in (2005) 8 SCC 618, is pronouncing judgements that have wide ramifications on the arbitral process.

Bharucha: The principle objective of the Act was to minimise court intervention. Owing to several rulings of the Apex Court, that objective has been lost. Indian courts must now take on an adjudicating role even in constituting the tribunal. If jurisdictional issues should arise — such as whether a dispute is covered by the arbitration stipulation – until such issues are decided, the tribunal cannot be constituted. Besides, the statutory grounds to appeal an award are narrow – effectively those contained in Article V of the New York Convention of 1958. However, Apex Court rulings have substantially expanded the grounds for appealing an award. Effectively, an international award contrary to Indian law will not be enforced on public policy grounds. Moreover, while the enforcing court cannot review the award on merits, an error apparent would render the award unenforceable. The Apex Court ruling in Venture Global v. Satyam Computer Services Ltd (2008) 4 SCCD 190 enables an Indian court to set aside an international award even though that award is not being enforced in India.

Kapoor: The Courts in India have held that Part I of the 1996 Act, which compulsorily applies to arbitrations if the place of arbitration is India, also applies to international arbitrations held outside India [(2002) 4 SCC 105].
Therefore Indian Courts have powers to interfere with arbitral proceedings whether being held in

India or outside India unless provisions of Part I of the 1996 Act have been specifically excluded by the parties. Also in [(2008) 4 SCC 190] it was held that a foreign award can be challenged under Section 34 of the 1996 Act before Indian courts. Broadly, the Courts have power to interfere with arbitral proceedings if, in their opinion, it is necessary or expedient to do so and when justice requires it. The arbitral proceedings being oppressive, vexatious or in a forum non conveniens may also warrant interference by the Indian Courts in pending arbitral proceedings.

FW: Are there any problems with the enforcement of arbitration awards by Indian Courts?

Kapoor: The Hon'ble Supreme Court has held that unless expressly barred, Part I of the Arbitration Act, 1996 also applies to international commercial arbitrations. This creates problems and complications for enforcement of foreign awards in India. Another problem with enforcement of arbitral awards is the delay due to a huge backlog in the courts. It is also difficult to have awards passed in a non-notified, non-convention country executed in India because such awards are not recognised by the Arbitration and Conciliation Act, 1996. In such cases the parties might have to file a suit before an Indian Court and based on such an award obtain a judgement from Indian Courts for enforcement, or such non convention awards may be enforced as domestic awards, as per reasoning in [(2002) 4 SCC 105].

Nankani: The power of the courts in this regard is circumscribed by Section 48 of the Arbitration and Conciliation Act, 1996 which is based on Article V of the New York Convention, 1958. However there have been few hiccups in the otherwise smooth enforcement of awards in India. One of the grounds of refusal is where the award is contrary to Public Policy. This has been interpreted by the courts to also cover an award which is 'patently illegal' which has been internationally criticised. The expression 'patently illegal' has been understood as conferring wide powers on the courts which has given the impression that the courts in India are not arbitration friendly.

FW: What clauses would you recommend that Indian companies insert into their commercial contracts to manage potential disputes down the line?

Bharucha: As a broad statement, three areas must be addressed: first, choice of law/governing law; second, dispute resolution, including seat of arbitration if arbitration is agreed; and third, jurisdiction for enforcement purposes. While the natural preference for Indian companies is to apply Indian law as the governing law, it is not uncommon for Indian corporates to agree English

law as the governing law.

Nankani: Not enough attention is paid to dispute resolution clauses in drafting contracts. Depending on the nature of the contract – for instance, contracts relating to financial transactions or civil construction – parties must agree to mechanisms which are speedier and more cost effective than arbitration. Any mechanism, like adjudication, ENE, or expert determination, which enables parties to assess the relative merits of their respective cases, must be provided for in the contract and implemented seriously. The arbitration clause must be exhaustive to cover all disputes, the seat or place of arbitration, the number and procedure of appointment of arbitrators, the rules for arbitration including those for taking evidence and costs so that arbitrations can be conducted efficiently and effectively in terms of time and cost. As arbitration clauses recommended by international institutions are tried and tested, the same may also be resorted to.

Kapoor: In light of the judgement passed in (2002) 4 SCC 105, in cases of international commercial arbitrations held out of India, provisions of Part I would apply unless the parties by agreement express or implied, exclude all or any of its provisions. Therefore, if the parties do not want to submit themselves to the jurisdiction of the Indian courts in international commercial arbitrations, it is advisable to specifically exclude the provisions of Part I of the Indian Arbitration and Conciliation Act, 1996 while phrasing the arbitration clause. The parties, however, may like to keep section 9 (provision for interim relief) and also Section 27 (court's assistance in taking evidence) applicable even to international commercial arbitrations.

M. P. Bharucha is a partner and founder of Bharucha & Partners, Sanjeev Kapoor is a partner at Khaitan & Co LLP and Vikram Nankani is a partner and head of the Dispute Resolution and Litigation practice at the Economic Laws Practice, Mumbai.

FEBRUARY 2011

Geoff Shaw, Frank M. Vettese and Allan J. Guty

TALKINGPOINT: RESOLVING COMMERCIAL DISPUTES IN CANADA

FW moderates a discussion between Geoff Shaw at Cassels Brock LLP, Frank M. Vettese at Deloitte and Allan J. Guty at Parlee McLaws LLP, on resolving Canadian commercial disputes.

FW: Have you seen an increase in commercial disputes in Canada over the last 12 months or so? Which sectors seem prone to corporate conflict?

Vettese: Over the last 12-24 months many Canadian litigators have reported an upsurge in dispute activity. For financial experts and advisers, the increased activity in commercial disputes has been more recent. It is not clear, however, whether this represents new work or work delayed by the economic crisis. I suggest it is a bit of both. The financial services sector has been particularly active, with institutions becoming more aggressive in pursuing loan fraud through creative and efficient legal techniques.

Shaw: Commercial litigation disputes are on the rise. In a difficult economic climate, when money is particularly tight, the stakes in commercial claims become higher. As such, in the past 12 months, delays or non-performance on the part of debtors has led to problems between lenders and third parties, as well as liabilities for large scale entities. There has also been an increase in lawsuits surrounding commercial transactions, which have been followed by financial failure. Further, large corporate bodies have increasingly been taking action against other corporations for large amounts of money and/or company control. Alternative dispute resolution has become a vital cost-cutting and time-saving tool under these circumstances.

Guty: I have not seen an increase or decrease in oil and gas litigation over the past 12 months. It has

stayed relatively constant which means it tends to be quite busy. For defendants in highly complex and high stakes litigation, however, the pace of litigation has slowed in some cases. Because litigation is sometimes a discretionary expense, plaintiffs will in some cases slow the litigation to make the expense more manageable during a time when revenues are down. For this reason, it is sometimes strategic for defendants to be the party pressing the litigation, thereby increasing the plaintiff's expenses and, at the same time, pushing for settlement.

FW: What types of disputes seem to be most prevalent?

Shaw: Disputes in which large amounts of money are at issue and those where parties are seeking declaratory relief seem to be most prevalent today. There has been a significant increase in securities litigation, particularly in the US, which in turn has profound effects on shareholders, borrowers and other businesses. Internal disputes relating to the management of businesses, such as shareholders' rights and remedies claims, oppression claims, and derivative actions, are widespread as well. Additionally, class action proceedings, often containing multiple issues and multiple parties seeking injunctive relief, are common. Product liability, franchising and intellectual property claims have similarly come to the fore of commercial disputes.

Guty: Bankruptcy and insolvency practitioners are significantly busier than they were prior to the recession in the US and central Canada. In western Canada, this increase in B&I litigation is largely due to low natural gas prices and the continued fallout from the 2008-09 credit crisis. I anticipate that B&I litigation may increase as natural gas prices increase as lenders will push borrowers into bankruptcy or receiverships at the point when the secured assets have gained in value allowing for greater recovery.

Vettese: International arbitration is definitely on the rise. A key question is where such arbitration will take place. Some Canadian legal firms have a high profile in this area of practice. Purchase price disputes and contract disputes also represent a significant portion of new assignments, as do class action suits against public companies for disclosure issues or errors made affecting the stock price. There has also been an upswing in disputes involving franchisees and distributors as companies act to reshape themselves due to the recession. Disputes around the boardroom table are increasing, with cases more likely to be resolved by mediation and arbitration as businesses realise that going the judicial route can be more expensive and time-consuming.

FW: How important is it for companies to establish a pre-emptive strategy to deal with potential disputes?

Guty: In my opinion it depends on the dollar value and complexity of a contract, and the parties to that contract. In Canada, unlike the US, commercial cases are rarely if ever tried before juries. They are typically tried before a judge sitting alone. As a result, companies do not elect to proceed with ADR because they are attempting to avoid the perceived unpredictability associated with the jury system. In Canada, companies elect ADR because they want to resolve any disputes before experienced and respected arbitrators/mediators who have an expertise relevant to the dispute. This is particularly the case when parties to a contract know that they will have an ongoing, or future, relationship regardless of whether there is a dispute and therefore, when disputes arise, they must be resolved in an expeditious and fair manner which does not impede that ongoing relationship. It should be noted, however, that in my opinion arbitration is rarely less expensive than going to court. Those companies that adopt arbitration clauses because they think they will spend less money in legal fees are misguided. For example, paying for a panel of three arbitrators in a complex and length commercial dispute will often prove to be very expensive.

Vettese: For companies and sectors prone to litigation, it is very important to demonstrate a proactive stance. Product recalls are on the rise as safety regulators intensify their enforcement efforts. With recalls, come class action and product liability claims, followed by shareholder actions against the board of directors and management. All of these events must be anticipated and planned for: once companies are immersed in damage control, developing a coherent strategy 'on the fly' is impossible. For example, every oil exploration company must anticipate the possibility of a disaster, large or small. Alternatively, companies facing one-off litigation appear less interested in pre-emptive efforts.

Shaw: Litigation must always be considered to be a potential business risk and it is therefore necessary to manage for it and insure against it. In the face of a dispute, it is extremely important to assess a case's strengths and weaknesses, as well as its costs and benefits, as early as is practically possible. Planning early is essential to developing an effective strategy which can be implemented throughout the life of the litigation. Moreover, building a pre-emptive strategy puts parties in a better position to prepare for the dispute; more specifically, it is vital to keep all information which is relevant to the matter, to collect every document and to consult every potential witness and expert, as early as possible. These types of preparations also enable parties to narrow issues by bringing

early motions, thus shortening the length of the proceedings as a whole.

FW: What general advice would you offer to Canadian companies on preparing for litigation and arbitration?

Shaw: Both litigation and arbitration require an evaluation of short and long term costs, as well as the types of individuals or corporate entities which will be parties to the proceedings. Controlling confidential information is also important in any dispute. For example, if an employee leaves his/her workplace, it ought to be considered whether that person may be a potential witness or if he/she possesses relevant information. It is key to conduct an analysis of the jurisdiction in which the dispute has arisen and determine whether the client would benefit from an arbitrator or from a judge or jury with a particular background or expertise. Further, corporations should consider budgeting for litigation by adopting evidence and document preservation systems, if possible. The preferred method of any proceeding depends on the dispute itself, as well as the nature of the relationship between the parties.

Guty: In today's litigation the number of documents produced by each side, and the length and amount of discovery, is far greater that what we have seen in the past. It can be quite a burden on the person within the company who is appointed as the corporate representative in highly complex and document intensive litigation. My general advice therefore is, depending upon the size of the company, to appoint an experienced knowledgeable person who understands and is willing to carry out the obligations of a corporate representative in major litigation.

Vettese: While arbitration appears to be gaining favour due to cost and speed, arbitrations are less likely to settle than litigation, although settlements in the latter may take longer to achieve. Clients are encouraged to pursue an acceptable settlement, as the decision of a judge or arbitrator can be unanticipated. They are also reminded that all advice should come from highly-qualified professionals. In Canada, sought-after financial advisers possess credentials such as CA, CA.CBV, CA.IFA and CA.CIRP, and are familiar with legal processes. One of the biggest and most immediate challenges companies face is lining up legal counsel and accounting or financial experts – conflicts may arise that can take weeks to clear. Advisers need sufficient time for case strategy development, document retention or creation, and examinations for discovery. Allegations of spoliation or the failure to preserve evidence are becoming very frequent. Many parties now undergo rigorous e-discovery processes – knowing this, companies are advised to implement a stringent internal email

policy at the outset. The need for e-discovery expertise is especially important for cases involving any nexus to the US.

FW: To what extent are companies in Canada embracing alternative dispute resolution (ADR) methods?

Vettese: ADR is being accepted in an increasing proportion of disputes, both mediation and arbitration. However, arbitrations seem to 'go all the way' more frequently than litigation. It's unclear whether the decision to embrace ADR is premised on speed to resolution or on other factors. Notably, the increasing popularity of ADR makes it difficult to quantify the number of commercial disputes today.

Guty: Companies both large and small are embracing ADR, particularly mediation. In Alberta, many are pleased that the Rules of Court now require litigants to participate in mediation before they can apply to the court for a trial date.

Shaw: Though arbitration has been a buzz-word since the early 1980s, most mainstream ADR is happening now. Today, ADR firms and mediation practices are commonplace. Companies seeking to resolve employment disputes often use ADR to keep costs down and preserve amicable relationships between parties. Insurance companies involved in personal injury disputes, as well as mining, construction and trade industry companies, are known to use ADR. ADR is helpful in these areas as there is often a relationship to preserve or an ongoing project or transaction to be completed, in spite of the dispute. Larger financial and corporate firms tend to put arbitration clauses in their commercial contracts, thus utilising the ADR processes when disputes arise.

FW: How would you describe arbitration facilities and processes in Canada?

Vettese: In the Toronto area, arbitration facilities are becoming widely available and increasingly sophisticated. Throughout Canada, processes are generally well established, with retired judges more likely to be arbitrators than lawyers with commercial backgrounds. The use of non-legal experts as arbitrators is not yet common, but has been effectively employed in certain circumstances. Arbitration panels consisting of legal, industry and/or financial experts appear to be a more frequent approach than has historically been the case.

Shaw: Canada has a wide array of independent arbitration service providers who are experienced in the legal community. These professional facilities are typically spacious and contain hearings rooms which can seat up to 40 people. Additionally, these arbitration facilities provide transcription services in both English and French, thus serving the population as a whole. Canada is also a well-received forum for arbitration proceedings due to its multicultural society and it reputation for fairness and neutrality. Canadian courts are increasingly giving effect to the Model Law and the New York Convention by limiting the scope of judicial review over Canadian arbitral awards, thereby supporting the arbitration process as an effective method of dispute resolution.

FW: Are there any issues surrounding the enforcement of arbitration awards by Canadian Courts?

Guty: There are few to no issues surrounding the enforcement of arbitration awards by Canadian Courts. Most, if not all, Canadian provinces, including Alberta, have reciprocal enforcement of judgment legislation – applicable to arbitration awards – and therefore there are few issues in enforcing foreign judgments, particularly when those judgments are from other common law jurisdictions such as the US or UK, for instance.

Vettese: Canadian courts increasingly seek to enforce arbitral awards, understanding the importance of freeing up court resources for areas such as family, children, and criminal law. The days when judges were reportedly offended by parties trying to avoid courts through arbitration are long past. In fact, today courts require that parties attempt mediation before going to trial.

Shaw: As Canada is a party to the New York Convention, the country is a receptive environment for foreign arbitration awards. The New York Convention provides the legal framework in Canada for the recognition and enforcement of foreign arbitral awards, and Canadian courts have been very reluctant to refuse enforcement under Article V of the legislation. Complications may arise, however, where the particulars of an international arbitration are not fully understood by the domestic court of law. As well, other issues may arise where the arbitration agreement is invalid, the award deals with matters beyond the scope of arbitration, or improper procedure has been followed. It is important to explicitly detail the applicable law and jurisdiction in arbitration agreements in order to avoid issues at the enforcement stage.

FW: What additional challenges tend to arise in multijurisdictional disputes involving companies?

Vettese: As Canadian companies increasingly conduct business overseas, they can face difficulties dealing with foreign legal systems and cultures – particularly when a disagreement arises. Depending on the size of the Canadian company and its bargaining power, the company may need to accept being governed by the laws of a foreign country. Any dispute arising under such an agreement will be litigated in a foreign jurisdiction, and the extent of damages awarded can be extraordinary compared to those in Canada. Language facilities, especially accommodations for French, can also be limited. Another notable challenge is the control of multinational disputes by US counsel.

Shaw: All of the regular challenges of litigation and dispute resolution are amplified in multijurisdictional proceedings. Determining the proper jurisdiction, as well as which law and procedure will apply, are common challenges. As well, locating witnesses and experts can be difficult. Differences in cultures, legal systems and spoken language also tend to prolong cross-border proceedings, thus creating a rise in costs. Complex scenarios with multiple parties are common features of multijurisdictional claims as it may be difficult to bring multiple parties in different countries under one arbitration agreement. To resolve these issues, it is a good idea to retain counsel experienced in multijurisdictional litigation and appoint internal persons with language capabilities and experience. Further, dispute resolution mechanisms should be clearly spelled out in contractual agreements in order to avoid these conflicts in the first instance.

Guty: Canada is a common law jurisdiction with a well-respected independent judiciary similar to the US and UK. I would imagine that pursuing multi-jurisdictional disputes involving Canadian companies would be no different than a dispute involving British or American companies – aside of course from the major difference between Canada and the US being the absence of juries hearing complex commercial disputes in Canada.

FW: What clauses would you recommend that Canadian companies into their commercial contracts to manage potential disputes down the line?

Shaw: It is difficult to recommend a 'one-size-fits-all' clause for resolution of commercial disputes. Clauses that are drafted for international agreements should pay particular attention to the seat

and governing law of any arbitration. As well, thought should be applied to enforceability of a decision.

Guty: Depending on the size and complexity of the contract, I tend to prefer mandatory mediation clauses over arbitration clauses. Mandatory mediation allows the parties to fully canvas the strengths and weaknesses of the other party's case as well as their own. As a result, the party's are well aware of the risks and expenses involved if they choose to proceed to trial or arbitration instead of settling at or soon after mediation. Of course, the skill of the mediator is essential.

Vettese: Canadian companies are well advised to insert comprehensive ADR clauses that define the desired process, as well as carefully-considered purchase price dispute mechanisms that include the definitions of relevant terms. Specificity and clarity are critical; for example, clauses can make reference to the use of experts who can address certain areas of judgment. To manage costs and complexity, the clause could state that arbitration or mediation take place in Canada, governed by the laws of Canada in a Canadian Court. Companies may also want to consider whether to provide for interim or immediate relief in the event of a dispute, as courts are reluctant to issue orders without a hearing.

Geoff Shaw is a partner at Cassels Brock & Blackwell LLP, Frank M. Vettese is the Canadian and global managing partner at Deloitte and Allan J. Guty is partner at Parlee McLaws LLP.

MAY 2011

Dale Stephenson, Carol Welu and Paul Oxnard

INTERNATIONAL ARBITRATION OF COMMERCIAL DISPUTES INVOLVING PARTIES FROM SAUDI ARABIA AND THE GCC

While the Arab world has a rich history of using arbitration to address a wide range of disputes, more recent experience in the latter part of the 20th Century has often been unsatisfactory for both local and foreign parties relying on arbitration to fairly resolve commercial disagreements. While 'freedom of contract' and the concept of arbitration are well founded under Islamic (or Shariah) law, there has been a particular wariness in Saudi Arabia towards international dispute resolution that seeks to designate a neutral choice-of-law and independent arbitral forum as an alternative to judicial enforcement of contractual rights in the Saudi courts. The present analysis looks at some practical issues and emerging developments that may affect the approach to be taken regarding international arbitration clauses and proceedings involving parties from Saudi Arabia and the GCC.

The practice of arbitration (tahkim) in the Middle East was an integral part of tribal justice in the pre-Islamic period. It is also specifically approved in the Qur'an (Koran), as is the use of consensus (ijma) as an alternative dispute resolution tool. Indeed, the Treaty of Medinah signed in 622 A.D. among Muslims, non-Muslim Arabs and Jews called for disputes to be resolved through arbitration. Even in the early 1900s, European merchants and traders made use of a commercial arbitration centre in Bahrain before London and Paris became prominent for such matters, and Saudi Arabia relied primarily on arbitration to resolve oil concession disputes through the 1950s.

That long tradition began to erode, however, when a series of arbitration decisions disregarded otherwise applicable Islamic domestic law and dismissively concluded that there was no general

law of contract in the Shariah, thus permitting foreign arbitrators to rely on English law to hand down decisions adverse to the Sheikh of Abu Dhabi (1951), Ruler of Qatar (1953) and Kingdom of Saudi Arabia (1963). The latter decision stemmed from a historic dispute between the Arabian American Oil Company (Aramco) and the Saudi government in which non-Arab arbitrators determined that Shariah was not a sufficiently detailed legal system to handle a complex energy dispute and thus could not serve as governing law. Since that decision, governmental entities in the Kingdom have been prohibited by Royal Decree from submitting to mechanisms for international dispute resolution or the selection of any foreign law to govern a dispute, absent a specific waiver from the Council of Ministers. The prevailing frustration and scepticism in Saudi Arabia and other GCC countries toward Western-style arbitration is grounded in the belief that the international framework as it has emerged gives short shrift to the core religious foundation, cultural values, language and legal traditions of Islam and the Arab world.

This lingering distrust has been paired with other stereotypical perceptions in both directions. Through Arab eyes, the Western world is often viewed as arrogant, disrespectful, overly posturing in written communications and generally manipulative of the legal system. In contrast, Saudis and other Gulf businesspersons may not be given the credit they deserve as successful (and sophisticated) professionals in finance, trade, technology, science, law and other areas of endeavour, sometimes because of limited second language capabilities. Further, the fact that GCC countries have relied to a significant extent on human resources from other countries as they develop business opportunities and diversify their economies should not be presumed to reflect on the quality or diligence of the talent being deployed. Finally, the assumptions and preferred methods with respect to business relationships and associated communications are simply different and more personal in Saudi Arabia and the GCC (with a general disinclination to engage in duelling correspondence in the Western tradition), which derives in part from Shariah principles and Arab culture generally. While the means of communicating in the Arab business world may be significantly different from the West – frequently relying more on personal relationships and verbal communications than written correspondence – it is certainly not wrong or any less credible. Many of these perceptions creep into the world of international dispute resolution when parties from Saudi Arabia or the GCC are involved, and efforts should be directed at evening the playing field and crafting arbitration mechanisms which help avoid misunderstandings, maximise good-will, encourage mutual fairness and make the entire process more efficient.

First, if the other party and its assets are in Saudi Arabia, careful thought should be given to the

effectiveness of relying on a standard arbitration provision that, for example, seeks to have an international tribunal apply English or New York law. Since any award would have to be enforced in Saudi Arabia, and the local courts will conduct a de novo review based on Shariah law as applied in Saudi Arabia, it might be wiser and more productive to simply designate Saudi law (or Shariah law principles) as controlling in the arbitration clause. For several reasons, it might also be preferable to select a regional arbitral forum that will apply recognised international standards, which may be more efficient, culturally sensitive and comfortable for the parties, and result in an award that will have a better chance of being recognised for subsequent enforcement in Saudi Arabia or other GCC jurisdictions. Finally, it may be that a different approach to selecting an arbitral tribunal is more productive. For example, each party might designate one member of the tribunal who would not have to be a lawyer, and those two members (or an independent arbitral body) would then designate a chairman who must be familiar with Shariah law. Again, the goal would be to obtain a more efficient decision, in a setting with greater cultural sensitivity, which would also be viewed more favourably in the context of enforcement.

London, New York, Paris, Hong Kong and Singapore are well recognised arbitration cities, and commonly designated in contractual arbitration clauses for the resolution of international disputes. But some new and interesting options are emerging in the Middle East, with legal reforms derived from the United Nations Commission on International Trade Law (UNCITRAL) Model Law on International Commercial Arbitration or other recognised standards and the establishment of regional centres promising to be progressive, accessible, transparent, confidential, efficient and user-friendly for both local and foreign parties. For example, Qatar recently opened its International Arbitration and Conciliation Centre. The UAE has the Dubai International Arbitration Centre, the Abu Dhabi Commercial Conciliation and Arbitration Centre (established in 1993), and the more recent Dubai International Financial Centre (DIFC) which has enacted comprehensive arbitration legislation making it open to parties beyond its own jurisdiction and aligned with the London Court of International Arbitration (LCIA). Similarly, Bahrain has partnered with the American Arbitration Association (AAA) to create the Bahrain Chamber of Dispute Resolution (BCDR). The BCDR-AAA was established in conjunction with legislation creating an arbitration 'free zone' so that disputes heard there will not be subject to legal challenge in Bahrain, so long as parties agree to be bound by the outcome. These and other regional alternatives are clearly competing to be on the cutting edge of international dispute resolution, which those countries view as being an important component of their continuing investment and economic diversification programmes.

Saudi Arabia's domestic arbitration system (Saudi Arbitration Act issued by Royal Decree in 1983) is not based on the UNCITRAL Model Law and has far greater uncertainties and duplicative judicial involvement than other arbitration laws in the region. However, it is possible that Saudi and international parties might both benefit from designating one of the newer alternatives in Bahrain, Qatar or the UAE. The Kingdom is a party to the 1983 Convention on Judicial Co-operation between the States of the Arab League (Riyadh Convention), and Article 37 provides that arbitral awards and judgments from originating states generally will be recognised and enforced in recipient states.

With the continued dramatic growth and economic diversification in Saudi Arabia and throughout the GCC, international arbitration of commercial disputes is becoming increasingly common. While arbitration has been a part of the region's religious, legal and cultural heritage for generations, current international dispute resolution mechanisms must be carefully tailored to provide a respected and efficient platform to reach fair resolutions, which can then be effectively enforced. Reliance on a standard arbitration clause with a foreign choice-of-law and designation of a location outside the GCC may not be the best option for either local or international parties. And if a commercial dispute is ultimately going to be governed by Shariah law as applied in Saudi Arabia, for example, the contractual provisions must be carefully reviewed for terms or conditions that may be rejected by Saudi courts. These issues are not always obvious, and the goal is to avoid unwelcome surprises down the road.

Dale E. Stephenson, Carol M. Welu and Paul Oxnard are partners at Squire Sanders.

MAY 2011

Paul Starr and Nicolas Groffman

DISPUTES WITH CHINESE ENTITIES: HOW TO WIN AND ENFORCE

For international firms with business in China, a legal dispute is one of their greatest fears. The Chinese legal system is criticised for protectionism, for discriminating against foreign litigants, for corruption, for placing undue emphasis on mediation, for having under-qualified judges, and lastly, for the difficulty of enforcement, even if you win.

While some argue there is truth in these criticisms, these authors have observed improvements in Mainland courts' handling of litigation, and have also been successful in what is probably the first enforcement of a Hong Kong judgment in mainland China, under the 'Arrangement on Reciprocal Recognition and Enforcement of Judgments in Civil and Commercial Matters' (REJA). In this article we examine how to win in China, placing special emphasis on REJA, and through real examples we study more common methods of dispute resolution, such as arbitration and litigation.

REJA was signed in 2006. It became effective in 2008 and provides a legal basis for PRC courts to enforce Hong Kong judgments, which is extremely significant. China signed the New York Convention on international arbitration, and so international arbitration awards can be enforced in China – but there is no equivalent arrangement for foreign court judgments. China has judicial assistance treaties with a few civil law countries, but these are too narrowly-defined to be useful. It has no such treaty with any common law country, which is why REJA is significant. Hong Kong, though part of China, has its own independent, common law legal system, and its courts are as fair as England's. It has long been the default jurisdiction for contracts involving Mainland Chinese parties and foreign parties, and it is important that Hong Kong court judgments are now enforceable in the Mainland.

In other words, REJA allows you to use independent courts for cases in China, and it works. In November 2010, the authors had a Hong Kong judgment recognised by a Shanghai court, the first ever such recognition.

REJA cannot be used for every type of dispute. First, it applies only to commercial contracts, not to consumer contracts, employment relationships or family matters. Second, the contract must be subject to the 'exclusive jurisdiction' of Hong Kong courts: if the contract has an arbitration clause, or if Hong Kong court jurisdiction is not 'exclusive', REJA cannot be invoked. And third, if enforcement would contravene Mainland public policy, the judgment may not be enforced.

The Hong Kong court will make its judgment without reference to REJA, and will then decide whether to transmit the judgment to the Mainland Court for enforcement. The Mainland Court must be satisfied that the judgment has met the three requirements above, and if so, it will enforce the judgment.

In reality, it is less simple. The Mainland court will allow advocacy from both sides before deciding whether or not the judgment falls under REJA. The burden is on the party that lost in Hong Kong to show why the Mainland court should not enforce, and that party can only argue on the three points above, or that procedure was not followed correctly. The latter is easier for the international plaintiff to dismiss, because the Hong Kong court would have effectively ratified procedure by accepting and ruling on the case. The former arguments are where the substantial debate takes place, because the three concepts have not been clarified and are open to sophistry.

Key to using REJA is consideration of potential disputes at the time of drafting the contract, and wording it to ensure that Hong Kong and Mainland courts will accept the application of REJA.

A more tested method than REJA is international arbitration, which is enforced either under the New York Convention or, for Hong Kong, pursuant to the 'Arrangement concerning Mutual Enforcement of Arbitral Awards between Mainland China and Hong Kong' (1999) (MEAA). The MEAA has become more attractive recently since the Supreme People's Court's clarification on 5 January 2010 that (with certain exceptions) ad hoc arbitral awards and arbitral awards made in Hong Kong by the ICC and other foreign arbitration institutions are enforceable in China.

Reading statistics about enforcement of arbitration awards in China is misleading. There is no public

database of enforcement statistics, and some researchers rely on statistics as to whether the award was successfully challenged or set aside. It is common to read articles with statements like this: "Contrary to popular belief that enforcement of arbitration awards in China is very difficult, statistics show that less than 10% of arbitration awards are set aside by Chinese courts."

This is misleading. Those who actually work on arbitration enforcement paint a different picture: in China, most arbitration awards are settled rather than enforced, and although courts hardly ever reject international awards, they ignore them – which works in favour of the Chinese party.

To reduce the risk of a local court overturning an arbitration award, ensure the arbitration arrangement is international, not domestic. Wholly owned subsidiaries of foreign companies are domestic entities, so if they are in dispute with Chinese companies, the seat of arbitration must generally be inside China and must be administered by a Chinese arbitration institution. Chinese courts have more discretion to refuse to enforce arbitral awards rendered by a domestic arbitration institution. For example, they can do so if they consider that the evidence for ascertaining facts was insufficient or that there was a clear error in the application of the law.

A foreign arbitral award is more difficult to overturn. The Convention permits courts to refuse to enforce foreign arbitral awards in limited circumstances. They can do so if the arbitral award offends the state's 'public policy'. Chinese courts are now very strict in how they interpret 'public policy', and on 17 April 2000, the Supreme People's Court of China (SPC) mandated that no foreign awards could be refused unless approved by the SPC.

A local court thus cannot refuse enforcement without approval from the SPC in Beijing, but this doesn't always help: the court need not issue documentary evidence that it opposes enforcement. There is little recourse for foreign companies in this case.

To increase the likelihood of successful enforcement, a litigant against a Chinese entity should ignore received wisdom. The idea that discussion is always better than litigation, that courts are the last resort, that one should rely on connections rather than the law – these ideas can waste years. This applies to enforcement of foreign arbitral awards, and also to civil litigation in China.

First, go to legal process earlier. Mediation involves great expense and yields little in return. The Chinese party may be willing to mediate – very slowly – since there is no downside.

Second, seek any interim relief that is available. Asset seizure orders should always be pursued aggressively, probably as a first option. Courts will readily accept asset seizure orders, especially if assets are located in the same province but a different city to the head office of the Chinese entity. Even more gratifying is an asset seizure order before commencing arbitration. This is only available from domestic arbitration institutions – which runs counter to the belief that overseas arbitration is always better.

Third, do not seek a quick fix by employing a 'local expert'. A local connections man will take credit for any positive development and will offer an 'expert' explanation for any negative development. At best, he will introduce officials that you would otherwise have been unable to meet – but they may not be relevant to your case. At worst, he will incur corruption-related liability for you and your company. Generally, he has a vested interest in constantly reiterating the message that China has no rule of law, that the courts will inevitably side with the Chinese side, and that his 'contacts' are the only way. None of these is true. If necessary, approach a local lawyer, properly supervised by a Beijing/Shanghai law firm, or international lawyers.

Overall, there has been much improvement over the last 20 years in the rule of law in China and in methods of enforcement against Chinese parties. Legal procedure itself is not the main problem, and practical problems of enforcement can be solved by application of aggressive litigation principles and determination not to be distracted. A claimant that has decided to enforce stands a better chance of success than one who still hopes to negotiate his way out of trouble.

Nicolas Groffman and Paul Starr are partners at Mallesons.

JUNE 2011

Fábio Peixinho Gomes Corrêa, Allan J. Guty and Edmond Grieger

TALKINGPOINT: COMMERCIAL DISPUTES IN THE MINING AND NATURAL RESOURCES SECTOR

FW moderates a discussion which covers commercial disputes in the mining and natural resources sector between Fábio Peixinho Gomes Corrêa at Lilla, Huck, Otranto, Camargo, Allan J. Guty at Parlee McLaws LLP, and Edmond Grieger at Von Wobeser y Sierra, S.C.

FW: Have you seen a notable increase in disputes involving companies in the mining and natural resources industry?

Grieger: In Mexico we have seen an important increase in disputes involving international as well as national companies which have engaged in activities concerning the mining and natural resources sectors. One of the main reasons for these disputes is the fact that in the past decade we have seen in Mexico a significant increase in legislation, regulations and standards applicable to the mining and natural resources activities which have more strictly regulated compliance in this area. The common lack of awareness of the obligations applicable to the companies who engage in these activities usually results in a breach of legal requirements, which ends up in a dispute between the parties involved.

Guty: Our focus is on Alberta and elsewhere in the Western Canadian Sedimentary Basin, including the oil sands in northeastern Alberta and northwestern Saskatchewan. We have seen a notable increase in disputes in this part of the natural resources industry over the last several years as Canadian and international oil companies invest billions of dollars in developing their oil sands projects and bringing those projects into production. Disputes arise between oil sands producers

and suppliers for a wide variety of reasons. As for disputes relating to conventional oil and gas projects, we have not seen a notable increase in the frequency of disputes that require litigation.

Corrêa: Brazil has been experiencing unprecedented growth in projects involving mining and natural resources. This boom has been fostered, among other factors, by the governmental plan to accelerate economic growth. Many foreign investors were encouraged to follow this tendency and relied on the prospect of quick financial results. However, the flood of governmental and international funds demanded highly capacitated personnel in quantities not available in the Brazilian market. This limitation caused costs to overrun in many projects that were seeking to meet the time limit contractually agreed. In other cases, the companies involved did not have the financial or material resources to overcome the barriers created by these difficulties. Consequently, many disputes have arisen out of EPC and M&A agreements regarding, for example, hydro, oil, and coal power plants, mining fields, and ethanol and paper plants. Most of these disputes have been referred to arbitral tribunals constituted under national or foreign arbitration institutions.

FW: Could you outline any notable cases, decisions and settlements that have taken place in the last 12 months or so?

Guty: The Alberta Court of Appeal recently issued a decision regarding shut in wells on freehold land, ending a long running a dispute between operators – Bearspaw Petroleum v. Encana Corporation. The operators had each claimed that the terms of an operating agreement granted them ownership of certain shut in wells that were the subject of the agreement. In interpreting the terms of the agreement, the Court held that even though they had not been in actual production for several years, the leases were 'producible' and could be returned to production relatively easily when it became economical to do so. In the end result, the Court held that the leases continued, and Bearspaw, as the lessee, retained rights to the wells.

Corrêa: These cases are normally confidential and not much information is available to the general public. Nonetheless, a case involving the Brazilian National Bank of Economic and Social Development (BNDES) and Equator was broadly discussed in the media after the issuance of the final arbitral award. According to BNDES, Equator filed a request for arbitration before the International Court of Arbitration of the International Chamber of Commerce (ICC) claiming that BNDES irregularly loaned US$243m to the construction of Hydro Power Plant San Francisco. However, the Arbitral Tribunal rejected the claim and ordered Equator to continue paying the loan

instalments. The construction of Belo Monte Hydro Power Plant has also raised several disputes during the bidding phase due to environmental and labour questions. While environmental protection has been the focus of the licensing institution and the Judiciary Branch, the contractors have dealt poorly with labour disputes, giving rise to physical confrontation and the destruction of private property at the site.

Grieger: One important recent case in the mining sector is related to a mine of the company Binsa which exploded and killed 14 miners and left one underage worker without an arm. The company carried out mining activities in northern Mexico, ignoring the applicable legal provisions and now will have to indemnify the families of the deceased miners and the underage boy who was illegally hired by the company. Criminal, labour and civil actions have been filed against the company and its directors, in addition to the corresponding administrative sanctions and fines, and its mining concession is being permanently revoked. There is also an important case in the tourism sector, where a public environmental claim has been filed by several non-governmental organisations against an important Spanish corporation, alleging that the 700m touristic development that the company intends to build in Baja California will irreversibly affect a corral reef and the natural resources of the area. The company already has an environmental impact authorisation; however, the supposed non-compliance issues are being re-evaluated by the federal environmental authority.

FW: What are the most common causes for environmental claims against companies in the mining and natural resources sector, and which entities normally initiate such claims?

Corrêa: Every large mining and natural resources project considers previous environmental studies as a part of the licensing process. Since different branches of the government are involved in such projects, it is not unusual that one specific branch attempts to fast track the licensing process, while Brazil's environmental protection agency (IBAMA) concentrates its efforts on ensuring the project's sustainability. Its intervention, though, is not always welcomed by the executive branch and private investors. Along with IBAMA, the Attorney General and their deputy counsels are actively controlling such projects from their inception until operation. Whenever the licensing process seems insufficient to ensure the lowest environmental impact, the Attorney General files class actions to claim the suspension of all activities in the site until further studies are produced. Brazil's economic development is routinely criticised for undermining environmental issues, leaving the responsibility of balancing both interests to the judge.

Grieger: The most common causes of environmental claims in Mexico arise from non-compliance with the terms and conditions included in environmental authorisations mandatory to carry out specific activities and construction works in Mexico, or by companies carrying out projects to assess the possible negative impact on the environment of their projects, without obtaining the necessary environmental authorisation. Other common cases are due to environmental liabilities or risks originating from contaminated soil, subsoil or water, as well as non-compliance issues in the management of hazardous wastes. The entities which normally initiate such claims in Mexico are non-governmental organisations, public entities or private companies which generally are direct competitors of those companies carrying out the irregular projects. The most common mechanisms to initiate a claim are the public environmental claims or a damage claim which is filed before federal civil courts.

Guty: Most environmental claims against companies in the mining and natural resources sector arise in connection with the reclamation process, when landowners, whether individual or corporate, dispute the quality and/or completeness of the reclamation work. A number of claims also occur between companies regarding liability for reclamation on projects where multiple operators have been involved.

FW: To what extent does the government normally involves itself in each phase of a dispute resolution process or claim in the mining and natural resources sector?

Grieger: Initially we should establish which specific dispute resolution process we are analysing. In Mexico we usually see judicial litigations before administrative or civil domestic courts, environmental public claims or mediation and arbitration procedures. In public environmental claims filed before the Mexican Federal Environmental Protection Agency (PROFEPA), the PROFEPA acts as intermediary by receiving complaints against any private or public entity, notifies the claim to the possible infractor, and begins an investigation. If it is determined that a breach exists, damages were caused to the environment or human health, or a risk of causing them exists, the PROFEPA orders the necessary measures and administrative sanctions as well as a statement establishing the damages and losses caused to the environment or to a third party. This statement can be used as evidence to claim the indemnification of damages and losses before the civil domestic courts. In judicial litigations before administrative courts the government usually plays the defendant role, since in most cases, entities, associations or persons within the private sector file administrative claims against irregular acts or omissions in the mining or natural resource sector carried out by governmental entities.

Corrêa: Whenever the dispute is related to environmental protection, the Brazilian government – through IBAMA and the Attorney General – is present in all phases of its resolution process. In fact, these institutions participate early in the planning phase of the project, despite their limited resources, in order to prevent future deviations from the regulatory mark. If the project fails to acknowledge in this phase that environmental protection is a priority, most likely the Judiciary Branch will have to intervene to settle the dispute. With regards to disputes concerning contractual performance, there has been a clear tendency to avoid state courts by choosing alternative disputes resolution methods. Since the enactment of the Brazilian Arbitration Act, almost all contracts related to the mining and natural resources sector provide for an arbitration clause. Such provision has been consistently applied by the Brazilian courts, with a view that the government should not become an obstacle in the adjudication of claims in these fields.

Guty: Very rarely does litigation between oil and gas companies require the involvement of government at any phase. The government of Alberta takes a 'hands off' approach to litigation within the oil and gas sector other than to make a very general statement to generally encourage settlement of disputes. However, the government is very involved in encouraging and even mandating dispute resolution processes over those areas under which it has direct regulatory control. For example, the majority of the natural resources regulatory bodies created by the government now have their own dispute resolution processes, which participants are strongly encouraged to use. Some of the bodies, like the Surface Rights Board and the Environmental Appeals Board, have actual board members act as mediators, while other bodies, including the Energy Resources Conservation Board, use third party mediators. On rare occasions, the government, while not getting directly involved in the dispute, may take action that directly impact disputes. For example, the Alberta government's recent legislation proclaiming that ownership of coalbed methane lies with the owner of the natural gas rights and not the owner of the coal rights. This has impacted, if not resolved, a longstanding dispute between coal rights owners and natural gas rights owners regarding ownership of coalbed methane.

FW: In your opinion, what are some of the most effective measures used to avoid disputes in the mining and natural resources sector?

Corrêa: First of all, the parties must realise that the agreements should be thoroughly negotiated to reflect the real situation of the project. Moreover, good faith in exchanging information during the negotiations is a key factor to avoiding future disputes. Furthermore, good faith should be applied

during and after the contractual performance to guarantee that all the parties are not surprised by any undisclosed factor. In the construction phase, the project owners have relied heavily on hiring specialised companies to act as the owner's engineer. Although the owner's engineer is conceived as a means of controlling the quality of the construction, sometimes these professionals have moved away from their initial functions and acted together with the engineer in charge. If this division of work is not clearly established by the parties, for instance, the construction agreements may stipulate that the issue is referred to a dispute resolution board, which is an internal board to solve conflicts raised due to this sort of misunderstanding of each party's role.

Guty: The most effective way to avoid disputes begins with the corporate culture of the client which is implemented long before litigation lawyers are involved in a dispute. Even when one is dealing with immensely complex contract negotiations or project planning, which is often the case in large oil and gas endeavours, it is ultimately the good relationship between the people on the opposite sides of an issue that is essential to avoiding disputes. Excellent documentation and contract administration are important and will also assist the client immensely if the dispute goes to litigation; however, in order to avoid disputes, people skills are indispensable. Litigation is expensive and time consuming for employees and officers of companies so employing sound people skills early in the process will save considerable money and time.

Grieger: The first measure should consist of preliminary due diligence to analyse whether the party with whom a contractual relation is intended fully complies with the legal provisions applicable to its activities in the mining and natural resources sector. This is to avoid future possible non-compliance risks which could prematurely end the business relationship and affect the standing and image of the complying company in the event of damages or risk to the environment or third parties. A subsequent measure should be to include the proper clauses in the agreements to outline the liabilities and indemnities of the parties involved. In this regard we always suggest a mediation and arbitration clause be included in the agreements in order to avoid a dispute, and in the event one arises it is resolved with the benefits of an arbitral procedure. The insertion of mediation or arbitration clauses in mining and environmental matters is not that common in Mexico; nevertheless, we strongly promote its implementation.

FW: Have there been any important legal and regulatory developments affecting dispute resolution and claim mechanisms in the mining and natural resources sector?

Guty: In Alberta, the government has created a new Rules of Court which includes the requirement

that all litigants participate in a dispute resolution process prior to the court scheduling a trial date. The court, however, has the ability to waive this requirement subject to certain conditions. There have also been proposals to create a regulatory 'superboard' for the oil and gas and mining industries, however, it is unlikely that this will be implemented prior to the next election.

Grieger: In March 2010, an amendment to the Federal Constitution was approved by Congress in order to incorporate the figure of collective actions, which is an instrument similar to class actions in the US. For the first time it will be possible for persons, associations and any private or public entity to file an action to defend the interests of a collectivity, without the need to evidence a direct damage to the person or goods of the person filing such judicial action. Collective actions are to be used mainly in the environmental, consumer protection and security sectors. Specific laws to regulate this judicial figure are being discussed in Congress and should soon pass. Currently there are no specific legal provisions in Mexico to clearly recognise damages caused to the environment, nor a specialised judicial procedure or federal courts to attend claims for environmental damages, since this procedure is normally ventilated in ordinary federal civil courts. A bill is also being discussed to issue a Federal Environmental Liability Act. The main purpose is to specifically regulate the judicial procedure and courts to attend claims for damages caused to the environment, as well as to provide clear rules to determine the concept and extent of environmental liability in the country.

Corrêa: The most relevant development in the last 15 years has been the enactment of the Brazilian Arbitration Law. Since then, investors and even state-owned companies have adopted arbitration as a dispute resolution mechanism. At the same time, Brazilian arbitration institutions have developed know-how in conducting cases in fields like mining and natural resources. Their list of arbitrators is formed by high profile lawyers and experienced experts, offering the parties a different choice from the Judiciary Branch. On the other hand, the regulatory changes affecting the Judiciary Branch have not been significant to the point of making the state adjudication adequate to the needs of these sectors. If a dispute cannot be solved through arbitration due to regulatory limitations – for example, environmental protection – there have been attempts to change the regulatory provisions regarding the environmental licensing process. If the government succeeds in changing this regulatory mark, it will most likely reduce the Judiciary Branch intervention in matters involving public policies.

FW: What advice would you give to companies on dealing with a dispute as it arises? How important is it to act early and assess all the options, including litigation, arbitration and alternative dispute resolution methods?

Grieger: The best advice in this regard is for companies to pursue agreements with a mediation clause in order to resolve any potential dispute if possible. It is also important for companies to timely assess and agree on the most efficient method to resolve disputes that do arise. The method should be adapted to the particularities and amount of the specific contracts. Acting early in order to establish the method that will be used by the parties to resolve their disputes should significantly reduce costs and time periods for the parties to resolve any dispute that does arise.

Corrêa: The sooner the company invests in a speedy resolution of a dispute, the higher the chances that the parties will amicably settle such dispute. Indeed, if the parties have all the necessary information at the outset, they will most probably reach the same conclusions on their chances of winning or losing their case. The legal counsel is responsible for evaluating the case specifics to point out the best course of action. If the legal counsel fails to exercise his or her role early in the beginning or if the company decides to move forward without a legal counselling, this window of opportunity will be lost and, even worse, the other party may gain a strategic advantage. The choice between litigating and settling the dispute should be based on an informed decision among the available dispute resolution methods. The wrong choice will not only waste time and money, but will also allow the counter party to be better prepared to claim or defend from a claim with lower costs.

Guty: There is not a 'one size fits all' response. The position taken by a client with respect to a dispute, including proceeding to litigation, arbitration, negotiation or mediation is heavily dependent on the facts and the client's legal position. Before a dispute reaches the litigation stage, clients must be made to understand the issues and facts as well as determine what dispute resolution processes have taken place up to that point in time. An important question is whether there has been a face to face meeting between the parties which would include those persons with the authority to agree to a resolution. Often times at this stage the respective parties will already conclude that no resolution is possible. However, after years of litigation, legal expenses, and damaged relations, most commercial litigation is settled before trial between representatives of the respective clients. One often wonders why that negotiation did not happen at the beginning of the dispute rather than towards the end, especially when the facts have not changed very much.

It is, therefore, very important to assess all options with respect to litigation, arbitration, negotiation and mediation early in the dispute.

Fábio Peixinho Gomes Corrêa is a partner at Lilla, Huck, Otranto, Camargo, Allan J. Guty is partner at Parlee McLaws LLP and Edmond Grieger is a senior associate at Von Wobeser y Sierra, S.C.

AUGUST 2011

Thomas Heitzer and Barry Leigh Weissman

TALKINGPOINT: INSURANCE AND REINSURANCE DISPUTES

FW moderates a discussion looking at insurance and reinsurance disputes between Thomas Heitzer at Noerr LLP, who takes a direct insurance perspective, and Barry Leigh Weissman at SNR Denton US LLP, who offers a reinsurance perspective.

FW: In your opinion, what impact has legislation/regulation resulting from the financial crisis had on insurers?

Heitzer: The financial crisis started in the subprime market and affected banks and financial institutions all over the world. Today, we still face an economic crisis with the bailout of countries like Greece, Portugal and Ireland. In 2008, politicians all over Europe blamed bank directors for the extensive damage caused and the respective need for financial aid from certain countries. Increasing the personal liability of the directors by respective amendments to the law – decided overnight and necessary or not – fulfilled the public demand for justice and compensation for additional taxes paid by them and future generations. Banks and their directors now face stricter rules on liability, but most of all they face the risk of being held liable for at least part of the financial crisis. This of course has a major impact for the exposure of insurers and reinsurers.

Weissman: For the first time in the US there is actually direct regulation dealing with reinsurers. In the past most of the regulations have been on an indirect basis, that is, regulators required the insurer to have certain language in the reinsurance agreement in order for it to receive credit for reinsurance. Now there is specific legislation requiring reinsurers to behave in a specific

manner. The National Association of Insurance Commissioners and the US Congress have enacted guidelines, model acts and legislation that allow non-US domiciled reinsurers to be licensed by a single jurisdiction rather than by every US state. In addition, several states are enacting revised laws dealing with collateral. In the past, if the reinsurer was not licensed in the jurisdiction it would have been required to post security for the insurers claims that would arise under the treaty. The amount of the security was, generally speaking, 100 percent of reserves. The new collateral requirements are reducing these security requirements based upon the financial status of the reinsurer. These reduced collateral requirements mean the stronger the rating of the reinsurer, the less collateral it is required to post. At the present time there are approximately five states that have enacted these reduced collateral requirements. These states generally have five levels of collateral ranging from no security to 100 percent security.

FW: Can you outline some of the specific issues you have seen arising from recent claims and litigation?

Weissman: The most fascinating issue here is the rise in life reinsurance disputes. In the past, almost all disputes were on the property and casualty side and it was almost unheard of to hear of a life arbitration. However, in the last several years we have seen a substantial increase in life arbitrations. A number of these arbitrations involve similar type issues, for example allocation, accounting, coverage, and so on, but life business is completely different because life reinsurers are on for the life of the contract, rather than having reinsurers change every year as one has in the property & casualty side of the business.

Heitzer: The number of disputes on insurance products like D&O and E&O policies has increased by a huge percentage, not only in relation to financial institutions but also as a consequence of the lack of capital and financial liquidity of companies. Companies' financing needs are not satisfied by the existing banks and other financial institutions as they are not able, or not willing, to lend fresh money to them. Also, the number of claims filed by private or institutional investors against banks for misselling has increased, and the BGH, the German Federal Court of Justice, has passed some decisions in favour of the investors, which can be seen as very consumer friendly and, of course, as a demand for stricter and more comprehensive compliance within the financial institutions. Finally, the current atmosphere of holding directors liable for any and all failure in business must be regarded as a result of the fear of the members of the supervisory board who do not want to breach their obligations by inactivity.

FW: Over the past 12 months, what are the most remarkable court decisions for the insurance industry that you have seen? How do you assess the impact of 'Morrison v. National Australia Bank'?

Heitzer: Morrison v National Australia Bank presents a very important decision for European business operations in the US. It limits the extraterritorial reach of US securities law to non-US conduct. In its decision, the Supreme Court emphasised principles of international comity which underlie its extraterritoriality jurisprudence and avoided conflicts with foreign laws and procedures. For those European companies which have been sued on the grounds of the Securities Exchange Act of 1934, the decision has supported the dismissal of claims brought against them in the US. However, as Europe still has no comparable system of class actions as the US has, the demand for the development of a similar legal framework in Europe will accelerate.

FW: What influence are regulatory investigations having on insurance cases?

Heitzer: Regulatory investigations initiated by the authorities and conducted and paid for by companies with the support of international law firms and accountants significantly increase the amount of damages awarded. In such cases the company has to commit to full cooperation with, and disclosure to, the authorities, otherwise the company risks endangering its business. In relation to the amount of insurance coverage, the costs for such investigations are outrageous and it is questionable whether or not such costs are covered under the D&O or E&O insurance policy. The differentiation starts where the investigations are not only for purposes of disclosure but also for the avoidance and implementation of a working compliance system. Insurance policies usually do not answer this very difficult question with the necessary accuracy.

Weissman: In the reinsurance world, we are not really seeing too much of an influence on disputes. The influence is more on the contract drafting and interaction between cedent and reinsurer.

FW: Are more of insurance cases ending up in litigation, or do insurance companies prefer to explore mediation and arbitration as alternatives?

Weissman: The majority of reinsurance cases have been resolved by arbitration. However, in recent

years, as the cost of arbitrations and uncertainty in results increase there has been an increase in looking at other ADR alternatives, including mediation. In fact, some cedents are requiring in the reinsurance contracts a mandatory mediation prior to going to arbitration or litigation. Additionally, there has been an increase in 'baseball' type of arbitrations. Here each side selects a result and the arbitration panel may or may not know the parties selection. The panel then has a hearing and issues its award. However, regardless of what the panel awards, the result will be the one selected by the parties that is closest to the panel's award. Finally, many reinsurance contracts are also including various forms of arbitrations depending upon the amount involved. The smaller the amount, the more restrictive the arbitration process, specifically limits on discovery.

Heitzer: Generally, insurers consider very carefully and diligently whether or not they will deny coverage and endanger a business relationship with a client. The facts and legal basis of each case are analysed to the highest possible extent, and most insurers try to anticipate how a cost and time sensitive litigation might proceed. Although the EU passed the European Mediation Directive in 2008, the procedures of mediation for out of court settlements are not regulated by a binding legal framework in every European country. Particularly in the insurance sector, mediation and arbitration are the preferred and appropriate legal courses and therefore should be supported by the European states to a much higher degree.

FW: What are some of the common challenges that surface in insurance and reinsurance disputes at the cross-border level?

Heitzer: All insurance cases in which European insurers deal with a US exposure create major problems in claims handling. The regulation in European countries differs from the US – as to what disclosures must be made by the insured parties, what damages are recoverable, what discovery is available in litigation, what constitutes fraud, and many other issues. Furthermore, the relationship among co-insurers differs widely from a US, UK or continental European perspective. The understanding of how such insurance programs are handled, which information duties the leading insurer has, and how a settlement and costs should be allocated among the insurers differs widely. In such contractual relations, it is essential to understand the technical legal ground that determines the rights and duties of the respective participating carriers.

Weissman: When dealing with the US the biggest challenge is always discovery. US lawyers are used to substantial amounts of written discovery and depositions while our European counterparts

do not have the same procedures.

FW: Where do you expect the next bubble to form, putting insurance companies at risk?

Heitzer: I expect the next bubble to come from any kind of bribery. In Europe we have already seen some major cases of bribery systems where companies have business all over the world. Obviously, in certain areas of the world and in certain areas of the economy, it is very difficult to run a business without the use of such a tool. In most cases, the allegation of bribery leads to investigations by the state prosecutors and tax authorities. If the company is listed in the US, the SEC and the DoJ are involved. Insurance coverage for such risks leads to a very high exposure for the insurance sector and the current atmosphere within companies to disclose and investigate any act of bribery will accelerate the quality and number of such claims.

FW: What advice would you give to insurance companies on dispute avoidance? What steps can they take to minimise future conflict, especially at the contractual stage?

Heitzer: Insurance contracts and the understanding of the scope of coverage, extent of exclusions and the process of pre-contractual disclosure remain very often unclear and create disputes when a claim occurs. The underwriting process and the necessary documentation of the agreed understanding and conditions of the insurance contract are essential, and it is surprising to see how these issues are dealt with in reality. The same applies for co-insurance agreements and the respective understanding of how the insurance program should work. An appropriate documentation of the contractual relation could avoid any differences in understanding how the co-insurers deal with a claim.

Weissman: Both parties must take more care in the drafting of reinsurance agreements. It is not uncommon to see a reinsurance contract that is internally inconsistent, where statements on one page are contradicted on the next page.

Additionally, it is not uncommon for companies to just copy prior agreements without paying attention to changes in practice or law that might have occurred in the interim. Finally, the parties must ensure that the contract contains only the paragraphs that are necessary for the program being reinsured. When a dispute erupts, the lawyers will look at the contract as a whole and will attempt to give meaning to each word in the document, regardless of how much sense they make

in the particular program being reinsured.

Dr Thomas Heitzer is a partner at Noerr LLP and Barry Leigh Weissman is a partner at SNR Denton US LLP.

FEBRUARY 2011

Tim Portwood, Robert L. Schnell, Jr and Dale E. Stephenson

TALKINGPOINT: RESOLVING M&A DISPUTES

FW moderates a discussion on M&A dispute resolution between Tim Portwood at Bredin Prat, Robert L. Schnell, Jr at Faegre & Benson LLP, and Dale E. Stephenson at Squire, Sanders & Dempsey LLP.

FW: Have you seen a rise in M&A-related disputes over the last 12-18 months? What key trends would you highlight?

Stephenson: The difficult market conditions presented during the past two and a half years have given rise to significant challenges for newly acquired businesses and assets, and the very business cases upon which some of these acquisitions were made. Not surprisingly, those markets most affected by the economic downturn have seen the greatest spike in post-deal disputes to address unmet business expectations. For example, Central and Eastern Europe have seen a decided uptick in M&A-related disputes, frequently related to valuation and performance-based issues but also involving potential exits, earn-outs and other performance-based deal mechanisms. Another trend is an increase in disputes arising out of the need of new owners to downsize staff and management. In the Middle East and other areas, sovereign debt uncertainties and bank credit issues have also come into play.

Schnell: Difficult economic times produce more disputes and the M&A area is no exception. Buyers disappointed with the results of their acquisitions are particularly likely to look for ways to renegotiate a better transaction in the guise of dispute resolution. The best example of that phenomenon is disputes over working capital adjustments, which are becoming more common.

Portwood: The financial crisis has rung its toll for M&A activity generally. Fewer M&A deals have completed as financing has become harder to find. Those transactions that have occurred have had little dispute type fall-out. We have noticed two trends over the last 12 to 18 months in this climate. First was an increase in disputes over price adjustment clauses in deals that were closed shortly before the financial crisis took hold. This trend died away, however, six months or so into the financial crisis. The typical resolution mechanism in France for this type of dispute is an ad hoc expert procedure before an accountant or accounting firm. The decision of the expert is binding on the parties and is deemed to form part of their agreement on the price. Recourse against the expert's decision is limited to gross error or fraud. The other trend has been an increase in claims under representations and warranties on deals that were completed before the financial crisis took hold.

FW: Can you provide some insight into the recurring themes driving recent M&A conflicts, such as working capital adjustments, earn-outs, indemnification and price-related disputes?

Schnell: Recent statistics suggest earn-outs are commonly used perhaps as much as 25 percent of the time. They can be particularly problematic because they often are the result of the fact that the parties have not reached a fundamental understanding on value. The earn-out is used to paper over that unresolved fundamental disagreement and, when the earn-out calculation results in a disappointing payment to the seller, that unresolved disagreement boils to the surface. The new owner's decisions, which arguably have caused the earn-out shortfall, are all available to be second-guessed. Other items, like working capital adjustments, can be problematic but the scope of the dispute is usually narrower and confined to more objective criteria.

Portwood: Working capital adjustments and price-related disputes depend upon the financial terms of a given transaction, the former being a sub-set of the latter. Disputes of this type fall into two basic categories. The first focuses on the proper interpretation of the contractual terms. The parties find themselves disagreeing over what items are to be included in, for example, the contractual notion of 'working capital' such as what is meant by current assets and current liabilities. The second focuses on the actual calculation performed by one or other of the parties when establishing the reference accounts. The first may well be within the jurisdiction of the overall judge of the contract – whether an arbitral tribunal or state court – whilst the second may well be submitted to a financial or accounting expert. The latter type of dispute occurs relatively shortly after the closing the transaction. They are often subject to an ad hoc and relatively short procedure provided for in

the SPA. Earn-out and other longer-term price adjustment mechanisms provide for an additional purchase price to be paid based on the future earnings of the target over a stipulated period. Disputes tend to arise when one or other of the parties' expectations are not met. Indemnification disputes are usually triggered by alleged breaches of representations, warranties, covenants or specific indemnity undertakings given by the seller in the SPA. These types of dispute tend to be fact intensive and rarely raise complex issues of law.

Stephenson: Common drivers of recent post-closing M&A disputes include a couple of primary categories. First, those involving valuation for final 'true-up' of the deal, such as the reconciliation of working capital using 'consistent' application of agreed accounting principles to move from an initial reference balance to a closing adjustment, or the calculation of earn-out payments and related financial metrics. Since parties can exercise a significant amount of business judgment in determining, for example, the valuation of accounts receivable and inventory reserves, a downturn in the underlying economy may create conflicting viewpoints when trying to reconcile financial statements. And with earn-out provisions, buyers and sellers may have divergent approaches on direct valuation issues with respect to new investments in the business or expenses associated with downsizing. A second recurring theme grows out of the underlying factual bases upon which the purchase price or deal were premised. This trend cuts across sectors and includes private equity transactions as well as industry-driven consolidations or add-ons. As market conditions grew more challenging, buyers were inclined to take a harder look at what they were told about the businesses they purchased. Claimed breaches of representations and warranties have played a significant role in recent and emerging disputes.

FW: In your opinion, how can companies reduce the likelihood of M&A disputes at the outset of a deal? What contractual issues do they need to evaluate?

Portwood: From the seller's perspective, the best of all worlds is to sell the company 'as is', as often is the case in real estate deals in France, for instance. This only rarely happens, however, in share deals. The trend is to sell on the basis of a long list of representations, warranties, covenants and (where specific risks are identified) specific indemnities – the whole purpose being to apportion risks that have not necessarily been disclosed during the investigative due diligence phase. Fuller disclosure by a seller should result in the price being more realistic and the risk of future successful claims for indemnification being reduced. From the buyer's perspective, if the purpose is to reduce the risk of having to bring claims for indemnification in the future, ideally the seller should be pushed

to make full disclosure of all risks facing the target so that the purchase price can be negotiated accordingly. In such a case, the extent of the seller's representations and warranties would normally be reduced with specific risks being covered by specific indemnity clauses.

Stephenson: Full and effective due diligence is always a critical component to avoid problems down the road. It is likewise important for the parties to clearly allocate risk between a seller's duty to affirmatively disclose and provide associated representations and warranties versus the buyer's obligation to satisfy itself through pre-closing diligence. Overall, parties should not gloss over key issues or be blinded by their desire to close the deal. A full and appropriate risk matrix which identifies and considers all key risk factors associated with a particular transaction needs to be carefully developed, using a risk-review team that includes members other than those leading the deal. To minimise future valuation problems, parties should agree beforehand precisely how financial statements should be prepared and what trumps if there is a difference between strict adherence to the chosen accounting standard and actual past practice.

Schnell: There is no substitute for careful and precise drafting. Matters left to future clarification or dependence on good will of the counterparty should be avoided at all costs, and the mutual incentive the parties have to get a deal signed should be used to force agreement, pre-closing, on as much as humanly possible. If an earn-out simply has to be part of the deal, the higher up the income stream – revenue versus earnings, for example – and the shorter the measurement period, the better. Lastly, the big risk is what isn't considered in the deal. Step back and think about what should be in the documents but simply isn't there.

FW: If a dispute arises, what considerations should companies make on how to resolve them and what preparations to set in motion?

Schnell: Every dispute gets settled at some point, and sooner is almost always better. An early direct contact between senior-level executives not involved in the dispute is often helpful. So is early mediation, as long as the parties have a sufficient understanding of the facts to have an informed discussion. A mediator will give both sides a fresh perspective and sufficient 'cover' for parties who want to settle but are afraid of being second guessed. While that is being done parties need to secure and protect all their paper and electronic materials, including texts and emails. What is destroyed after the dispute arises – even in the ordinary course – will be used against the destroying party.

Stephenson: Since most M&A disputes are subject to arbitration provisions, that process can move along quickly and the early characterisation of a party's position can significantly affect the entire process and final outcome. It is important to get experienced arbitration counsel involved at the outset to help establish a system that preserves and manages relevant information, fully evaluates strategic options, maintains confidentiality, properly organises files and electronic data, obtains critical information from key employees while they are still available, and provides for substantive legal input in the preparation of early correspondence related to the dispute.

Portwood: This question needs to be looked at from two perspectives. For the buyer, who would usually be the claimant, the first step is to establish the extent of the breach of the covenant, representation or warranty or specific indemnity in the SPA. This should be documented as best as possible with the collection of all relevant contemporaneous documentation and statements of individuals with actual knowledge of the facts of the alleged breach. Second, a full record of the disclosures made and the negotiations behind a given covenant, representation or warranty or specific indemnity researched with all individuals involved requested to participate in this fact finding exercise. Armed with this factual material, an analysis of the contractual terms, including all limitations to indemnification claims should be made. Finally, a tactical decision should be made as to whether the claim is to be made individually or grouped with other potential and similar claims under the SPA. From the perspective of the seller, usually the respondent, a careful record should always have been kept of the dataroom and other disclosures made to the buyer before closing. Upon receipt of a claim, this information should be analysed to assess first whether there are any contractual defences (for example, through a disclosure exemption clause) or any causation arguments. Care should also be taken to be sure that the buyer has complied with all procedural requirements.

FW: Is arbitration suitable for dealing with all aspects of M&A disputes? What complications can arise in multi-party or multi-contract structures?

Portwood: Price adjustment disputes related to closing accounts – as opposed to earn-out and other similar long-term price clauses – tend not to be well suited to arbitration. The technical nature of the issues that are usually raised, as well as the parties' wish to have the dispute resolved in a very short period of time, mean that the arbitral process is not as well designed as an ad hoc expertise proceeding. For the other typical types of disputes that tend to arise, including indemnification claims, arbitration is usually an efficient means of resolution,

providing for a final and binding mechanism that is not subject to multiple forms of recourse. Often the issues are factual rather than of great legal complexity. Multi-party disputes raise difficulties for arbitration as a means of dispute resolution (as opposed to court litigation) when one or more of the entities or persons involved in the dispute is not a party to the arbitration agreement. Most typically this occurs where groups of companies are involved, although the types of situations are numberless. There is no easy solution when a party to the dispute is not a party to the arbitration agreement, although arbitral tribunals may find as a matter of fact that although not formally a signatory to the SPA, a third party closely associated with and involved in the transaction was intended to be bound by the arbitration agreement. Where all parties to the dispute are also found to be parties to the arbitration agreement, issues such as equality between the parties in the formation of the arbitral tribunal and rights of due process may arise.

Stephenson: Virtually all M&A deals rely on arbitration to resolve disputes arising out of the deal. Some agreements distinguish carve out areas for expert accounting determination to handle valuation issues while leaving broader disputes to general arbitral forums. In situations involving parties where the potential enforcement of a foreign arbitral award may present particular difficulties, it may be advisable to craft an agreement providing for another means of dispute resolution or which takes into account the unique considerations. Multi-party disputes and multi-contract structures can give rise to difficulties in constituting an arbitral tribunal to afford equal participation, although the principal arbitral institutions now have mechanisms in place to effectively handle that scenario. The most difficult problem arises when disputed issues involve parties who have not signed the arbitration agreement.

Schnell: International arbitration is often preferable to resolution in a court because the decisions of an arbitrator tend to be more-easily enforced internationally. But if there are multiple contracts or multiple parties you can have a situation where someone has not agreed to arbitrate and cannot be forced to do so. In that case a party may well decide to sit on the sidelines and watch the others fight, awaiting the outcome without the expense of participation or the risk of an adverse outcome.

FW: What kinds of disputes can arise out of cross-border deals, including situations where both sides are headquartered in the same country but have international operations?

Stephenson: In many cases, and especially with joint ventures, the parties may structure their relationship through a shareholders agreement governed by English law. However that agreement may not be enforceable in the country where the business is located since the local entity is subject to the law of the host country and its underlying statutes. As a result, a party relying on the shareholders agreement may find itself unable to obtain effective enforcement in the country vis-à-vis its other shareholder who is instead relying on local law to prevent enforcement of the agreement.

Schnell: Cross-border deals give rise to complex issues related to antitrust laws, which differ in terms of application and timing in various jurisdictions. What to file, with whom and when can all come into play—although mostly those matters are resolved in the course of the deal construction. Foreign Corrupt Practices Act (FCPA) issues are also a major factor in cross-border transactions. Due diligence and attention to red flags in the FCPA area are key matters, and it may well be that a buyer is held to an even higher standard when it is already arguably familiar with how business can be done in the target's country from its own business dealings there.

Portwood: Cross-border deals are typically characterised by the need to cater for two or more company law, tax law and accounting regimes in addition to any other specific legal regimes applicable to the industry sector of the particular transaction. Transfers of shares and changes of control may require specific formalities to be accomplished, corporate and tax filings to be made, payments to be made, time periods to be observed for each entity sold and so on. All of these aspects will have to be carefully catered for often with the assistance of local counsel, failing which the purchaser may not, on the closing date, receive everything that it had bargained for.

FW: Can you outline some of the practical difficulties of resolving M&A disputes in emerging countries?

Schnell: The legal systems in emerging countries are often less robust in terms of discovery pre-hearing, and even in terms of what is required at a hearing. We recently had an experience in China where a party attended a hearing and argued his case opposing our client's claim, but could not be required to make information or testimony available at the hearing. Since proving wrongdoing in the context of an M&A deal often involves looking at information in the exclusive possession of the counterparty, that sort of one-way participation can make matters especially difficult for a foreign claimant.

Portwood: The less sophisticated the legal regime in which a target company operates, the more difficult it is for the seller and the buyer to provide contractually for the sharing of the risks associated with the ownership of the target before and after the closing of the transaction. The due diligence process is rendered more difficult simply because transactions tend to be less carefully recorded, accounting systems and principles tend to be less sophisticated and the regime generally tends to be more susceptible to manipulation of one sort or another. In other words, the parties face a more challenging task of gathering the data on the basis of which they can negotiate the sharing of risks.

Stephenson: In Saudi Arabia, for example, there are numerous hurdles and pitfalls associated with the use of international arbitration to resolve commercial disputes. While Saudi Arabia is a party to the New York Convention on Recognition and Enforcement of Foreign Arbitral Awards, the Kingdom has not enacted any domestic implementing regulations and has broadly invoked the 'public policy' exception in previous cases. It also has the reputation of being highly sceptical towards applying non-Saudi governing law. Thus, it is entirely possible that a complex dispute may proceed through the significant business distraction, time, and expense of international arbitration only to find that the entire case will be subject to local de novo judicial review and subsequent appeal in the Saudi courts, and that all or a significant part of the arbitral award may not be enforced for reasons that are a surprise to the foreign party – for instance, prohibitions on consequential damages, liquidated damages, some types of indemnification, injunctive relief, adjustment of monetary values to reflect interest or the award of costs to a prevailing party. The local determination of whether an award violates any of the Islamic law principles as applied in Saudi Arabia is conducted in Arabic and determined subjectively by the presiding Judge, without the benefit of any judicial precedent. This review must comply with all other procedural requirements imposed by Saudi courts, and can take years to complete through all appeals.

Tim Portwood is a partner at Bredin Prat, Robert L. Schnell, Jr. is a partner at Faegre & Benson LLP and Dale Stephenson is a partner at Squire, Sanders & Dempsey (US) LLP.

CHAPTER 2

TAX DISPUTES

in association with:

APRIL 2011

Matt Atkins

TRANSFER PRICING DISPUTES

Transfer pricing is one of the key challenges facing multinational enterprises (MNEs) today as the frequency of disputes has increased markedly. While most MNEs have transfer pricing policies and documentation in place, globalisation has changed the playing field and transfer pricing arrangements have become more sophisticated and complex. Not only are large companies falling under the watchful eye of regulators, mid-sized multinationals are also being audited with greater frequency. As this activity intensifies, we can expect more transfer pricing related disputes to emerge between international companies and tax authorities globally. In addition, since regulatory reforms do not occur in a harmonised fashion around the world, companies with operations in various jurisdictions face an uphill battle to maintain compliance.

Fertile ground for disputes

With the global economy in slow recovery, and deficits at record levels, governments have focused on raising revenue through taxation. More and more jurisdictions are boosting their tax monitoring and enforcement efforts, providing greater opportunities for disputes to arise, according to Claudia Kühnlein, a partner at PwC Germany. "The main driver is certainly the government's everlasting need for a higher tax income – further fuelled by the economic downturn. This has in recent years resulted in lower business profits and thus, lower tax bills, and the need to inject money into the economy. As a consequence, many countries have introduced more challenging transfer pricing legislation, including documentation requirements. In addition, compared to five or 10 years ago, tax auditors have gained transfer pricing knowledge and experience, and have been encouraged to focus on this area during an audit."

Tax authorities have upgraded and increased their workforce while at the same time placing greater demands on corporations. The US Internal Revenue Service (IRS) added 1200 employees in 2009, and a further 800 in 2010. In the UK, Her Majesty's Revenue and Customs (HMRC) has made similar efforts and reported that approximately 100 new transfer pricing inquiries have been initiated annually since 2008. "HMRC have built a strong centre of expertise," says Liesl Fichardt, a partner at Berwin Leighton Paisner LLP. "In addition, they have sought actively to engage with MNEs in an open manner, which enabled them to acquire an appreciation of the relevant business issues concerned. HMRC are also actively expanding the scope of their powers: they do not merely look at pricing or percentages but they consider comparables and methodologies and attempt actively to engage earlier closed years by issuing discovery assessments, even alleging careless conduct on the part of the taxpayer."

This trend toward more assertive enforcement is not limited to developed nations, but is also observed in emerging markets. In 2009, China issued new transfer pricing regulations and tax authorities there have begun to establish a several hundred-strong transfer pricing team. Similarly, Indian tax authorities have substantially increased the size of their transfer pricing team over the last two years. Since the introduction of transfer pricing legislation in 2001 the law has developed further and tax officers have become increasingly inquisitive. A surge in transfer pricing disputes is the inevitable result, helped by a regulatory framework which is relatively vague. Pranay Bhatia, an associate partner at Economic Laws Practice, explains that so far six rounds of transfer pricing audits have been concluded in India. "The cumulative transfer pricing adjustments in these six rounds have been close to $9bn, which is a clear indicator of an extremely aggressive approach being adopted by tax authorities in transfer pricing audits. Transfer pricing regulations, as provided under Indian Tax Law, are brief compared to OECD guidelines, US 482 regulations and regulations adopted by other western jurisdictions. There is a lack of clarity which is one of the core reasons for an increase in disputes," he adds.

These developments come at a time when competitive pressures on MNEs are at a high. Corporations are compelled to operate more efficiently, by adjusting corporate structures and functions, and searching for low-cost raw materials, labour and suppliers. Part of this drive is to identify attractive and competitive, but ultimately defensible, global tax rates. Considering this combination of factors, it is unsurprising that the incidence of transfer pricing disputes is on the rise.

Legislative and regulatory change

At the same time that tax jurisdictions are placing increased emphasis on transfer pricing, rules and regulations are in a state of flux. MNEs are facing a new era of regulations, penalties, transparency and disclosure. In July 2010 the Organisation for Economic Co-operation and Development (OECD) approved a revised version of its Model Tax Convention, with revisions to chapters one to three, covering profit methods, and a new ninth chapter which considers the transfer pricing aspects of business restructuring. A key aspect of the 2010 update is the replacement of Article 7.

The new version takes into account the results of work by the Committee on Fiscal Affairs on the attribution of profits to permanent establishments, and a 2010 version of the Report on the Attribution of Profits to Permanent Establishments. These alterations have implications for all OECD member countries. "Following the recently amended Article 7 of the OECD Model Convention, the Dutch Ministry of Finance published a decree on the attribution of profits to permanent establishments in January 2011," says Patrick Van Oppen, a partner at Loyens & Loeff. "Preferences expressed in the decree include the application of the dynamic approach to the interpretation of treaties and changes to the OECD Commentary; and the application of the 'capital allocation approach' for the attribution of a minimum equity of a PE. Transparency of the Dutch views should result in fewer disputes with the Dutch tax authorities."

A key concern for MNEs operating in emerging markets has been a lack of clarity in transfer pricing regulations. However, this issue is being addressed. The Government of India's Direct Tax Code (DTC), scheduled for implementation in 2012, brings the introduction of Advance Pricing Agreements (APAs) to the region, as Mr Bhatia explains. "APAs as understood in the west can be unilateral, bilateral or multilateral and are between the tax payer and the taxation authority, or authorities. Section 118 of the DTC provides for a unilateral APA between the assessee and the tax authorities, which will be binding on the transaction, the respective assessee and the Commissioner and his subordinates."

In the past, APAs have also been uncommon in the UK, though in recent months HMRC has published a revised statement of practice on the matter. The new statement of practice means that businesses operating in several countries may seek multilateral APAs, involving all of the tax authorities affected by the transfer pricing issues. HMRC will examine new factors when deciding if an APA is an appropriate tool for dispute resolution. In addition, HMRC will not generally view UK to

UK transactions as meriting APAs. Finally, HMRC will aim to complete the APA process within 18-21 months from the date of formal request.

Important developments affecting transfer pricing have also been laid down by judicial precedent. Recent US court decisions in the intellectual property arena have raised the standards of evidence that can be presented when valuing certain assets, points out Lisa Cameron, a senior consultant at The Brattle Group. "The Federal Circuits January 2011 decision in Uniloc v. Microsoft sounded the death knell for the '25% rule' that plaintiffs had often relied upon to calculate the portion of profit attributable to a patented technology. In February 2010, the Federal Circuits decision in ResQet v. Lansa raised the standard for what constitutes a comparable agreement. The developments send a clear signal that valuation experts must avoid analytical shortcuts and focus on the differential profitability that can be attributed to the intangible asset at issue."

Regulatory amendments in areas not directly associated with transfer pricing have further implications for MNEs, according to Nathaniel Carden, a partner at Skadden, Arps, Slate, Meagher & Flom LLP. "In the US a number of changes in international taxation related to foreign tax credits and internal corporate restructurings are increasing the importance of transfer pricing in many MNEs' global tax compliance and deployment and allocation of corporate cash. As a result, it is critical for MNEs to integrate their transfer pricing structures into their overall corporate treasury needs, because it may be very difficult to otherwise redeploy cash as needed for various corporate and operational purposes," he says. In light of the consequences that such decisions can have on transfer pricing policy, it is imperative that MNEs keep abreast of all legislative and regulatory developments.

Audits and investigation

As tax authorities amend their rules and regulations, and cast an increasingly analytical eye over transfer pricing policies, MNEs must be prepared to respond to tax audits and investigations. An appropriate response depends on the particular case in hand, but in any scenario an organised approach is imperative. "It is essential for a company to have its policies, agreements, books and records organised and reviewed," says Mr Carden. "Many transfer pricing disputes get bogged down because data is not available or transactions were booked in a manner inconsistent with corporate transfer pricing policies or documentation." He uses the example that many companies base their transfer pricing analyses and documentation on product-level financial analyses, but are then unable to recreate those analyses due to systems limitations or accounting changes.

Prevention is better than cure, and although it is impossible to avoid every tax dispute or controversy, it is possible to take steps to limit the chance of an adverse audit which may end in dispute. Many companies, however, remain ill-prepared for this eventuality. "Steps to adequately respond to an enquiry or an audit are often ignored or simply put lower on the agenda," says Ms Fichardt. "Above all, organisation is key to resolving a transfer pricing enquiry or dispute. The roles of each individual should be defined very clearly from the outset – for instance the management of disclosure, regular meetings, action lists, discussion workshops and consultation with experts." It is wise for a company to seek external advice, whether or not it has a well functioning in-house tax department. As regulatory developments come thick and fast, up-to-date information and practices are essential.

The starting point of any audit will be a request from the tax auditor to provide a copy of the transfer pricing documentation. Companies should respond to any notices issued by the authorities in a timely manner in order to shift the burden of proof. In the event that no documentation is available, the auditor will formulate his own questions to build his case. Preparation is key, suggests Mr Van Oppen. "One should allow inspection of all records, documents and other data, including electronic data storage, relevant for taxation," he says. "There is a limited right to refuse providing information regarding tax advice or tax considerations, so it makes sense to store all external correspondence on tax advice and considerations separately from files covering tax compliance and facts. It is crucial to consider at every moment that the case might end in litigation. One should build a case for convincing a judge," he adds.

Naturally, the approach to transfer pricing, and subsequently to investigation, differs from company to company, and the expected outcome of such an investigation can also have a bearing on an MNE's response. "How a company should respond to an investigation depends on whether the inquiry is directed at an issue that can be settled relatively easily," says Dr Cameron. "If it is possible to anticipate a sensible settlement and the audit team is composed of reasonable individuals, cooperation is always the best strategy. However, as in any other instance where litigation is a reasonably likely outcome, care must be taken in determining which information will be shared and how that information should be presented."

If an investigation uncovers an issue for dispute, MNEs would be wise to investigate all of the alternatives before launching into litigation, says Ms Kühnlein. "If a dispute does arise, all potential options should be identified and evaluated carefully. Points to consider in this case do certainly include whether or not arbitration procedures are available, or what the likely outcome of a court

proceeding may be. Typically one should look not only at the years in question, but at subsequent years, too. In addition, it might be required to consider other aspects such as potential damage to the company's reputation."

Alternatives to litigation have the added advantage that they are less time consuming and expensive. "Arbitration and mediation are the two principal options for settling disputes out of court," says Ms Fichardt. "However, for transfer pricing, there is hope that with more resources put into Mutual Agreement Procedure (MAP) cases and an expansion of APA programmes, disputes will be resolved in a more timely fashion. One side effect of this may be that to cope with demand, most countries will require the payment of a fee, possibly linked to the size or complexity of the case."

Generally, the desirability of a settlement will depend on a number of factors, including the importance of the issue to the ongoing operations of the company, the expected impact of the issue in the future, and the reasonableness of the tax authority's position. It may not always be the best option, however, coming with a price tag that may, overall, be more expensive than one of the alternatives available. By whatever means a dispute is settled, organisation and preparation should be integral to the process. Sorting books and records and developing an overall strategy for addressing issues is preferable to waiting for, and then reacting to, any problems that may arise.

Litigation and risk

In the event that a tax dispute progresses to arbitration or litigation, a dizzying array of courts and tribunals can become involved, though procedures differ from jurisdiction to jurisdiction. In the US, tax disputes that are not resolved under IRS examination typically proceed to an administrative review known as IRS Appeals or, if involving a dispute between treaty countries that could result in double taxation, to Competent Authority review. Cases that are not resolved at this stage usually involve very large disputes or issues on which the IRS is trying to establish a clear position. From there, cases either go to the US Tax Court, the US Court of Federal Claims, or US District Court. The choice of forum depends largely on whether the taxpayer wants to dispute the IRS position without paying and go to Tax Court, or instead pay the amount at issue and seek a refund in the Court of Federal Claims or US District Court.

Legal procedures in the EU differ in each member country, but typically involve two or three levels of jurisdiction. In limited cases access to the European Court of Justice may also be possible. Regarding arbitration, a specific EU vehicle exists to resolve disputes where double taxation occurs

as a result of transfer pricing issues, as Mr Van Oppen explains. "The EU Arbitration Convention provides for mandatory arbitration in cases where member states cannot reach mutual agreement on the elimination of double taxation within two years of the date on which the case was first submitted to one of the competent authorities of the member states involved. The mandatory character of this procedure provides tax payers an important tool to force a solution in a multi-jurisdiction transfer pricing dispute."

In the UK, significant developments have been made with respect to transfer pricing arbitration. A draft statement of practice published by HMRC in September 2010 calls for greater openness to arbitration and more guidance on when invoking the mutual agreement procedure is appropriate. UK tax authorities believe the statement of practice has become necessary after the introduction of self assessment and the increased volume of work in transfer pricing. Whilst the number of requests for arbitration remains fairly constant, issues are becoming larger and more complex.

The process of litigation in India is somewhat more complicated, starting with the tax payer making a claim to an Assessing Officer. The Officer reviews and forwards the claim to a transfer pricing officer for adjudication on arm's length price. After receipt of the transfer pricing order, the assessing officer frames the assessment and issues a draft assessment order outlining his basis for allowing or disallowing tax claims including the transfer pricing adjustments. From the draft order an application can be made before the Dispute Resolution Panel (DRP) which consists of three independent Commissioners of Income Tax. The directions of the DRP are binding but the tax payer can take the matter further by filing an appeal before the Tax Tribunal. Tax payers who are aggrieved by the orders of the Tax Tribunal may appeal to the High Court for adjudication. The taxpayer can file a further appeal to the Hon'ble Supreme Court from the order of the High Court.

Wherever litigation surfaces a number of risks apply, and as transfer pricing disputes tend to be more complex, costs may be significantly higher than other tax disputes. Expert witnesses and economic and financial analysis may be required. Cases are fact intensive, labour intensive, time intensive and cost intensive. They are complex, difficult and often misunderstood.

Conclusion

Bearing these factors in mind, it is clear that putting in place a centralised transfer pricing policy, though undoubtedly time consuming and expensive, is the best way to mitigate the risks associated

with transfer pricing. Commercially honest, efficient and contemporaneous transfer pricing policies are the best prevention for, and defence against, tax enquiries, audits and disputes. "Centralising a transfer pricing policy is critical in today's economy but the gains that such centralisation provides will be primarily defensive in nature," says Dr. Cameron. "In today's world of straitened government finances, taxing authorities are seeking new ways to fill their coffers. As a result, even with a centralised policy, companies may be left facing uncoordinated actions by taxing authorities with competing interests."

Most companies are now beginning to understand the risks, suggests Ms Kühnlein. "In particular, big multinational groups have designed and implemented centralised transfer pricing policies. The challenge is to make the transfer pricing system as detailed as possible, while leaving sufficient flexibility to respond to local business or regulatory specifics and – perhaps most importantly – making sure that the policy is applied properly in each and every company."

Jurisdictions where large companies could traditionally exploit non-existent or confused legislation are now few and far between, with emerging markets applying new regulation in earnest. This is certainly true of India, says Mr Bhatia. "An important aspect of an effective and robust policy is its flexibility to adapt to the requirements of local laws and economic conditions. Companies with Indian operations, until now, definitely underestimated the importance of transfer pricing compliance and risk management. However, with the aggressive approach of tax authorities, and in light of sixth round adjustments nearing $5bn, the focus of companies on transfer pricing risk is now at its peak."

There is now no defence for companies that ignore the issue of transfer pricing. In a global economy where the finances of governments are increasingly reliant on tax revenues, and where tax regulation evolves at a rapid rate, transfer pricing disputes should be a major concern, and must be tackled before they escalate. The challenge for companies is to make their transfer pricing systems as detailed as possible, while leaving sufficient flexibility to respond to local business or tax regulatory issues. To avoid further difficulties it is necessary to regularly re-examine compliance and risk management policies, and keep a watchful eye on the ever-changing regulatory landscape.

MAY 2011

Natasha Vaidanis, Michael Fortmann and Michiel Els

TRANSFER PRICING TAX DISPUTES IN AFRICA

Due to the recent slowdown in the world economies, Revenue authorities have been placed under immense pressure to collect additional taxes and South Africa is no different. It is therefore no surprise that in the current Budget speech it was once again highlighted that transfer pricing will be a focus for the South African Revenue Service (SARS) to collect additional taxes.

The promotion of transfer pricing by tax authorities as a mechanism to collect additional taxes seems to be a global phenomenon. This, coupled with the growing sophistication of tax authorities, means that multinational companies confront an increasingly challenging risk management landscape. This is further evident due to the fact that nearly all the current tax surveys undertaken and published by recognised tax professionals show that transfer pricing is the greatest tax concern to companies and their directors.

However, even though SARS has been of the opinion that transfer pricing could present a lucrative opportunity, it has had its setbacks in employing skilled resources. Specialised transfer pricing professionals are needed to assess transfer pricing cases and it takes years to build up this experience. It is therefore no surprise that SARS has been building a very skilled and diverse transfer pricing team. Transfer pricing skills are a scarce resource and SARS has done well by managing to lure a number of people from both commerce and the professional advisory areas. It would probably be fair to say that SARS has the largest transfer pricing team in South Africa. It is also known that the SARS Large Business Centre has sourced the services of an experienced transfer pricing specialist from the UK's HMRC to assist with more aggressive transfer pricing audits. The

scarcity of experienced transfer pricing professionals is a serious issue and we understand this is the main reason why SARS has excluded transfer pricing from the Advanced Tax Rulings (ATRs) process and a taxpayer cannot request Alternative Dispute Resolution (ADR) proceedings. It therefore seems that SARS is basically saying transfer pricing issues are too subjective and complicated and any dispute should therefore be taken to court.

To date there have not been any reported court cases involving transfer pricing in South Africa. It is inevitable that in the near foreseeable future this will most certainly change. We cannot say for sure what the reasons are – whether SARS is unsure if the courts have the relevant expertise to determine the appropriate outcome or whether SARS does not believe it has the right case to take to court. We are, however, aware that SARS is very aggressive in the area and has been raising additional assessments on taxpayers. Several of these additional assessments were in fact settled on some kind of agreement. However these settlements are normally unbinding and private and therefore do little for other taxpayers trying to obtain some clarity as to how SARS is handling transfer pricing matters. This uncertainty is a concern for many company executives.

Although South Africa is not a member of the Organisation for Economic Co-operation and Development (OECD) it does have observer status. Further, the South Africa Transfer Pricing legislation does follow the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations ('the OECD Guidelines'), but whether SARS will adhere thereto is yet to be seen and tested.

The lack of publicly available databases in South Africa that are available to be utilised for comparable benchmarking studies forces companies and advisers to make use of European comparables that are freely available. This creates a further concern as most tax authorities would normally require an adjustment to be made to these comparables to affect the differences in the markets and the difference in risks. SARS has not provided the taxpayer with any guidance as to whether this is the case and if so how they expect these comparability adjustments to be made.

During 2005 SARS issued an addendum to its Practice Note 7 on transfer pricing with regards to the submission of transfer pricing policy documentation, wherein SARS confirmed that its policy remained unchanged. SARS therefore confirmed that there is no statutory requirement for taxpayers to compile a formal transfer pricing policy document. However, SARS did go further stating that taxpayers choosing not to prepare documentation must realise that they are at risk and that it may

be more difficult to discharge the onus of proving that an arm's length price has been established. It would therefore be in the taxpayer's best interest to document how transfer prices have been determined. Since adequate documentation is the best way to demonstrate that transfer prices are consistent with the arm's length principle, as required by section 31, it is therefore recommended to have a transfer pricing document in place.

A taxpayer electing not to prepare transfer pricing documentation is at risk on two counts. Firstly, it is likely that the Commissioner will examine a taxpayer's transfer pricing in more detail if the taxpayer has not prepared appropriate documentation. Secondly, if the Commissioner, as a result of this examination, substitutes an alternative arm's length amount for the one adopted by the taxpayer, the lack of adequate documentation will make it difficult for the taxpayer to rebut that substitution, either directly to the Commissioner or in the Courts.

Outside of South Africa's borders within Africa, transfer pricing remains one of the main focus areas for revenue authorities in many African countries. Revenue authorities in Africa are also increasing their capacity and expertise and are becoming increasingly aggressive in their approach to transfer pricing audits. Legislative measures are also being enacted in many jurisdictions to enforce compliance.

Many Southern African states are treating transfer pricing as a prominent and topical issue. Countries such as Mozambique, Namibia, Malawi, Zambia and Angola have entrenched transfer pricing regulations which allow the tax regulation authorities to adjust the consideration to reflect an arm's-length price.

The transfer pricing regulations are being updated on a regular basis. Even in countries with no formal regulations, such as Botswana and Zimbabwe, transfer pricing is being policed in terms of general anti-avoidance legislation with the authorities having the power to attack cross-border transactions between connected parties which are not of an arm's length nature.

In East Africa, the most active tax authority in the transfer pricing area is the Kenyan authority. Kenya introduced substantive transfer pricing legislation in 2006 which is being strictly enforced. Kenya resident enterprises that transact with non-resident related parties are required to formulate and implement an appropriate transfer pricing policy setting out the criteria that the entity has selected for determining the arm's-length price. Transfer pricing audits are common, many leading to

litigation. Revenue authorities in neighbouring states such as Tanzania and Uganda which currently monitor transfer pricing through anti-avoidance legislation are expected to collaborate with the Kenyan authorities to implement similar rules.

It is therefore reasonable to say that in general the need to prepare and maintain contemporaneous transfer pricing documentation has become a necessity in not only South Africa but the majority of African countries. This is particularly relevant as in most territories there is no APA process. Resulting in taxpayers being in an uncertain position as they might not be sure whether the transactions entered into are of an arm's-length nature.

Accordingly, as Revenue authorities are becoming increasingly sophisticated, taxpayers should ensure that documentation that has been prepared by a taxpayer for its global operations is considered from a local jurisdiction point of view and adequately provides the tax authorities with sufficient information relating to the South African or its African operations. Multinationals not paying sufficient attention to the transfer pricing compliance of their African group companies could face complex and lengthy audits and an increased risk of penalties.

Natasha Vaidanis is a director, and Michael Fortmann and Michiel Els are associate directors, at KPMG.

MAY 2011

Rahul K Mitra and Kunj Vaidya

TRANSFER PRICING LITIGATION IN INDIA

Litigation in India, especially when it comes to tax matters, has been unparalleled. Almost every other matter in which a tax adjustment is made eventually turns into a case of protracted litigation. Transfer pricing disputes are no exception.

Today, more than 50 percent of cases that go through a transfer pricing audit end up being adjusted. While there are no official statistics available, based on informal sources one can safely assume that at least 90 percent of these cases end up being litigated at various levels – first through the CIT (Appeals), now also available in the form of Dispute Resolution Panel, and then the Income Tax Appellate Tribunal (ITAT).

The number of cases involving transfer pricing disputes at the ITAT level is unprecedented. To put things in perspective, India contributes to more than 70 percent of transfer pricing disputes worldwide. This is topped only by the condition of such litigation, which has resulted in companies being forced to carry unwanted tax contingencies on their books.

It is alarming to note that the ITAT is currently dealing with transfer pricing matters as old as pertaining to financial year 2003-04; this means that the company has been carrying uncertain tax balances for the last seven years. How does one conduct its business affairs with this level of uncertainty?

In our experience, companies suffering transfer pricing adjustments, more often than not, are interested in achieving certainty – it is not really a matter of winning or losing in most cases.

Moreover, in today's world there are no significant tax rate differentials (barring a few exceptions) that would fetch a handsome arbitrage by influencing the transfer prices.

This brings us to the obvious question – where does this end? It is a question with no straight answer, for obvious reasons. In India, the domestic litigation route involves going through the normal judicial process starting with CIT (Appeals), then ITAT, then the High Court and finally the Supreme Court. Let us pause here for a moment. This has been the normal route for other tax related disputes, and while in theory it also applies to transfer pricing matters, it is important to note some of the technical nuances, namely: (i) transfer pricing matters are highly fact intensive with very limited issues stemming from the law; (ii) only questions of law, and not of fact, can be admitted by the High Court; (iii) this makes the ITAT the last fact finding authority.

Therefore, it would be safe to say that the life of a typical transfer pricing litigation case should end with the decision of the ITAT. This is also supported by empirical evidence which suggests that less than 20 percent of transfer pricing related matters have reached the High Court following the ITAT decision. Also, the recent ruling of the Delhi High Court confirms this dictum where the High Court dismissed the appeal stating that there was no question of law.

It has to be recognised that in following the domestic litigation route, both sides, be it the taxpayer or the tax authority, are trying to defend their respective stance. What is interesting to observe is that no matter what, irrespective of the merits of the arguments, both the parties are more than willing to stand their ground till the end; lest one should drop its guard to only let the other notch up its attack.

Against this backdrop, one can only imagine the state of affairs of the transfer pricing litigation landscape in which both the parties are trying to make a black and white case out of the rainbow coloured subject of transfer pricing.

Over the past decade, since the transfer pricing regulations were first introduced in India, there has been immense learning on this subject, both among the practitioners as well as the tax authorities. However, there is a lingering sense of fear in implementing this knowledge by both the sides. As a result, the practitioners continue to serve the same old recipe which craves the need to be improvised upon; on the other hand, the tax authorities continue to digest the information and produce an output which is equally removed from the fundamentals of transfer pricing.

Only when this gridlock is broken can we expect to see sanity in the process. Also, the proposed introduction of the APA (Advance Pricing Agreement) mechanism effective April 2011, and its judicious administration, should mitigate litigation in transfer pricing going forward, providing some certainty to taxpayers. Until then, both the sides would continue to fight with the same mindset: 'my way or the highway'.

Rahul K Mitra is National Head of Transfer Pricing and Kunj Vaidya is a director at PricewaterhouseCoopers, India.

MAY 2011

Richard Fletcher

EUROPEAN TAX DISPUTES ENVIRONMENT – AN INCREASING COST TO BUSINESSES

This article focuses upon recent developments in the European tax dispute area, with particular focus on transfer pricing, given this is a major common component of tax disputes across all countries, and also with specific references to the UK.

The recent tax disputes environment has been influenced by a number of specific factors; by needs of many taxing authorities to maximise tax revenues in the short term, and the desire to collect tax where the tax authorities believe that some level of tax avoidance has occurred.

This has collided with the following business factors and developments. First, a decrease in global profits. Many groups have had to take actions to share financial pain, by decreasing profitability margins in jurisdictions or even recognising losses where operations have historically only been profitable. Although often commercially realistic, taxing authorities naturally have some aversion to this situation.

Second, centralisation of business operations and assets. Groups are naturally evolving to minimise size, functionality and strategic management at local levels, often to meet regional and global customer needs and requirements, but also to recognise that elements of strategic management can be centralised with reduced operational costs, for example in respect of IP development. This generally leads to a reduction of tax profitability of the business in many tax jurisdictions.

Third, one-off transactions. Groups continue to look at one-off transactions, often financing related, to achieve specific tax benefits. As a result, many tax jurisdictions either already have reviewed, or are currently reviewing, introduction of anti-avoidance legislation, either targeted at certain transactions, or more general all-encompassing provisions.

There are a number of recurring high level direct tax themes that are raised in Europe by tax authorities as a result of these factors and developments. Are local operations more than only supportive of central operations and consequently deserve much higher financial returns? Are significant profits of companies in other jurisdictions drawn into the local tax net because of local operational presence, or involvement in management of the foreign operations? Are one-off transactions undertaken mainly for tax benefit purposes, and as such should that benefit be disallowed?

As a result of the above often highly fact-intensive issues which are under review, the tax dispute system in Europe, and wider, is at full stretch and arguably in some cases strained to breaking point. Perhaps as a result, one often has a sense that supporting information and documentation provided to taxing authorities is left unread when the authority is responding to the taxpayer. In addition, taxing authorities also often appear to take very extreme views with the hope that some extra tax will ultimately be paid. One also hears of tax authority meetings where an extensive list of all possible tax issues is provided, and the sense is that the authority is hoping that at least one of these issues will provide an opportunity for a material tax settlement.

At a domestic level, different tax authorities have very differing approaches to the tax dispute development and resolution process.

In respect of tax audits, jurisdictions such as UK and Netherlands are more focused on isolating 'high risk' taxpayers, with typical characteristics such as complex cross-border structures, and will also take into account historical behavioural aspects in planning and disclosure. Other jurisdictions are more scatter gun in targeting taxpayers and centred more on finding specific types of transactions undertaken, such as recharges of centralised HQ services, and arguing that little (or even nil) benefit is obtained by the local subsidiaries so charges should not be deducted.

Where tax audits cannot be resolved at the tax auditor level, then tax litigation is generally the main route of escalation. Certain jurisdictions can relatively quickly come to a litigation scenario,

for example Italy. However, in other jurisdictions, such as the UK and Netherlands, litigation is seen as a relatively rare occurrence, and in the UK almost as a failure by the tax authorities. That is not least because the litigation process in the UK is complex and costly for all parties and the outcome often very uncertain, so the litigation route is followed typically only where significant amounts of tax are at stake.

A very recent 'experiment' in jurisdictions such as the UK and Netherlands is the use of mediation to try to solve cases where taxpayers and tax authorities have come to long-held, and typically entrenched, positions. The idea is that there can be significant benefits in having an independent mediator meeting with both sides to highlight strengths and weaknesses of the respective arguments, but also areas where the parties do in fact agree. Interestingly, most cases where this experiment occurs tend to be resolved before the mediation, possibly because purely having the programme in place focuses both the more senior experienced tax authority bodies and the taxpayer on the case facts and potential outcomes.

If a domestic tax dispute in an area such as transfer pricing leads to some further taxation in a jurisdiction because of a tax adjustment from re-pricing of a transaction, then ideally relief should be provided by an equivalent opposite adjustment in the jurisdiction on the other side of the transaction. However, historically taxpayers have had no ability to force this, and there are many examples where double taxation has occurred.

The main mechanism to attempt to obtain such relief has been through double tax treaties, where the ability exists to request that taxing authorities negotiating together must make 'best endeavours' to agree a position such that double taxation does not occur (known as Mutual Agreement Procedure, or the Competent Authority process). In fact, this has been a relatively successful mechanism between certain jurisdictions given that this is only a best endeavours mechanism, but there have been some recent notable public failures, for example in the pharmaceutical sector involving the UK and US.

To counter this issue, over recent years certain arbitration mechanisms have been introduced, mainly relevant for transfer pricing. The first of these, the European Arbitration Convention (EAC) was actually in place in the mid-1990s, but only became more institutionalised throughout the 2000s, principally as a result of focus by the European Union Joint Transfer Pricing Forum, a government/business forum set up by the EU Commission, to clarify the principles of the EAC process.

As implied by its title, this Convention is only relevant for cross-border transactions between taxpayers in EU (and EEA) jurisdictions. Essentially a small committee of experts chosen by the relevant taxing authorities have authority to come to a conclusion concerning their views on the pricing of the relevant transactions and, if the taxing authorities once they see these views still cannot come to a consensus, then the arbitrators' view will hold. In practice, although a fairly high number of cases have been listed for the EAC process, only a relatively small number of cases have actually been through the process. This is partly owing to criticism that certain tax authorities have dragged their feet in starting the arbitration process, for example arguing that insufficient information has been provided by the taxpayer.

A more recent mechanism is the introduction of arbitration under certain newly negotiated tax treaties. This has been lead by the US and Canada where disputes have historically been numerous and often extremely combative, but now many European jurisdictions have also been introducing this mechanism. Experience of the process is very limited at this stage owing to its very recent introduction, but there is hope within the tax community that this will be a successful addition to the tax dispute resolution set of tools.

In conclusion, taxing authorities in Europe, and also wider, are focusing upon raising tax revenues, and there are increasing numbers of aggressive tax disputes regarding highly fact-intensive issues. As a result, tax authorities are stretched, tax disputes can become prolonged and can escalate because the right resources in tax authorities to deal with the issues are either not there, or are insufficient. Although there are more avenues for resolving disputes outside litigation, particularly arbitration and mediation, tax dispute costs are likely to increase for taxpayers, in terms of management time, professional fees, and potential double taxation.

Richard Fletcher is a Principal Tax Advisor at Baker & McKenzie.

CHAPTER 3

INTELLECTUAL PROPERTY DISPUTES

in association with:

FEBRUARY 2011

J. Michael Jakes, Pierre-Andre Dubois and Daniel Ryan

TALKINGPOINT: DEALING WITH INTELLECTUAL PROPERTY DISPUTES

FW moderates a discussion concerning intellectual property disputes between J. Michael Jakes at Finnegan, Henderson, Farabow, Garrett & Dunner, LLP, Pierre-Andre Dubois at Kirkland & Ellis International LLP and Daniel Ryan at LECG.

FW: Are you seeing an increase in intellectual property disputes? What are some of the common sources of these conflicts?

Ryan: There has been an increase in the level of disputes in the last couple of years, which appears in part to have been fuelled by the economic downturn and the need for companies to focus on protecting their competitive advantage. In the UK, routine patent and trademark cases have shown an increase of between 10 and 20 percent compared to before the recession. However, the trend for trade secrets cases has seen a huge increase, more than trebling in recent years, as employees moving on in the turbulent economic climate have sought to monetise information owned by their former employers.

Dubois: While in Europe there is not a wave of new litigation, there are more cases than a few years ago. There is no real common thread to these cases. We do see, however, more and more cases where challenges based on competition law are made against IP rights.

Jakes: While patent lawsuits in the US have steadily increased over the last 20 years, 2009-2010 saw a slight dip in the overall number of suits filed. There were significant increases in cases brought in

the US International Trade Commission (US ITC) to stop imports of infringing products and lawsuits filed by non-practicing entities (NPEs) in the US district courts. The US ITC has become a preferred forum for enforcing patent rights against products made outside the US. The cases move quickly and provide effective relief to exclude infringing products. Suits filed by NPEs have also increased, often naming upward of 10 or more defendants accused of infringing the NPEs patent rights.

FW: Why is it so important for companies to develop a strategy for resolving IP disputes through quick and decisive action? In your opinion, are companies paying enough attention to this issue?

Dubois: IP disputes can be very expensive and a drain on a company's resources, such as R&D and marketing. They are a distraction to senior management who should be focussed on other matters. Some companies have well established practices on how to resolve these disputes. While pursuing litigation is often the only option, there are many cases that are best settled early on through commercial discussions. This may be best achieved by having a multidisciplinary team involving not only the legal team but also senior management.

Ryan: IP assets are often the result of significant, often highly risky, investment over a sustained period of time with the intention of providing a sustainable competitive advantage over other players in the market. The most valuable IP assets create significant barriers to entry to that market. One of the issues with IP infringement is that value which has been built up over a long period of time at great cost can be destroyed very quickly. In a number of IP disputes it has become clear as part of the assessment of the losses incurred by the IP owner that the dynamics of the market have been changed irredeemably by the infringement of the IP rights, even though that infringement is not ongoing. Once an infringer has established themselves in the market they can be difficult to dislodge. Further, the IP owner themselves may also have damaged their value position in the market through competitive responses at a time when it is unclear what the legal outcome of any legal process might be.

Jakes: Most technology companies today know the importance of intellectual property to their businesses. But there are different strategies for using that intellectual property. In technology areas where many patents may cover a single product, a company will want to protect its investment in research and development and at the same time have a large enough portfolio for defensive use in negotiations or litigation. Start-up companies will want patents to allow them to attract funding

or make them more attractive for acquisition. But only one or two key patents may be needed for a company to protect its place in the market and keep others from stealing its market share. And that's where quick and decisive action is needed. That action could be filing a case in the US International Trade Commission or seeking an injunction in a US district court.

FW: What advice would you give to companies on effectively protecting their IP through monitoring potential infringements and enforcing IP rights?

Ryan: To effectively protect their IP, companies should first periodically undertake an audit of their IP portfolio, so as to understand the importance of individual items of IP to their business. Within their portfolio, they should identify their key IP assets, or rather, those assets of critical value to the operation of the business. This then allows companies to identify the focus of their monitoring and help them prioritise their response should enforcement be required. One factor that helps with the process of monitoring for IP infringement is that when companies have intangible assets that they believe will be desirable to customers such features are at the forefront of the sales proposition. Increasingly, companies are using patents as a marketing tool even when the technology is of limited value. This means that the regular ongoing process of competitor intelligence will require monitoring of competitor's marketing literature and this is often an early indicator of a potential infringement. It is therefore essential that staff involved in monitoring activities are trained to spot signs of such infringing activity particularly in relation to business critical IP assets.

Jakes: Effective IP protection has to be built from the ground up. Too often, a company facing increased competition looks to its patent portfolio only to find that the cupboard is bare. So as a first step, a company must capture its innovations in valid and enforceable patents. This takes time. It also takes an intimate knowledge of the business, whether it is in-house or outside patent counsel. Armed with that knowledge and a matching patent portfolio, monitoring potential infringement follows naturally. Once potential infringement is uncovered, however, then action should be taken without delay. The initial action can range from a notice letter and an offer to enter licence negotiations to filing a lawsuit and pursuing a preliminary injunction.

Dubois: Having in place proper monitoring systems, using both internal means with dedicated resources and outside advisers is key and should be considered a good thing to do rather than a waste of money, even in tough economic times. The internal culture should be that this is a real priority, requiring dedicated resources which will focus on monitoring on a regular basis – sometimes

daily in sectors such as new media and the internet – and take enforcement measures rapidly. All too often we see cases where clients have been waiting for months, if not years, to decide to take action, and by then, if it is not too late, it is surely not an easy case.

FW: To what extent should alternative dispute resolution methods be considered as soon as a dispute surfaces?

Jakes: Alternative dispute resolution (ADR) methods, including arbitration, can be used effectively to resolve patent disputes in the US. Arbitration is encouraged in the US by both the Federal Arbitration Act and Section 294 of the Patent Statute. ADR is most often used for patent disputes when the parties have a pre-existing relationship, usually through an existing patent or technology licence. This allows the parties to set out in advance the ADR method that will be used, how the neutral evaluator or arbitrator will be selected, and what rules will apply.

Dubois: Starting ADR at the beginning of a dispute is usually a good idea – it sets the right tone before hostilities get the best of the parties' rational intentions. Often it is impossible to resolve a matter at its inception because insufficient information is available to make informed decisions and also because the parties still feel righteous in their positions. But setting a process in motion early on that gets the parties talking – and listening – to each other and defining the issues so that a creative solution can be crafted will sometimes avoid what happens in many cases – namely that by the time the parties grow weary of the battle and actually start talking about a settlement they each have so much invested in the fight that settlement becomes much more difficult or impossible.

Ryan: As discussed earlier, speed can be critical to minimising any permanent damage to the IP assets. There may be situations when infringement has not been deliberate, or where the infringer, once made aware of the repercussions of their actions, is concerned about the economic implications of a legal dispute with the IP owner. In such cases, a more speedy resolution may be achieved without pursuing a standard legal process – whilst this may not often result in the same level of, or any, damages from the infringing party, that may well be secondary to the primary objective of ending the infringement.

FW: If litigation is unavoidable, what general preparation and procedures should companies undertake in pursuit of the best possible outcome?

Ryan: Once litigation is deemed unavoidable, the focus is frequently on obtaining an injunction because the speed with which the infringement can be halted is critical to maintaining the value of the IP. However, if the claimant is successful in establishing infringement, any damages enquiry may occur a long time after the infringement occurred due to the time spent resolving the liability side of the litigation. Therefore, it is important that claimants retain information and records that are relevant to proving their loss. Where the potential damages are large, the claimant could consider undertaking a preliminary estimate of loss at the outset of the case which will help them to establish the information that will be required.

Jakes: It depends, of course, on which side the company is on. For companies considering filing suit to protect their intellectual property, they must first undertake an investigation and have a reasonable belief of infringement. Beyond that minimum, however, the company may want to perform additional diligence on the validity of any patent it intends to assert and review its internal files, including inventor's notebooks and patent files. Also, when litigation looks likely, the company should put in place procedures to ensure that relevant documents – including electronic documents – are not destroyed. From the accused infringer's perspective, once the company is aware of a potential infringement claim, it should also investigate. In most situations, the company should seek the advice of competent patent counsel. Although not necessary to avoid a finding a wilful infringement – and possible increased damages – advice of counsel is one of the best ways to show that the company's position was reasonable.

FW: Can you outline any recent court cases and judgments which will have important implications for the treatment of IP?

Dubois: In Europe, recent referrals to the ECJ on the interpretation of copyright and the Brussels Regulations could have an important impact in terms of copyright law and jurisdictional issues.

Jakes: Last year, the most important case was Bilski v Kappos, which concerned patentable subject matter. The US Supreme Court refused to restrict patentable methods to those that use specific machines or transform physical objects, leaving such things as computer software and medical diagnostic methods available for patenting. The Court also refused to exclude 'business methods' from patent-eligible subject matter, which will allow continued patenting of financial methods among others. In 2011, the case to watch is i4i v Microsoft, in which the Supreme Court will consider the evidentiary standard for proving a patent invalid, whether it is a mere 'preponderance of the evidence' or the current higher burden of 'clear and convincing evidence.'

Ryan: In last year's Hotel Cipriani case, the defendants operated a London restaurant whose name and logo were found to have infringed the claimants' trademark. The claimants elected for an account of the defendants' profits. As a valuation expert, the most interesting issue in the calculation of the account was whether any account should include value in the name that was covered by the trade mark but generated by the defendant. The claimant did not operate restaurants in the UK and the defendants alleged that it was their own efforts that had made the name valuable. However, the judge rejected this argument and agreed with the expert that the name was the means by which the restaurant conveyed its other positive qualities to consumers. Potential infringers should therefore be aware that any account of profits may include the value of goodwill generated by the infringer himself.

FW: What advice would you give to companies on contractual issues surrounding IP rights? What key clauses should be included in contracts to account for the possibility of future disputes arising from an agreement?

Dubois: An obvious but often neglected piece of advice is to make sure that the rights of the parties are clearly defined, in particular when the agreement terminates – who keeps the IP, who has access to new IP, and so on. Make sure that all terms are properly defined. Too often, it is tempting to use precedents without considering the exact meaning of each word. If you are to agree to arbitration, make sure the clause is properly drafted and consider if you wish to have the right to also have recourse on appeal to the courts.

Jakes: Although it's often an afterthought when concluding a licence agreement, attention should be paid to future dispute resolution. I would recommend more than a standard arbitration clause that refers to a particular set of rules or an organisation – although that is better than nothing if the parties want arbitration over litigation in court. Careful thought ahead of time on how the arbitrators will be selected, deadlines, and limits on discovery, for example, can significantly reduce future costs and provide quicker resolution of any disputes.

J. Michael Jakes is a partner at Finnegan, Henderson, Farabow, Garrett & Dunner, LLP, Pierre-Andre Dubois is a partner with Kirkland & Ellis International LLP and Daniel Ryan is a managing director at LECG.

AUGUST 2011

Selina Harrison

SMARTPHONE INNOVATION LEADS TO RISE IN PATENT DISPUTES

In recent years there has been an explosion in the number of patent infringement disputes involving handset manufacturers and application developers operating in the smartphone market. Eager to protect products and maintain market share, Apple has led the wave of patent disputes in this sector. Other smartphone makers, including HTC, Samsung, Motorola and Nokia, have also jumped on the bandwagon. With smartphones and tablet sales on the increase, it is expected that this trend will continue and the outcome of these cases could dictate technology development in this space for years to come. As the patent war wages on, the question is what impact it will have on innovation and competition within the smartphone market.

Apple has been the main instigator of these lawsuits. Since 2007 the tech giant has sued Samsung, HTC, Nokia and Motorola, to name just a few, for copying its device designs and infringing its intellectual property. However, Samsung and HTC counter sued, while Apple actually paid Nokia an undisclosed sum in June to settle their dispute. Beneath these cases, another, bigger battle is being fought against the world's number one smartphone platform, Google Inc's Android.

Android's race to the top has been driven by its support of an open ecosystem which allows handset makers such as HTC, Samsung and Motorola to make Android devices without direct licensing fees, while Google profits from mobile advertising and app sales. This strategy has helped to shape an ecosystem that frequently delivers hardware that is arguably more advanced than Apple, Research in Motion (RIM) and Microsoft's offerings, with a broader selection of smartphone models to boot. Despite the iPhone's prestige, in the last quarter, phones running on Google's Android Platform outsold the iPhone by more than twice the amount globally.

Anti Android

But Android is under threat on three fronts. First, Apple and Microsoft seem intent on suing Android handset makers into submission. Apple's disputes with HTC, Samsung, and Motorola stretch across multiple countries and continents. Microsoft is also suing Motorola and is using legal threats to try to force Samsung into a per phone licensing deal, as it did with HTC last year. Second, Oracle Corp. is suing Google for damages of $6.1bn, claiming that Android is infringing on the Java patents it obtained in its acquisition of Sun Microsystems. Finally, Apple, RIM, and Microsoft's growing portfolio of purchased intellectual property threatens to stunt Android's future development.

In June 2011, bankrupt Canadian telecoms equipment maker Nortel Networks put a portfolio of roughly 6000 patents on the block. Google had hoped to win the portfolio and put forward a bid of $900m for the collection, which Nortel described as touching "nearly every aspect of telecommunications and additional markets as well, including Internet search and social networking". However, with a bid almost five times the amount Google offered, an obscure buyer called 'Rockstar Bidco' secured the deal for $4.5bn, which cash thirsty Nortel could not refuse. However, when Rockstar Bidco turned out to represent the combined interests of Apple, Microsoft, RIM, EMC, Ericsson and Sony, antitrust experts waved a red flag. The American Antitrust Institute (AAI) has serious concerns regarding the legality of the Rockstar Bidco alliance. Shortly after the announcement of the deal in July 2011, it asked the US Department of Justice to investigate the transaction.

Google's senior vice president and general counsel Kent Walker feels the outcome of the pending sale could be a matter of life or death for the Android ecosystem. In a statement issued by Google to members of the press on 1 July he said, "this outcome is disappointing for anyone who believes that open innovation benefits users and promotes creativity and competition. We will keep working to reduce the current flood of patent litigation that hurts both innovators and consumers." It is possible that broader attempts to undermine Google's Android may force handset makers to utilise other software operating platforms to avoid the constant threat of patent infringement and stay profitable. This would leave the Android ecosystem significantly diminished in the market.

Ideas in jeopardy?

In the midst of rising patent disputes, observers are debating whether a threatening legal environment has the potential to reduce competition and suppress innovation. In the smartphone arena, patent allocation has increased substantially from each generation of mobile technology to

the next, and industry wide R&D investment has rapidly increased. But Roger G. Brooks, a partner at Cravath, Swaine & Moore LLP, sees no evidence to suggest that this increase in patents threatens innovation. "I expect to see the upward path of R&D investment continue, and likewise to see continued intense competition to introduce innovative smartphone products, features and software to the consumer market," he says. "It is true that certain industry players who have until recently adopted a 'wild west' approach to intellectual property will find themselves obliged to pay royalties for the use of the patented inventions of others. But copy-catting is not 'innovation', and a huge body of experience shows that enforcing payment for use of patented inventions stimulates rather than discourages innovation."

According to Richard Willoughby, a partner at Rouse, the issue is not so much the huge number of patents that have been issued in the telecoms arena, but their quality, which many perceive to be questionable. "In Europe, we're finding that many patents that are ultimately tested in litigation are either found invalid or not infringed," he explains. "The problem is it takes time and money to reach that outcome and to be certain which ones cover real inventions and are therefore valid – this time and financial cost probably does have some effect on innovation in a fast moving area."

Certainly, the current wave of patent litigation is making the smartphone market a challenging sector to operate in.

Although the likes of Apple and Google have the financial might to fight these disputes, developers that support their platforms are now being caught in the crossfire. With little or no funds to sustain a legal battle against patent holders, and little support from the vendors themselves, developers are facing tough decisions that could seriously impact their revenue streams.

Another high-profile patent case is that of Lodsys, which sought to protect technologies it believes developers are infringing with the use of Apple's and Google's in-app subscription mechanisms. In May, Lodsys began targeting iOS developers that utilise in-app purchasing features, threatening to issue creators with a patent infringement lawsuit. Despite Apple sending a letter to Lodsys and those concerned confirming that all iOS developers are already licensed for Lodsys patents, and that Lodsys had no grounds to continue pursuing developers, Lodsys later filed seven lawsuits, one of which was against an Android developer.

Apple has since reiterated its assertion that the infringements are covered by the company's existing

licence agreement and has said it will support iOS developers by taking on legal costs as the case unfolds. So far, however, Google has remained silent on the matter and unless the tech giant steps up to the plate, the Android developer in this case will have to pay its own costs. Analysts have voiced their surprise at Google's reluctance to match Apple's move in this case, as not only are both companies competing for support for talented development, the rivals could actually unite in this case to increase their chances of successfully avoiding further developer licensing agreements with Lodsys.

Impacting handset makers and application developers, the cases mentioned are some of the most high profile in a wave of disputes that looks set to dominate headlines and unsettle the smartphone market for some time. However, within the smartphone industry there is a school of thought that this explosion in patent litigation is the result of too many patents being granted, particularly for features and services that would have been developed independently. Inadvertent infringement means that the first company to file a patent is rewarded and all subsequent developers are penalised even if they make an independent creation and do not commit any wrongdoing.

This scenario needs to be put in context, however. For Matthew Warren, a partner at Bristows, the central issue is whether there are so many essential patents in the smartphone arena that it becomes impossible for a company to launch a viable smartphone without infringing, or being able to take a licence under, essential third party patents. "Whilst there may be a large volume of patents that cover smartphones, not all of those patents cover essential features and those features that are essential, such as 3G connectivity, are often covered by international standards. Licences to many of the essential patents covering such standards are made available by various patent pool organisations." As Mr Warren also notes, the underlying issue here is not new. Concerns about the patent system are often raised whenever a new technical field or sector develops – such as the electrical engineering sector at the end of the 19th century, the digital electronics sector in the 1970s and the biotechnology sector in the 1980s. "There is little evidence that the patent system did in fact hinder innovation in any of these sectors," he says. "In fact, many would argue that the patent system promoted rapid innovation in these sectors as investors would not have provided the capital to develop these sectors unless the patent system was in place to protect their investments."

Calls for reform

Against the backdrop of rising disputes, some have called for a reform of patent law. Speaking at the London School of Economics this May, Steve Ballmer, the chief executive of Microsoft, criticised

US patent laws for being outdated and pointed out that two of the biggest industries which use patent law – the pharmaceutical and software industries – did not exist when original patent law was written in the late 19th century. But many experts believe that major changes to the patent law would be unwise. "Empirically – whatever academics and theoreticians may say – the US patent system continues to be the 'gold standard' of the world, and to support by far the most successful ecosystem of investment in innovation," argues Mr Brooks. "That said, there is much room for improvement in the quality of the patent examination process. There are grounds for reform that would ensure that US Patent Trade Office fees are left with the PTO to enable it to improve both its personnel and the time it devotes to each application."

Mr Willoughby agrees that the quality of examination at the US Patent Trade Office is not as good as it should be. "Too many patents are being granted and the inconsistency of the law on patentability makes their ultimate enforceability uncertain," he says. "In addition, the litigation process in the US does not help. Nowhere else in the world are juries assigned to decide patent cases, and nowhere else in the world are such potentially ruinous infringement damages awarded." This system puts more pressure on defendants in US litigation and has the potential to drive even perfectly legitimate players from the US market, he adds.

With many patent disputes ongoing, it is difficult to foresee the eventual impact these cases will have on the smartphone market. However, as smartphone and tablet sales continue to increase, it is expected that the number of patent suits will continue to surge. Even so, the sale of Nortel's patents should provide a key signal to the market. If the deal is approved by US regulators without restriction, smartphone makers may find themselves operating in a market where it is not the competitor with the best products that gains success, but the company with the best patent portfolio and legal experts.

NOVEMBER 2011

R. David Donoghue

SEA CHANGE FOR US PATENT LITIGATION

In mid-September President Obama signed a sweeping patent reform bill into law, the America Invents Act (AIA). The bill was the result of years of congressional effort and intense lobbying from many diverse trade associations and other stakeholders. The most significant changes will come at the US Patent Office where the US will finally harmonise with the international community by implementing a first-to-file system. But the AIA introduces significant changes to US patent litigation. Here are the six key changes to the US patent laws that every business person should understand.

Smaller patent troll suits. The most immediate impact on most companies will be Section 19, limiting joinder in a single suit of unrelated parties. This is not the more extreme restrictions on venue or joinder that many had hoped for from the AIA. But it will have some positive impact on patent troll litigation. For suits filed on or after the date of enactment, plaintiffs will only be able to join related parties in a single suit. For example, multiple manufacturers, distributors or resellers of an identical product could be joined in a single suit. And while cases against unrelated parties could still be joined for discovery, they will not be able to be joined for trial.

At first glance, this is not much of a barrier to entry for patent trolls. Very few defendants get to trial, and cases may still be consolidated for discovery purposes at the court's discretion. Where a troll today could pay one $350 filing fee and sue 100 unrelated defendants, after enactment that same troll would have to file 100 suits and pay $35,000 in filing fees. $35,000, however, is dwarfed by the settlement demands in most cases. The hassle of filing the extra suits and the related filing fees, however, may be enough to prevent suits against some of the much smaller entities that almost

always end up in these suits. And the requirement of separate suits will allow defendants a much greater ability to seek transfer to an appropriate venue.

The inability to join defendants for trial will significantly increase plaintiff's trial costs at least for the rare patent litigation that gets to trial. So, while this is not the sea change that many sought from the AIA, it is a real benefit to companies who are tired of being sued in Texas or other distant districts and want a better shot at transferring cases. This Section only applies to cases filed after enactment, not pending cases. So, existing cases will not be impacted.

Post-grant review. The AIA establishes a brief window for post-grant and inter partes review in Section 6. Third parties may challenge the validity of any claim of a patent for nine months after a patent is granted or issuance of a reissued patent. But you cannot seek post-grant review after filing a suit involving the patent. And when post-grant review ends in a final board decision, you give up the right to use the arguments used in post-grant review or arguments that could reasonably have been used, in a later ITC proceeding or district court litigation.

False marking restrictions. Private citizens that file false marking claims will be required to prove competitive injury and their damages will be limited to the injury. Additionally, Section 16(b) excludes marking with an expired patent from the false marking statute. Furthermore, Section 16 applies to all cases pending when the AIA was enacted, as well as cases filed thereafter. Section 16 will clear out many of the existing false marking cases, but leaves considerable room for competitor false marking cases.

Prior use defence. The AIA creates a prior use defence. This is an inherently reasonable defence that helps balance a company's natural frustration in the past of not being able to use its own pre-existing secret system as prior art. Defendants confronted with this circumstance before the AIA saw a fundamental unfairness, and the prior uses defence will fix some of the unfairness. Having created or performed the invention more than a year before the patentees' filing date will be a defence. The key here is to make sure you have internal documentation regarding your systems and processes.

First to invent. One of the most publicised changes to the US patent laws is the move to a first-to-file patent system, the system used by most of the rest of the world. The first-to-file system incentivises filing patents as quickly as possible to avoid an earlier filing by a competitor. As explained earlier, first-to-file will not have a direct litigation impact. But it remains significant for how it changes

litigation-like proceedings. Section 3 softens the first-to-file system providing for a proceeding between patent owners if the junior patent holder can show that the senior patent holder's invention was derived from the junior patent holder's invention. These 'derivation proceedings' will replace the current, seldom-used interferences. Derivation proceedings appear similar to interferences and may therefore be more widely used.

Death of best mode. The failure to set out the inventor's best mode is the source of many inequitable conduct claims and invalidity defences. The AIA removes those best mode defences by removing the requirement to disclose a best mode.

R. David Donoghue is a trial lawyer at Holland & Knight LLP.

CHAPTER 4

INVESTOR-STATE DISPUTES

in association with:

OCTOBER 2011

Mark N. Bravin, Ricardo Ugarte and Tomás Leonard

INVESTOR-STATE ARBITRATION: EFFECTIVE MEANS TO RESOLVE DISPUTES BETWEEN FOREIGN INVESTORS AND SOVEREIGN STATES

Today, perhaps to a much greater extent than ever before, sovereign or political risk is dictating the direction and flow of private investment capital into international projects. Savvy foreign investors are looking to the protections of bilateral and multilateral investment treaties in structuring their projects. These treaties are turning out to be every bit as important, if not more so, than traditional corporate tax-based considerations. Investment treaties provide a realistic means of planning for the risk that arbitrary, discriminatory or unreasonable governmental action by a host state will impair or curtail completely a foreign investor's ability to manage and fully enjoy the economic benefits of its investment.

Largely because of the proliferation of treaties with investment-protection provisions, a body of international law governing investor-state rights and obligations has evolved dramatically in recent years. This body of law affords foreign investors broad protections against adverse host state conduct and the means to enforce those protections by asserting claims through international dispute settlement mechanisms in a neutral forum. Below we provide an overview of this global system of investment treaties and their enforcement mechanisms.

States around the world have concluded nearly 3000 bilateral investment treaties as well as regional (e.g., NAFTA, CAFTA) and other multilateral treaties in order to promote an influx of foreign investment into their territories. Investment treaties generally provide foreign investors with broad protections under general principles of international law and the right to assert claims against

host states to enforce those protections through international arbitration or mediation. They were conceived initially as a means to level the playing field between developed economies and developing countries in the global competition for private capital by reducing the non-commercial risks inherent in investing in the latter economies.

Qualified investors may claim the protection of these treaties if they satisfy specific requirements that vary from one treaty to the next. 'Treaty planning' when structuring a cross-border investment can ensure that the prospective investment and the investor are eligible for treaty protection. Most investment treaties contain protections for the investment itself. Some also extend those protections to the investor. Generally, an investor can claim the protection of an investment treaty if it is a national of a state party to that treaty and the investment is in the territory of the other state party. An individual's nationality is determined by his citizenship. A corporation's nationality is usually determined by its state of incorporation. Entities incorporated in the territory of the host state may also qualify as investors when controlled by nationals of the other state party. Consequently, the nationality of shareholders can be as important as the country of incorporation in claiming treaty protection. Strategic structuring of a foreign investment to maximise such protection (e.g., use of a Swiss rather than US investment vehicle for investments made in China) is oftentimes essential.

Most forms of investments are protected by investment treaties. Investments are commonly defined in those instruments as 'every kind of asset'. But sometimes treaties are interpreted as imposing restrictions, for example that the investment be used to promote the development of the host state, before treaty benefits will apply.

Treaty planning also entails considering the varying protections that investment treaties may afford. Most investment treaties provide investors with rights to fair market value compensation for direct or indirect expropriation of their investment. Typically, they also will guarantee fair and equitable treatment and protections against arbitrary or discriminatory measures, acts of corruption, and legislative or regulatory measures that materially alter the regulatory framework on the basis of which the investor originally invested. Treaty protection usually extends, as well, to the unilateral amendment or termination of an investment contract, or to measures that impair or eviscerate the value of the investment.

Most investment treaties afford qualifying investors the right to assert claims against the host state through international arbitration. Resort to arbitration in a neutral forum, as an alternative

to litigating in the host state's domestic courts, is one of the most significant features of modern investment treaties. This right is established by the host state's advance consent to submit to the jurisdiction of an arbitral tribunal should a dispute over a qualifying investment arise. Some treaties have more limited protections or restrict consent to arbitrate only certain types of claims. Investors typically may choose from a number of dispute resolution venues specified in the treaty. Most investment claims are submitted to the International Centre for Settlement of Investment Disputes (ICSID) or to ad hoc or administered arbitrations under the arbitration rules of the United Nations Commission on International Trade Law (UNCITRAL).

Arbitrating investor-state treaty claims to a final award on average takes three to four years. The cost may range from US$2-25m and tends to be roughly proportional to the complexity and overall worth of the claim. These costs may be recoverable by a successful claimant (or respondent). Arbitration costs, including attorneys' fees and other arbitral expenses, increasingly are awarded to the prevailing party. Where financing is required, third-party funding may be available. International banks, and private funds, are looking to such claims as a potentially lucrative investment opportunity.

States do, for the most part, pay arbitral awards to successful investors. According to a PricewaterhouseCoopers study, host states complied with about 90 percent of the investment arbitration awards rendered against them. Should a state refuse to pay an adverse award, investors may compel payment through recognition and enforcement proceedings.

These are court actions by which the arbitral award is transformed into a binding court judgment that can be enforced through the attachment and execution of the host state's assets. Foreign sovereign immunity, however, may impose limitations on the types of assets that can be seized and sold. State assets that are generally considered immune from execution include those used for sovereign purposes, such as military property, embassy property, and accounts held by foreign central banks. Sovereign immunity generally does not extend to state assets that are used for commercial purposes.

Based on a well-established United Nations treaty for the recognition and enforcement of foreign arbitral awards (known as the New York Convention), enforcement actions may be pursued in the courts of nearly 150 countries. The mechanics of an enforcement action will depend to some extent on local law and procedure in the courts where the action is brought. Recognition and

enforcement proceedings are often successful as the New York Convention and applicable national laws provide very limited grounds for resisting enforcement. The Washington Convention provides additional opportunities for enforcement of ICSID investor-state arbitration awards. A recent United Nations survey of nearly 200 investor-state claims indicates that foreign investors have been largely successful in seeking recourse against host states. This explains in part the increasing number of investor-state arbitration claims around the world.

Investment treaties provide foreign investors with opportunities for risk management and relief from unfair actions by a host state. Adequate treaty planning when structuring an investment overseas may ensure that investors enjoy the broad protections afforded by investment treaties and international law, and the means to enforce treaty rights against host states through international arbitration.

Mark N. Bravin is a partner and co-chair of the International Arbitration Practice Group, Ricardo Ugarte is managing partner of the Geneva Office and co-chair of the International Arbitration Practice Group and Tomás Leonard is of counsel at Winston & Strawn LLP.

NOVEMBER 2011

John Whittaker, David Herlihy and Marco Tulio Venegas

TALKINGPOINT: INVESTOR-STATE DISPUTES

FW moderates a discussion focusing on investor-state disputes between John Whittaker at Clyde & Co. LLP, David Herlihy at Skadden, Arps, Slate, Meagher & Flom LLP, and Marco Tulio Venegas at Von Wobeser y Sierra.

FW: Have you seen an increase in disputes between governments and foreign investors operating in their country? Are emerging markets a hotbed of such conflict?

Whittaker: Yes, there has been an increase. Bilateral and multilateral investment treaties are an important framework for the protection and stimulation of foreign direct investment in the host country. Naturally, states have always looked to conclude such treaties with a view to enhancing new investment and, more recently, emerging markets have similarly been attracted by the perceived capital flows from the conclusion of such treaties. There are now about 3000 treaties in place. Capital investment in natural resources has increased substantially in the last five years. The increase in activity in this area has increased the likelihood of disputes. At the point of conclusion of an investment treaty, the focus is on the treaty benefits, particularly economic development of these emerging markets. However, eagerness to conclude such treaties can blind states to the high levels of protection granted to investors and some states, notably in South America have sought to withdraw. Emerging markets are not the only reason for the increase in disputes; other factors include greater investor awareness and a willingness to pursue claims, particularly in the context of additional triggers such as poor economic performance of investments and government austerity measures.

Venegas: The increase is due to various reasons, but mostly because of the growth in foreign

investment across the globe, the rising number of investment protection treaties executed worldwide, the awareness of foreign investors with respect to their rights under international law, and the relative success of international arbitration as an effective means to resolve these types of controversies, many of them highly politicised. States with emerging economies are often involved in these conflicts and have been the usual respondents in those arbitration cases made public. Emerging economies sometimes lack the knowledge, expertise, and resources to deal with various aspects of public administration and governance, which often leads to problems giving rise to investor-state disputes. Nonetheless, states with developed economies have also been sued.

Herlihy: The main institution administering foreign investment disputes is the International Centre for Settlement of Investment Disputes (ICSID), part of the World Bank. Since 2000, ICSID has registered 300 new investment disputes, compared to just 66 in total between 1965 and 2000. 2011 looks set to be ICSID's busiest ever year. Of the new cases registered by ICSID during the first six months of 2011, 28 percent involved countries in South America, 25 percent were based in Eastern Europe and Central Asia, 19 percent centred on Sub-Saharan Africa, 16 percent involved South and East Asia, with a further 9 percent in Middle Eastern and North African countries. In our own practice, we've seen a substantial upturn in new disputes involving African states.

FW: In recent years, what developments have you seen in international law governing investor-state rights, obligations and protections? How have these developments influenced claims and dispute settlement mechanisms?

Venegas: Investor-state arbitration is currently the most important area in the application of international law. Although awards are binding only on the parties involved in the dispute and do not constitute mandatory precedent, arbitral tribunal's decisions have shaped many figures of international law. Awards are often made public and are always reviewed by academia under high scrutiny. Many articles and publications on international law criticise the decisions and arguments adopted by tribunals in their awards. Also, previous awards often influence the decision made by tribunals in subsequent cases. The Articles on State Responsibility for International Wrongful Acts, which many argue are a reflection of customary international law, have been interpreted and applied by several arbitral tribunals. To mention an example, the cases filed against Argentina have in some ways shaped the scope of the necessity defence, particularly in light of an economic crisis.

Herlihy: We are seeing a wider cross-section of investors waking up to the protections available

to them under bilateral and multilateral investment treaties. Whereas this field was historically the focus of lawyers in the hydrocarbon sector, the latest data illustrate the breadth of international investment law and its relevance to all aspects of the global economy. Recent disputes involved not only oil and gas but other sectors including mining, energy, telecommunications, agriculture, finance, construction, transportation, and service. 2011 also witnessed the first 'class action' investment treaty claim, when an ICSID tribunal accepted jurisdiction over a dispute lodged by several thousand Italian bondholders against Argentina. Given the turmoil in the financial sector at present, many expect an upturn in investment treaty claims against other sovereigns who default on their debt.

Whittaker: One of the key recent developments in international law now concerns the role of the EU law in the investor arena in light of plans by the European Commission to kill off intra-EU investment treaties. However, this effort to create a level playing field for investment in Europe may have the unintended consequence of driving European companies that wish to invest in another European country to incorporate in jurisdictions such as Switzerland or Singapore, and thereby preserve the investor protections. It would be a bizarre result. Other developments are not directly related to investment treaties but to sovereign immunity which may be relevant to enforcement. There is a growing divergence between countries on this issue; for example China – and now Hong Kong – has absolute immunity compared to countries such as France which treats a submission to arbitration as a waiver of both jurisdictional and execution immunity.

FW: In your experience, what are some of the common causes of investor-state disputes? What role do bilateral and multilateral investment treaties play?

Herlihy: Certain disputes arise from an outright expropriation. Recent examples include the approximately 20 pending claims against Venezuela arising out of President Chavez's policy of nationalisation; a recent successful claim against Georgia for expropriation of an oil pipeline; and claims by the former Yukos shareholders against the Russian Federation. Most claims, however, involve state conduct which is more nuanced. Common triggers for investor-state claims include the state's breach of an investment contract; changes to industry regulation; changes in taxation, including 'windfall' taxes; revocation or non-renewal of operating permits; restrictions on the repatriation of dividends; denial of justice by the local courts or administrative agencies; or discrimination against foreign firms. Investment treaties are key in such cases, because they offer a wide range of protections, including the 'fair and equitable treatment' standard which aims to

protect investors' legitimate expectations.

Whittaker: Arbitration cases have involved the whole range of investment activities and all kinds of investments, including privatisation contracts and state concessions. Measures that have been challenged include emergency laws put in place during a financial crisis; value-added taxes; rezoning of land from agricultural use to commercial use; measures on hazardous waste facilities; issues related to the intent to divest shareholdings of public enterprises to a foreign investor; and treatment at the hands of media regulators. Probably the greatest challenge is reconciling the civic duties of a government in terms of raising revenue during times of economic difficulty against the reasonable expectations of investors who are looking for a consistent fiscal regime.

Venegas: Investor-state disputes have a wide variety of causes including the implementation of decisions adopted during an economic crisis; treatment provided to a foreign investor by the judiciary; tax measures; preferential treatment of domestic investors; corruption of public officials; lack of predictability in the domestic legal framework; and, of course, direct takings or expropriations. Bilateral and multilateral investment treaties play a major role in investor-state arbitration. Through these treaties states consent to submit their disputes with foreign investors in the event that any provision of the treaty itself is breached. The usual rights conferred to investors in these treaties are: prompt, adequate and effective compensation in the event of a direct or indirect taking; national treatment; most favourable nation treatment; fair and equitable treatment; and full protection and security. Different tribunals have shaped the meaning of these different rights in various manners, sometimes with contradictions.

FW: What general advice would you give to an investor that finds itself embroiled in a dispute with a foreign government? What factors should be considered when deciding whether to stop negotiation efforts and begin an investor-state arbitration? Is retaliation from the state common?

Whittaker: As with any legal advice, the answer depends on the facts. Generally, the first consideration ought to be the protections offered under the investment treaty governing the dispute and the rules under which that dispute would be conducted. As an investor claimant, this is the framework within which every decision must be made. Whether and when to move from the negotiating table will depend on the state party's ability to put forward a realistic pre-action offer. It would be wrong to rush into an arbitration which can be protracted and expensive and may have longer term implications for a

company wishing to maintain good relations with the host state. Every effort should be made to resolve the dispute by negotiation, including diplomatic means. According to PricewaterhouseCoopers, 38 percent of investor claims are settled before arbitration. This consensual approach makes sense both economically and reputationally – no state will want to lose out financially and neither will a state wish to be seen as an easy target in relation to investment disputes.

Venegas: Investment arbitration is a specialised field that requires advice from counsel with experience in handling these types of cases. Domestic remedies sometimes exclude remedies under international law and vice versa, so it is important to receive this advice at the early stages of the dispute. Investor-state disputes are often politicised and they must be handled with the utmost precautions. Arbitration cannot be rushed and settlement negotiations should be exhausted. If it is clear that the state is not willing to compromise, then arbitration should be considered, and the pros and cons evaluated. An investor must always have in mind that effective representation in investor-state arbitration could cost a few million dollars, and that receiving non-effective advice at a lower cost can lead to more troubles, and damage the relation with the state even more. Finally, retaliation from a state being sued is not common, but it depends on a case by case basis. Particularly in countries with smaller economies, retaliation could exist.

Herlihy: Plan ahead. Well-advised investors hedge against state interference by structuring their investment in a way that takes advantage of an investment treaty signed by the host state. But this is best done at the outset – when the investment is made, or during its operation – and before the state takes action against the investment. When a dispute arises, seek legal counsel early. This will reduce the risk of making statements, or generating internal documents, which might prove to be harmful in a subsequent arbitration. Investors sometimes fear that filing a claim will worsen their position, but in our experience the opposite is often true. Many times politicians defer hard choices, or the decision-making structure within the state can be slow and rigid, leading to fruitless negotiations over months or years. Although it is always best to resolve a dispute through negotiation, if possible, the filing of a claim can sometimes bring the state to the table. Each case, however, turns on its specific circumstances including the particular government involved.

FW: Could you provide a general overview of the types of international arbitration available to resolve investor-state disputes?

Venegas: International arbitration can be categorised under different criteria. A common criterion

is to distinguish between institutional and ad hoc arbitration proceedings. Institutional arbitration proceedings are managed by an international institution under a predetermined set of rules, while ad hoc proceedings are not. Nonetheless, although ad hoc arbitration is not monitored by an institution, the proceedings in this type of disputes are usually followed under the arbitration rules of the United Nations Commission on International Trade Law (UNCITRAL). The role of administrating institutions is limited to the organisation of the proceedings. Arbitral institutions do not deliberate or render awards. This task is exclusively left to the arbitrators working alongside the institution.

Herlihy: Foreign investors benefit from three main routes to international arbitration. First, they can include an arbitration clause in their contracts with the host state. A second and more common path to arbitration is to invoke a bilateral or multilateral investment treaty between the host state and the investor's home country. There are more than 3000 such bilateral investment treaties (BITs) worldwide. The right to arbitrate under those treaties exists irrespective of whether or not a contract has been signed between the investor and the state. Any qualifying investor under a BIT can have its dispute resolved by an independent tribunal under one of the main institutional rules, for example ICSID, UNCITRAL or the Stockholm Chamber of Commerce. A right to international arbitration sometimes exists also in states' domestic investment laws – these need to be checked alongside the applicable treaties.

Whittaker: The basic elements of the types of international arbitration rarely differ to a significant extent. A vast majority of investment treaties offer, as a central protection element for the investor, the possibility of resorting to international arbitration under ICSID or ad hoc arbitration using the UNCITRAL rules. Sometimes, investment treaties do not even require recourse to the national courts of the host country. Other arbitration frameworks include ICC, SIAC and LCIA. Similar types of dispute settlement provisions can also be found in concession contracts, privatisation schemes, stabilisation agreements or ordinary state contracts, whereby an alleged violation will not be heard by a national court but by an international tribunal.

FW: What is the average cost and duration of an investor-state arbitration proceeding? When it comes to damages and awards, is it often a challenge for winning parties to receive due payments from the losing party?

Herlihy: Investor-state disputes are often slow and expensive, although ultimately effective. Many claims achieve a successful outcome before the hearing: 38 percent of ICSID claims have been settled or otherwise discontinued. The remaining 62 percent were decided by a tribunal. The length

of an investor-state arbitration will vary according to the facts and legal issues. A recent study of 115 ICSID cases found that the average length from the request for arbitration until the tribunal's award was 3.6 years. If there is no challenge to jurisdiction, the timeline is likely to be shorter. Historically, virtually all investor-state awards were paid voluntarily by the losing state. Most states still pay when so ordered by a tribunal. But in an increasing number of cases, investors are having to take enforcement proceedings against commercial assets of the state to satisfy their awards or trigger a settlement. This is a challenge but often a surmountable one.

Whittaker: On a broad basis the duration is likely to be three to four years; shorter if there is no jurisdictional challenge. The cost will depend on the case, but pursuit of these claims will be a substantial investment. Enforcement difficulties appear to be confined to particular states rather than being a general problem.

Venegas: The answer to this question varies on a case by case basis. Sometimes, cases are charged depending on the time counsel spends in the defence of its client, and the duration of the proceedings could certainly be a factor determining counsel's fees. In other occasions, both investors and states require a predetermined fee to be charged by its counsel at certain stages of the proceedings. The average duration of an investor-state arbitration ranges between two to five years, but there are exceptional cases that have lasted more than a decade. The average cost of these proceedings ranges from $3m to $15m and in some exceptional cases even more. The vast majority of states condemned by arbitral tribunals in their awards have ultimately paid. The economic and political consequences of not paying this compensation could be considerable. Also, it sends a bad signal to possible future investors in the country.

FW: What lessons can be learned from recent arbitration decisions in this area?

Whittaker: The main point to draw from recent developments is that certain governments do feel that they are becoming easy targets for investor challenges and are therefore strengthening their dispute resolution capabilities to meet the increase in these challenges. Having seen this occur, other states, such as African states, beginning their first substantial forays into investment treaty negotiation, will do well to closely consider the protections offered in these investment treaties and the obligations that such treaties impose on states. There are long term obligations which cannot easily be reshaped. It may also be the case that this re-think forces states to consider the actual benefits of investment treaties when reports indicate that investment treaties do not seem to have

increased flows of investment and that countries that had concluded an investment treaty were no more likely to receive foreign investment than were countries without such a pact.

Venegas: International law is constantly developing, sometimes through the adoption of different views on the same issue by prominent legal authorities sitting as arbitrators. The fact that the vast majority of decisions are made public has widely increased the relevance and usefulness of international law, and has updated many programs at law schools worldwide. International law remedies are now available to several foreign investors suffering from the arbitrariness of the governmental authorities in power at the place they do business. Governmental authorities are now aware that they could be subject to arbitration and are exposed to liability in the way of compensation for their unlawful acts. States commonly refuse the jurisdiction of arbitral tribunals, making proceedings more costly and lengthier. Irrespective of this, several foreign investors have been compensated for the damages they have suffered and the system has proven to be successful to them.

Herlihy: My advice would be to plan ahead and structure your investments to maximise treaty protection. Periodically review your existing investments to see if they qualify for treaty protection and, if they do not, find out what can be done to improve their standing. Once a dispute arises, consult counsel early in the process. Finally, think outside the box. Clients sometimes focus on their contractual rights and have no idea that they also benefit from valuable international treaty rights, including fair and equitable treatment, non-discrimination, free repatriation of dividends, guarantees against uncompensated expropriation and the right to resolve disputes through a neutral, international tribunal.

John Whittaker is a partner at Clyde & Co. LLP, David Herlihy is counsel in the International Arbitration Group of Skadden, Arps, Slate, Meagher & Flom (UK) LLP and Marco Tulio Venegas is a partner at Von Wobeser y Sierra.

CHAPTER 5

DISPUTE RESOLUTION STRATEGIES

in association with:

VON WOBESER Y SIERRA

JANUARY 2011

Tim Portwood

TO MEDIATE OR TO ARBITRATE... AN INTERESTING QUESTION?

"The results are astonishingly good. Try it more often". What, might you ask, was Lord Justice Ward praising in his decision in Egan v Motor Services (Bath) Ltd [2007] EWCA Civ 1007: a new motor oil; a new water-free car wash; a self-dispensed breathaliser test? No, he was in fact praising mediation.

This endorsement has been mirrored in Europe. A European Directive on mediation was issued in June 2008 to be implemented by June 2011 (Dir 2008/52/EC [2008] OJ L136/3) and a Code of Conduct issued in 2004. Whilst not making mediation mandatory (a quasi-anathema), the purpose of the Directive and Code is to render mediation more attractive by improving the quality of mediators, ensuring the enforceability of post-mediation settlement agreements, protecting the confidentiality of the mediation process and giving mediation a special standing in the Member States' civil procedural rules.

All of this interest in mediation is to be encouraged, but with at least two caveats. The first is that the process itself is only as effective as the mediator. Mediation is unlike any other form of dispute resolution mechanism. It is not about judging the dispute or judging the parties. Mediation is about bringing the two antagonists to terms with the weaknesses of their own positions, preparing them psychologically to say 'à Dieu' to their dispute without having their day in court, bringing them to accept the idea that a peaceful future is better than the conflict-ridden past. The bag of skills that a mediator needs for his or her shuttle diplomacy is very different from that of the litigator.

The second caveat is that mediation is not by default binding. It is not a true alternative to arbitration or court litigation. An agreement to mediate will, by default, mean court litigation. If the parties wish

to avoid the courts, they must stipulate arbitration or another form of final and binding dispute resolution in the underlying contract in addition to mediation.

We have asked the 'wrong question'. Mediation, yes, why not, but then the issue to be addressed should be whether 'to arbitrate or to litigate'.

Outside the realm of arbitration by 'amiable composition' (where the arbitrators rule in equity), both the courts and arbitral tribunals must rule under the applicable law.

Why, then, might one ask, is there today criticism that arbitration is becoming unpredictable and unfair. The reason is, it is suggested, disconcerting. Time and time again, arbitral tribunals are seen to seek a solution that it thinks is just. The reasoning is then constructed under applicable law around that solution. The result is often camel-like and sometimes downright wrong. But because arbitral awards cannot be challenged for getting the law wrong (as opposed to not applying the applicable law at all), there is no sanction. There is, however, dissatisfaction. And that dissatisfaction is found in the party that is right in law but wrong in equity.

This phenomenon is more often found in panels of arbitrators than with sole arbitrators. Sole arbitrators often find comfort in the law and rightly so. Panels have to deliberate collegially and often the result is a compromise of which the applicable law is all too often the victim.

The difficulty that this trend poses touches on legal certainty. Arbitration must not become a process in which the rule of law is abandoned for what arbitrators think (or negotiate) is just. The parties need legal certainty to transact and do business. Counsel need legal certainty to advise their clients. Arbitration needs legal certainty to survive.

Tim Portwood is a partner at Bredin Prat.

MARCH 2011

John Reynard, Derek Malcolm and Chris Hine

TALKINGPOINT: ROLE OF EXPERT WITNESSES IN LITIGATION AND ARBITRATION

FW moderates a discussion about the role of expert witnesses in litigation and arbitration between John Reynard at BTG Global Risk Partners, Derek Malcolm at Grant Thornton and Chris Hine at RSM Tenon.

FW: Are you seeing expert witnesses used more frequently in litigation and arbitration proceedings?

Reynard: Traditionally, litigation tends to increase when times are hard – what might be left to pass when it merely deflects from money being made, can become altogether more important during a downturn. However, I wouldn't say there's an increase in frequency of expert instructions at the present time. The recession has meant that businesses have to be careful in setting their priorities, and there's little appetite for full-scale litigation while funds are in short supply. This doesn't mean that disputes aren't happening; just that only limited early work is being done now, until the financing situation eases. When that happens, I'd expect the litigation momentum to pick up and the flow of instructions to experts to increase.

Hine: After a lull following an introduction of the Civil Procedure Rules in 1999 the level of expert witness appointments has remained reasonably consistent. There are certain areas, for example technology and construction cases, where accounting experts are used much less frequently than previously. This has resulted from specific legislation, and in this case, the effect of adjudication. The compressed timescale, and the need to focus on the key aspects of the case require a concentrated

effort from the legal team, which allows limited use of experts. In other areas volumes of instructions have recovered, although single joint expert appointments are much more prevalent in certain areas, notably family cases.

Malcolm: I have noted an increase in the use of expert witnesses. However, in Canada, as a result of a number of issues that have arisen regarding the objectivity of some experts, the courts will be increasingly vigilant in allowing expert evidence in the future and could therefore reduce their frequency going forward. In the financial area, while we expect increased rigour to ensure expert independence and qualification, the complexities of business concerns leading to litigation, coupled with changing accounting standards, difficult loss quantification calculations and complex fraud schemes, the use of experts will continue.

FW: In your opinion, under what circumstances should parties consider bringing expert witnesses into the process? In what types of disputes are they most beneficial?

Hine: Expert witnesses are most appropriately used where the key areas of the case are those known to be covered by expert evidence. In relation to forensic accounting, it is those cases where the issue of quantum is most difficult to resolve and where the calculation of the amounts of damages may be very complex. This will typically be a large commercial case where there may be a loss of profit claim arising from, for example, the failure of the machine to perform at the level specified within the contract. An assessment has to be made of the profit that would have arisen had the contract been performed.

Malcolm: In relation to fraud, we have likely all read about the Ponzi schemes that contributed to the demise of our financial systems. Such schemes are extremely complex to unravel, and often difficult to separate from legitimate investments. Identifying and interpreting sufficient evidence that can meet even the lesser burden of proof in a civil action can be extremely difficult. Expert witnesses in such cases will be essential to ensure the evidence is correctly understood. Other types of fraud will also continue to require experts to notice and explain the fraud footprints in the windblown sand of corporate records. Outside of fraud, financial disputes that require complex quantification modelling or 'what if' calculations are those in which experts will be most beneficial. Such experts would be best used providing a critical assessment of the facts and assumptions underlying the loss as well as the quantification

itself. An expert who only acts as a human calculator may be subject to criticism by the trier of fact if they have accepted without question the information provided to them.

Reynard: Commercial and shareholder disputes may centre on matters of law, in which case there's little that an expert witness can bring to the party. It's rare, though, for a dispute to turn only on a legal point, and quantum matters will always play some part. All litigation and arbitration will require some assessment of the financial consequences of action or inaction. Business performance is never certain, so this will involve making estimates of profits that might have happened, not just measurement of ones that have. Therefore, the value of the claim will rarely be straightforward – there can be many strands to the arguments, and complex matters of accounting measurement, practice and interpretation. The experts' input will be invaluable in these areas.

FW: An independent perspective can be critical in any dispute. To what extent can experts help to analyse the strengths and weaknesses of a pending case?

Malcolm: Experts can be very helpful in this regard but care needs to be taken if such a 'consulting expert' is then also used to prepare an expert report. An expert in a consulting or advisory role may be able to take an advocacy position, for example advising the client on the most beneficial calculation methods, the pros and cons of different options and estimating preliminary high and low ranges of losses. Such advocacy should not, however, extend into preparing an expert report which needs to be impartial and balanced. In addition, in all cases I recommend engaging experts early in the process, because they can often help reduce the litigation costs by identifying relevant information that should be disclosed or analysed and avoid costly information fishing expeditions.

Hine: A good expert will always seek to add value to the case. This could involve analysing the nature of the claim and identifying those areas where it can be improved and those aspects which will be vulnerable to evidence provided by the other party. This may well allow the clients to be better informed which would assist both in the progression of the case, tactical issues such as the issuing of Part 36 offers and approach to settlement of the case generally. Expectation management is a key part of the legal advisers' role which facilitates dispute resolution, and experts can play a pivotal role in this.

Reynard: The key word here is independence. Whilst the parties to the dispute are essential to the

factual background and impacts on the business, it's not unusual for them to become emotionally involved in the proceedings. Equally, the advice of their incumbent accountants or tax advisers can be tainted by the importance to them of focusing always on doing their best to support their client. The independent expert, on the other hand, will be bound by a primary duty to the court, and must strive to retain that objectivity. Some of the most valuable input that the independent expert may have is in identifying and quantifying issues that the party does not want to hear, but which can be essential if costs are not to be wasted on lost causes.

FW: Is it fair to say that a properly qualified witness can have a defining influence on the outcome of litigation and arbitration?

Malcolm: A properly qualified expert can certainly influence the outcome; however, an unqualified expert could have more impact on the outcome, in a negative way. It must be understood that it is not the expert's job to win the case for their client. That is counsel's role. The expert's job is to assist the court by clearly presenting their opinion evidence in the best way for a court to understand and provide a sound basis on which the court can make its decision after it evaluates all the facts and evidence in the case. A qualified, experienced expert can help the court in this regard and in doing so helps the client. An expert who forgets or neglects this role can find their opinion ignored or worse, viewed adversely, which results in negative consequences for both the expert and the client.

Reynard: Over the years, I've seen many cases where the legal differences between the parties' stances have been the dominating factors right up to the final stages when, with court or arbitration looming, attention has turned to the bottom line – how much is this claim really worth? It's surprising how often it turns out that the expert's input can lead to a view where the strongest of most intractable legal points turn out to be the ones of least financial merit. Invariably in my experience, that input has the benefit of enabling the litigation team to separate the wood from the trees, and focus their energies – and cost – on those that provide the greatest benefit or least risk.

Hine: In those cases where an expert is addressing the key area of the dispute then their input can be fundamental to resolving the matter. A comprehensive and compelling expert's report can transform the dynamics of proceedings. In one case a company was anticipating realising a modest sum in litigation arising from a breach of contract. However, devising an alternative method of quantifying loss resulted in a settlement substantially greater than the company's expectations.

Where the defendant is insured, the insurance company will set a reserve at an early stage. There have been cases where the receipt of the expert's report has significantly influenced the insurer's assessment of the likely outcome and has led to a substantial increase in the reserve.

FW: What are the pros and cons of court-appointed expert witnesses? Can contrary views between expert witnesses complicate the process?

Reynard: Through the Civil Procedure Rules in the UK, Lord Woolf sought to reduce the costs of litigation as a barrier to access to justice. A move towards court-appointed or single joint experts was one strand of those changes, aimed at avoiding having separate findings from two single-party experts, followed by rebuttal reports, etc. One of the key benefits of having a court-appointed expert must be that he will be addressing one agreed set of issues and reaching one set of findings, avoiding some of the difficulties of parties polarised in their views and instructions to their expert. The outcome can undoubtedly be far preferable to simultaneous exchange of single party expert reports that address widely differing 'facts' as their starting points, and require fresh submissions on issues new to one or other of them. Of course, whether warring parties can agree on a single expert can be an issue in itself.

Hine: Few expert witnesses are directly court appointed. More are appointed as single joint experts by both sets of solicitors. This can be of assistance, particularly if the area of expertise is not focal to the case, but it can also create difficult situations for the parties. On many occasions three experts have been instructed – the independent single joint expert, and party appointed advisers from each side. This obviously increases rather than reduces costs. Contrary views between party appointed experts can be narrowed by the use of discussions between experts and preparation of joint statements. If this procedure is properly undertaken it can be of considerable value to the court. In one recent matter the experts agreed the structure of a complex loss of profit spreadsheet model shortly before trial, so that it could be populated with data from either side. This removed a large amount of uncertainty as to the method of calculation of loss that would be determined.

Malcolm: While there has been movement to increase court appointed experts, we have not yet seen a lot in our specific field. It may appear that having one expert reporting to the court is the answer to a lot of problems; however, it can also create a number of new ones. First, paying for only one expert seems to make financial sense, but in some cases the plaintiff and defence will engage their own non testifying expert to help them understand the court appointed expert's

work, costing lots more. Second, the court appointed expert can find themselves like Daniel in the lion's den, on their own, fighting off attacks from both sides. In extreme cases, the expert may have to retain their own legal counsel to protect their professional interests because the courts are unable or reluctant to get involved. Contrary views can complicate the process, but they are often necessary to shed light upon the issues.

FW: There has been some criticism that expert witnesses are simply 'hired guns'. What is your reaction to such claims? Have there been any recent rule changes affecting the use of expert witnesses in court proceedings?

Hine: Following the Civil Procedure Rules experts are much more aware of their duties to the court rather than the party that instructs them. It is therefore much less likely to be the case that there is criticism of experts as 'hired guns'. Experienced experts recognise that their creditability is fundamental to their ability to undertake expert witness work and recognise the role that they have to play, and managing their clients understanding and expectations of their role in the proceedings. In addition the more frequent use of single joint experts reduces the opportunity for one party to unduly influence an expert. It should be noted, however, than if a single joint expert does produce a report advocating an extreme position it can be very difficult to change this.

Malcolm: In Canada, the primary duty of an expert witness is to the court but, while this has been recognised for many years, there have been instances of expert witnesses in a number of areas advocating, consciously and unconsciously, for their clients and therefore giving the appearance of hired guns. In our area of expertise, we are trained to be objective and impartial in preparing expert reports; however, there are some that still step over the boundaries. A recent judicial review, related to mistakes arising from erroneous medical expert testimony, identified serious issues in the use of expert witnesses which has resulted in a significant rethink about how and when experts are to be used. This has caused the codification of the expert's obligation to the court into several provincial Rules of Civil Procedure including Ontario and British Columbia where every expert must now acknowledge this in writing.

Reynard: The introduction of the Civil Procedure Rules in 1999 brought major changes for experts. Before that, some experts were undoubtedly believed to be hired guns. This was particularly true of some medical experts in injury cases, but equally of some accountants. Whilst it can be seen as a benefit to lawyers that they act only for claimants or defendants, for experts this as a big weakness.

Independence and objectivity are important, and it would be of no service for experts to be forced on the witness stand to admit that, no, we never act for claimants or defendants, as the case may be. Even before the CPR, we have always seen it as a benefit that we have acted on both sides of the fence, so that we know what responses to expect on important issues.

FW: Should expert witnesses have a part to play in settlement discussions? When is this appropriate?

Malcolm: They certainly can play a useful part in settlement discussions, but again they must be careful and balanced in their assistance, particularly where they may be called to testify. In addition to determining reasonable financial amounts we are also requested to help structure settlements to minimise tax consequences or to establish the best 'value' of the available alternatives. In some matters, it may be beneficial to separate the expert providing advice in settlement discussions, where advocacy and strategy can be discussed, from the testifying expert where knowledge of such strategy could be used against them under cross examination.

Hine: Expert witnesses, particularly accountants advising on quantum, can add value to settlement negotiations. In a recent mediation, quantum was the key aspect of the discussions. In this environment, presenting arguments in a number of different ways facilitated discussions and negotiations during the day. The matter successfully concluded at a figure above that which could be justified by strict legal analysis. It is rare for expert accountants to be involved in such discussions and it is generally applicable where the quantum of the dispute is the key matter to the resolved and legal complexities are less apparent.

Reynard: Our experts are focused on effective resolution of disputes, whether by mediation, arbitration or at court. This encompasses effective management and control of costs, as well as providing meaningful input at all stages of the process, from pre-issue advice through detailed fieldwork and reporting, through to expert witness appearance. Settlement discussions can be an efficient means of bringing the dispute to an end. Achieving that will involve resolution not just of the legal differences but also the financial disagreements between the parties. If opposing experts have already met and narrowed their differences, it may be that the parties and their lawyers have sufficient template to fine-tune any final calculations. Absent that, the live input of an expert assisting their team can be invaluable in understanding and quantifying the financial consequences of points agreed or compromises offered or received.

John Reynard is executive chairman of BTG Global Risk Partners, Derek Malcolm is a partner at Grant Thornton LLP and Chris Hine is national head of forensic accounting at RSM Tenon.

MAY 2011

Hossein Hamedani, Will Davies and Colin Johnson

DISPUTE RESOLUTION WITH THE END OBJECTIVE IN MIND

Disputes have been on the rise in recent years as can be seen in the number of disputes in the UK that went to arbitration or mediation – 34,541 cases in 2009, up over 75 percent from 19,384 in 2007 and are expected to rise. The recent economic woes are also leading to a wave of new cases involving financial institutions and many in the energy sector seem to expect increased claims this year. Trends also show that there has been a decline in the number of cases sent to High Court for trial and significant increase in arbitrations.

Another trend is the increasing complexity of international transactions. Major businesses have adopted more complex structures in recent years. For example, major infrastructure projects can be split into offshore/onshore elements for goods and services, sometimes with piecemeal contract splits between multiple contractors in different jurisdictions and transactions between connected entities that may not be at arm's length.

The financial services sector has increasingly used off balance sheet vehicles that use a variety of structures such as trust structures, partnerships and multiple special purpose vehicles in numerous offshore jurisdictions to achieve particular aims. Lack of regulatory requirements and resources in some such jurisdictions can often lead to a loss of management control on custody of assets and accounting. Lack of legal precedents for vehicles such as trusts that were traditionally used for low risk investments has also led to new problems emerging. In such an environment, disputes can create challenging legal, causation, accounting and tax issues. Often legal advice is required in multiple jurisdictions and quantum issues may fall outside the comfort zone of some of the traditional experts.

Against such a background, managing and controlling the dispute process is essential in avoiding costly surprises and achieving realistic and commercial outcomes. In this article we touch on the choice of forum and consider how expert witnesses or advisory experts can assist in helping to achieve such an objective.

The question of whether disputes should be determined by arbitration or to go to the traditional courts is normally predetermined at the outset when contracts are signed. From a commercial perspective factors to consider with the legal team are speed, cost, confidentiality, certainty and ability to enforce.

International parties choose London's specialist courts as a forum for dispute resolution for qualities that include skilled and impartial judges who are free of political influence, clear and consistent decisions, enforceable judgments and the requirement for disclosure of relevant evidence by the parties. Arbitration offers the choice of confidentiality of the proceedings and is often preferred by parties who do not wish to be subject to laws of particular jurisdictions with underdeveloped, overburdened, slow court systems that could also create uncertainties in enforcing the judgment.

Cost is also a major factor. Some parties prefer speedy hearings and procedural flexibility at arbitrations. However, the flexibility can lead to lengthy delays in preparation for the hearings. This can result in spread of costs over a long period of time. By contrast, UK court hearings can be lengthy and expensive and procedural requirements mean that significant costs are incurred in a short period of time.

Whichever form of dispute resolution is chosen, achieving the commercial objectives most effectively requires treating the dispute and its related costs as an investment project. That requires the following. First, establishing clear and realistic financial and other objectives. Second, considering other issues such as reputation and opportunity costs of senior management dealing with the claim. Third, a risk assessment of potential outcomes and plans to minimise risks, including exploiting opportunities for early settlement. Fourth, ensuring that the decision making is dispassionate and not solely reliant on key people involved in the original activities that led to the claim. Finally, ensuring that the actions taken take account of a realistic cost benefit analysis.

The above also requires a clear and realistic consideration of the quantum issues at the outset. Leaving quantum until other issues on liability are all resolved can lead to significant costs and effort being incurred without knowledge of the risks and potential returns. The development of business practices noted above has introduced added complexities in assessing quantum that flows from disputes. Early investment in the assessment of realistic outcomes can make a big difference to the overall costs and the effort required to resolve the dispute. Engaging a quantum expert to advise early in the case is a key part of this.

Expert witnesses can assist on liability or quantum aspects when opinion evidence is required to resolve a dispute. Advisory or non-testifying experts are used to assist clients and their legal advisers with identification of issues and case preparation. Experts are often engaged to express views on accounting, auditing, commercial issues and analysis, interpretation and presentation of a large quantity of data.

Testifying experts will normally have a primary duty to assist the court or the tribunal with their objective opinion. This requires independence and lack of conflicts with the parties involved. Major disputes often involve a number of parties who have existing relationships with the advisers. This can lead to difficulties in finding suitable conflict free experts.

Appointing experts at the outset avoids the risk of running out of options for suitable experts. This also helps parties and their legal teams obtain insight on the quantum aspects, the evidence required and the collection and preservation of that evidence. Loss of key evidence, including evidence from witnesses of fact, can cause serious difficulties in establishing the quantum of a claim with reasonable certainty. Early attention to quantum issues, including expert opinions, can also create a focus on setting and achieving realistic objectives that can also lead to an early resolution of the dispute, again saving costs.

Sadly there are certain pitfalls in using an expert that need to be avoided. These include: (i) selecting experts based on the lowest rates rather than those with the required capability, experience and local resource and technical support in the relevant jurisdictions; (ii) issuing inadequate or inappropriate instructions to the expert that can lead to limiting the relevance or value of his evidence; and (iii) risking credibility of the expert witness's report or oral testimony by oversight of the requirement for objectivity, independence, appointment of experts who are conflicted, or requiring the expert to act as client advocates.

The above matters can be avoided by early scoping of expert work and ensuring the right expert is appointed. It is also advisable to seek professional references.

Hossein Hamedani and Will Davies are partners and Colin Johnson is a Director at Grant Thornton.

JUNE 2011

Matthew P. Vafidis

TEN FEATURES OF SUCCESSFUL MEDIATION IN COMMERCIAL DISPUTES

Mediation is increasingly widespread and popular. However, of all the methods available for resolving commercial disputes, it is perhaps the least well understood. Those participating in successful mediations are often unaware of how the strategies employed by the mediator assisted in resolving the dispute. Similarly, after an unsuccessful mediation it is rare that any analysis is applied to whether the mediator's conduct of the process played a role in the outcome.

This paper attempts to offer some guidance to the procedure of mediations by identifying 10 features common to successful commercial mediation.

First, the commitment of the parties to the process. Mediation is distinct from litigation and arbitration in that, unless all parties consent, it can have no direct consequence that is enforceable by the power of a court: it works only if the parties are committed to the process. To encourage this, the process must therefore have formality. There should be a pre-mediation conference of counsel, and the mediation session should involve attendance sheets and confidentiality agreements, and a review of the procedural framework and rules. The parties should submit and exchange confidential written briefs (and should be encouraged to submit an additional private statement for the mediator only). The mediator should require that parties' representatives participate in person.

Mediation should take time and effort. The parties must know they have been given a thorough and fair hearing. Nobody should be permitted to abandon the process prematurely. All parties must be kept engaged, and, if they cannot agree, the decision to end the session should be a joint one.
Second, the responsibility of the parties for the outcome. The mediator is a facilitator for the parties'

negotiations. It is the parties, assisted by their counsel, who must decide whether the case settles and, if so, on what terms. The mediator must never be the one to tell the parties what to do: the parties must be in charge and should be reminded of that responsibility.

Third, the crucial role of the lawyers. Mediation works when all parties are represented by counsel who understand the strengths and weaknesses of their case, and provide honest and astute advice to their clients. Conversely, it is hard to succeed in mediation when one or more of the lawyers is unprepared or ineffectual. However, although mediators are in the best position to judge the value of the contribution made by the parties' counsel, a mediator should never go around the lawyer and deal directly with a party. The mediator must respect the role of counsel, and never step into the lawyer's function.

Fourth, an objective view of the dispute. The mediator is in a unique position to identify or frame the issues in dispute. It is therefore a good practice for the mediator to summarise the various elements of the dispute at the outset, encouraging input, clarification and confirmation from the parties. This helps remind the parties of the issues as to which they agree, and invariably promotes a more comfortable start to the process. Characterising the issues comprehensively, disinterestedly and fairly helps the parties look at their positions more objectively, which is essential to exploring ways to find compromise.

Fifth, awareness of the litigation or arbitration. Mediation is always played out against a backdrop of actual or potential litigation or arbitration. Accordingly, many mediators like to take time, in joint sessions or in separate caucuses, analysing the risks involved in pursuing the litigation or arbitration alternative, particularly the costs and uncertainty attached to having a court, jury or arbitration panel determine disputed issues of fact or law. With sophisticated parties, however, this may not be necessary, and can be unwelcome. It is much better to use the underlying actual or potential litigation or arbitration as a common issue, to emphasise to the parties that they have the joint opportunity to avoid it through mediation. The court or arbitration process – as opposed to the Judge, jury or arbitrator – may be viewed as a form of 'common enemy' of all parties.

Sixth, the effective use of the joint session. The joint session allows the parties to gain confidence and trust in the even-handedness and commitment of the mediator, and enables the parties and their counsel to be heard and to speak their mind openly – to have their 'day in court'. But it must be handled correctly. At the joint session, mediators should therefore be ready to ask neutral, non-

controversial questions. The point is to start the dialogue, not exacerbate the dispute between the parties.

Seventh, the effective use of the separate caucuses. There are three useful techniques for conducting separate caucuses. First, the mediator must always perform the function of conveying a message from one separate caucus to another; this part of the mediation is a facilitated negotiation between the parties, with the mediator as a go-between. Second, the mediator must always be aware of what is happening with the parties and their counsel who are left alone; all parties must be aware of what is going on in the other rooms. Third, the mediator must always be looking for ways to keep the process going, and should involve the parties and their counsel in this process; when all else fails, the mediator must throw responsibility back on the parties in control – "That didn't work, so what do you want to do now?"

Eighth, the mediator's personality. The parties and their lawyers must know that they can talk to the mediator in absolute confidence, that their positions will be conveyed honestly and reasonably, that the mediator will always keep a positive outlook and, as neutral, will maintain the best interests of all parties at all times. In successful mediations, the parties and their lawyers are well aware that the mediator is fully committed to helping them resolve their dispute and cares deeply about whether the parties can reach a settlement.

Eighth, the mediator's personality. The parties and their lawyers must know that they can talk to the mediator in absolute confidence, that their positions will be conveyed honestly and reasonably, that the mediator will always keep a positive outlook and, as neutral, will maintain the best interests of all parties at all times. In successful mediations, the parties and their lawyers are well aware that the mediator is fully committed to helping them resolve their dispute and cares deeply about whether the parties can reach a settlement. It is important that the parties and their lawyers not only trust and respect the mediator, but it is also helps if they actually like him or her.

Ninth, the evaluation of the merits of the case. Whether, when or to what extent to offer an evaluation of the merits of the dispute? Clearly, the answer depends on the dispute, the stage of the negotiations, the parties, their counsel and the mediator. However, a mediator should always be prepared to offer his or her evaluation, if asked. And the mediator should offer to provide an evaluation if all else fails to bring the parties together. At some point, there may be nothing to lose and the parties may benefit from the mediator's opinion as to how the case should come out at trial

or in arbitration, or its settlement value.

Finally, the record of the settlement agreement. The final rule is sometimes forgotten, especially after an exhausting mediation session. Once a settlement is agreed, the parties and their counsel must be brought together and the terms of the settlement must be clearly expressed so that all can hear them for one last time and confirm their agreement to all aspects of the settlement. If possible, the terms of the settlement should be written out and signed by all parties.

Matthew Vafidis is a partner at Holland & Knight LLP.

JULY 2011

Ben Knowles

WEIGHING UP ARBITRATION VS MEDIATION AND LITIGATION

Different jurisdictions can hold completely opposing views on the subject of which form of dispute resolution to recommend to a company. In a particular case, a UK perspective might weigh heavily in favour of taking the matter to the commercial court while in another European jurisdiction arbitration might be presented as a much more appropriate option.

This demonstrates the conundrum facing dispute resolution lawyers and in house counsel. What is the appropriate forum for the resolution of disputes?

The differences

Arbitration and litigation can be viewed as two different but similar techniques to resolve disputes. They are both processes where, ultimately, if no prior settlement is reached, a third party, whether a judge or judges or an arbitrator or panel of arbitrators, will decide the dispute on the basis of material presented by the parties. Mediation and other forms of alternative dispute resolution are more akin to assisted forms of commercial settlement. In the case of mediation, although the mediator is likely to express his views at some stage, it is ultimately the parties who will have to decide whether to reach an agreed settlement to their dispute.

Arbitration and litigation are frequently mutually exclusive. The parties usually choose one mechanism over the other. Mediation and other forms of alternative dispute resolution are often used in combination with arbitration or litigation.

The factors

Every case is unique and there may be critical factors that will steer the choice of forum in one direction or another. The parties may have already made an irrevocable choice regarding the forum, often in the form of a commercial contract, e.g., arbitration in London under the auspices of the London Court of International Arbitration (LCIA). However either at the contract drafting stage, or when a dispute has arisen, general counsel will have to consider: what is the preferred form of resolution given the set of circumstances?

Below are some of the key factors to consider during this decision making process.

Enforceability

In today's post financial crisis straitened times, many would believe cost to be the main, if not the only relevant factor, or at least the factor that should be looked at first. However, closely examining whether an award or decision will be enforceable may save substantial amounts of time and money being invested in a process that could result in an unenforceable award.

When reviewing enforceability the basic point to consider is the domiciles and places of business of the respective parties. There is no point in winning a hard fought battle through an ICC arbitration in Paris only to find that the paying respondent operates within a jurisdiction where arbitration is difficult or impossible to enforce.

Cost and duration of proceedings

These two points should be considered together. It is a reasonable assumption that the longer the proceedings, the higher the legal bill. In this context it is worth considering not only the duration of the proceedings themselves, but also the possibility of appeals. In some forms of arbitration an automatic right of appeal amounts to a full rehearing. On the other hand some forms of arbitration, particularly when the seat is in certain jurisdictions, will virtually rule out any form of appeal.

The costs may be dramatically affected by the identity of the tribunal, the rules of the forum and the requirement or otherwise for legal representation. Some arbitral authorities have increasingly sought to control the issue of costs but this is not always as effective as it might be. In a recent case, the ICC set a cap for the duration of the arbitration on the per diem costs of the arbitrators. A few weeks before the arbitration the parties were approached by the tribunal chairman who indicated that he thought the tribunal would be unable to survive in London on these per diem rates. Leaving

aside the issue of whether tribunals are only able to survive in five star accommodation (a view that did not receive much sympathy from the impoverished clients) this incident illustrates that costs are not always as predictable as they ought to be.

One important factor is that in some jurisdictions, such as the UK, the time costs of the court are effectively free. This can have a very significant impact if proceedings might run on for a week or more.

Quality of justice

It is unfortunate but perhaps inevitable that the quality of justice is not uniform amongst the different forums. It is also regrettable but undoubtedly true that certain jurisdictions may give certain parties a home advantage (although this may be more perception than reality). Different forums are more familiar with and therefore more appropriate for certain types of dispute. There are a variety of trade arbitration bodies and the (limited) pool of arbitrators will have particular knowledge of certain commodities and the disputes that arise. And certain courts, such as the commercial court in London, have a particular familiarity with commercial disputes. For example, over the past two years there has been a spate of disputes concerning freight derivative contracts with English High Court choice of jurisdiction clauses. Therefore, two or three Commercial Court judges have developed an in depth understanding of the operation of these derivatives. By contrast it would be very difficult to find a commercial arbitrator with a similar understanding.

In arbitration, (unlike litigation) the parties may have a free choice regarding the identity of arbitrators to decide their dispute. In international arbitration there appears to be a growing practice of seeking to appoint arbitrators who might potentially have a propensity to support one party or the other on account of some perceived factor in their background, professional or otherwise – although the true effectiveness of this practice is questionable.

In the middle ground, the ability to choose the tribunal is probably less advantageous than might at first seem the case. The vast majority of arbitrators will of course seek to decide their cases on the basis of an objective and dispassionate consideration of the facts and law. However, there are cases where it is advisable to steer clients towards selecting arbitrators who are commercial men rather than lawyers, or vice versa.

The role of mediation

Mediation should be considered by all parties as part of their dispute resolution armoury. It was once thought, by some commentators, to be an appropriate part of the process in all circumstances. However, it is now accepted in commercial circles that mediation is best suited to the resolution of disputes over quantum, i.e., where it is accepted that a sum is payable, but the parties cannot agree the sum.

Mediation is also particularly appropriate where the parties have an ongoing relationship to preserve – a relationship that is probably much more likely to be damaged, perhaps irreparably, through arbitration or litigation.

In summary

This is a real question of horses for courses. When a company is facing an issue that needs resolution, if there is a choice of mechanism, it is prudent to consider all the available options, including arbitration, mediation and litigation, and try to select the solution or solutions that provide the company with the commercial resolution it requires.

Ben Knowles is a partner at Clyde & Co.

SEPTEMBER 2011

Fiona Gillett

COMPETING DISPUTE RESOLUTION CLAUSES UNDER UK LAW

The English court is clear: an arbitration agreement's construction starts from the assumption that, as rational business people, contracting parties are likely to have intended that any disputes between them be resolved by the same tribunal. But where more than one agreement governs the parties' relationship, with competing dispute resolution clauses (court jurisdiction versus arbitration agreement), in deciding which dispute resolution regime a claim is to be determined under, there is no presumption in favour of the arbitration agreement, even if drafted in terms wide enough to cover the claim. The question is entirely one of construction and the court must consider carefully the nature of the claim and the particular agreement out of which it arises.

In PT Thiess Contractors Indonesia ('Thiess') v (1) PT Kaltim Prima Coal ('KPC'), KPC challenged the jurisdiction of the English court to hear Thiess' claim, seeking a mandatory stay pursuant to section 9 Arbitration Act 1996, alternatively pursuant to the English court's inherent jurisdiction, on the basis that the claim in the English action must be referred to arbitration.

Blair J dismissed KPC's application holding that the English action raises a discrete claim, related to, but distinct from, the underlying dispute which is the subject of a Singaporean arbitration.

Background

This case arose from KPC's engagement of Thiess to perform mining services in Indonesia. A suite of agreements governs the relationship including an Operating Agreement – Mining Services which regulates the performance of, and entitlement to payment for, the mining services ('the OAMS'). The OAMS contains an escalating dispute resolution clause, including for disputes over pricing

arrangements an expert determination, and ultimately, arbitration.

KPC is also party to, and Thiess is entitled to enforce the terms which are for its benefit of, the Cash Distribution Agreement ('the CDA') which, in essence deals with the distribution of the sale proceeds of several mining service agreements. Other parties to the CDA include the 'Account Banks' which administer the bank accounts through which the sale proceeds are distributed.

The CDA requires: (i) Thiess to issue monthly to KPC a Principal Contractor Claim ('PCC') which must include the total payment claimed; (ii) KPC to then issue a responsive Principal Contractor Claim Confirmation ('PCCC') identifying the amount claimed in Thiess' PCC and the amounts which KPC agrees to pay and disputes (the latter being the 'Dispute Amount'); (iii) the PCC and the PCCC to be served on the relevant bank which pays the Dispute Amount into a dispute account in the name of KPC. The sums in the dispute account are only paid out upon receipt by the relevant bank of joint instructions or pursuant to a final judgment or arbitral award.

The CDA contains a non-exclusive jurisdiction clause in favour of the English courts.

The disputes

Thiess and KPC failed to reach agreement on the renegotiation of pricing arrangements under the OAMS and this dispute, after an expert determination, was referred to arbitration in Singapore.

Thiess issued its PCCs claiming the rates as determined by the expert. KPC challenged this and issued PCCCs which Thiess claims are non-compliant with the CDA, i.e., KPC failed to include in its PCCCs the total amount claimed by Thiess and then the amount that KPC considered payable with the difference between the two being identified as the Dispute Amount. Instead, KPC included as the total amount claimed by Thiess the amount KPC considers payable. The result means that the 'Dispute Amount' in KPC's PCCCs is nil and nothing is transferred to the dispute account.

Thiess therefore issued proceedings in England seeking KPC's compliance with the CDA's provisions in regard to security.

The arguments

KPC challenged jurisdiction given the arbitration in relation to the OAMS dispute. KPC contended

that the dispute in the English action falls within the wide definition of disputes to be resolved by arbitration.

Thiess submitted that the CDA was not only concerned with account administration and cash management arrangements as KPC contended; its function also includes the provision of security to contractors pending resolution of an arbitral dispute. Thiess' claim in the English action is concerned only with enforcing the CDA security. Thiess argued that if, as KPC contended, it was always necessary to investigate whether a sum claimed in a PCC is legally payable then nothing would ever end up in the dispute account pending a final arbitral award.

There is no overriding rule of policy, Thiess argued, which prevents parties to arbitration agreements from separately agreeing to refer to the court questions concerned with security pending arbitration. Indeed, sometimes this is desirable where there are multi-party transactions including banks which might not wish to become privy to lots of different arbitration clauses and arbitration references.

The judgment

Blair J, applied the principles settled recently by the Court of Appeal in Sebastian Holdings Inc v. Deutsche Bank AG [2011] 1 Lloyd's rep. 106: where there are multiple related agreements, the task of the court in determining whether a dispute falls within the jurisdiction clauses of one or more related agreements, depends on the intention of the parties as revealed by the agreements. This intention is to be considered against the general principles that just as parties to a single agreement do not intend, as rational businessmen that disputes under the same agreement be determined by different tribunals, parties to an arrangement between them set out in multiple related agreements do not generally intend a dispute to be litigated in two different tribunals.

Stating that "there is nothing unusual about submitting a contractual dispute to arbitration whilst referring matters relating to security to the jurisdiction of one or more courts.

This is frequently a feature of international transactions, and the choice of jurisdiction in the security agreement may have to do with factors independent of the principal agreement", he agreed with the approach taken in such circumstances by Andrew Ang J in the High Court of Singapore case of Transocean Offshore International Ventures Ltd v Burgundy Global Exploration Corp [2010] 2 SLR 821, namely that where different but related agreements contain overlapping and inconsistent dispute resolution clauses, the nature of the claim and the particular agreement out of which the

claim arises ought to be considered; where a claim arises out of or is more closely connected with one agreement than the other, the claim ought to be subject to the dispute resolution regime contained in the former agreement, even if the latter is, on a literal reading, wide enough to cover the claim.

Accordingly, he went on to hold that "Thiess's claim in the English action is a claim under the CDA concerned with a procedure whereby the sums in dispute are to be set aside until the dispute is determined. It raises a discrete claim, related to, but distinct from, the underlying dispute arising under the [OAMS] which is the subject of the arbitration. There is no reason why the parties cannot be taken to have intended that these claims are to be the subject of different jurisdiction clauses. [...] In my opinion, the parties have not agreed to refer to arbitration the issue in the English action, which issue arises under the CDA. As a matter of construction of the arbitration clause, the substance of the controversy does not arise under or in connection with the [OAMS]. [...] Disputes in connection with the CDA are submitted by the terms of the CDA to the jurisdiction of the English court, and only the English court can decide them. It is possible and commercially rational to do so, even though this may result in a degree of fragmentation in the resolution of the dispute."

Fiona Gillett is a partner at Stewarts Law LLP.

SEPTEMBER 2011

Tim Portwood, Peter Henein, Mark Friedman, John L. Oberdorfer, Brenda Hoorigan, Lee A. Rosengard and Marco Tulio Venegas

ROUNDTABLE: EFFECTIVE DISPUTE RESOLUTION

Disputes are a fact of corporate life. Conflicts emerge from a combination of factors, and when an international element is added to the mix, further challenges arise. Understanding disputes and developing a comprehensive resolution strategy is imperative. While disputes are often unavoidable, litigation is not, and companies can consider arbitration, mediation and other forms of dispute resolution as a viable option. They should also draft contract clauses from the outset that deal specifically with potential future conflict.

FW: Could you outline some of the current market challenges at the centre of commercial disputes? What recurring themes are you seeing?

Friedman: One of the continuing challenges for commercial parties is the expense and length of time required to resolve a dispute. In US courts, this challenge is amplified by broad discovery, extensive motion practice, the possibility of civil juries, and the general absence of fee shifting. Even in international arbitration, commercial parties express concern that the process is getting to be too long and costly, and may have lost some of its efficiency edge over court litigation. Fortunately, to some extent the courts, and to a greater extent arbitration practitioners, have attempted to respond to these concerns.

Henein: There has definitely been increased financial pressure on companies. I think the largest shift occurred when the recession hit in North America. At that point we saw more litigation; rather than the recession slowing things down, it sped things up. More companies started asserting

their rights, enforcing their contracts more aggressively and following the terms of their contracts by the letter. When the market is healthy, regardless of the sector, companies are more likely to provide indulgences and work with other parties to allow their relationships to continue. In such circumstances they may vary contracts or even ignore actual breaches of terms in order to resist applying those contracts in a draconian fashion.

Horrigan: Many of the disputes that we see, particularly in the CIS, CEE, and Greater China, arise out of failed joint venture projects. Often, the parties have entered into the project with different understandings and expectations, and the project documentation was either not fully understood by one of the parties, or failed to cover all of the promises and agreements made during the course of the negotiations. In other scenarios, particularly in ventures in newer economies, the commercial bargaining power of the parties has changed over time, leading one of the parties to seek to renegotiate or amend the project's terms either through discussions or unilateral action. With the volatility of natural resources prices over the last several years, we have also seen a number of disputes in the energy sector.

Venegas: The challenges we are facing in Mexico are the lack of liquidity to pay outstanding debts; problems in enforcement due to the lack of assets; and fraudulent strategies of debtors to hide assets. Due to these recurring obstacles we recommend clients follow preventive strategies, rather than try to resolve the problems once they arise. First, it is advisable to have in place good contracts supported, if possible, with enforceable guarantees. In general it is believed that a promissory note granted in Mexico would benefit the creditor, but this type of document simply does not translate into good strategy when the debtor is not in a good financial position.

Portwood: The key market challenge that we have been seeing in commercial disputes relates to enforcement. Claimants or potential claimants are focusing on their ability to make good any judgment or award that may be rendered in their favour with defendants facing financial difficulties. Apart from this it is difficult to say that we have been seeing any recurring themes. The financial environment has become so uncertain again that parties or potential parties to litigation often lack the foresight needed to be able to cast the sorts of solid litigation strategies that they would otherwise wish.

Oberdorfer: No matter what the market, we continue to see parties arriving at a dispute situation and then finding that they haven't provided an adequate dispute resolution procedure in their

contract documents because they did not consider it to be a business priority at the time. Poor or ambiguous contract drafting with respect to both the substantive obligations and the dispute resolution process multiplies issues between commercial parties, leading to increased uncertainty and greater expense associated with resolving them. These problems are only exacerbated by the economic and financial volatility of our times. Liquidity of one or more of the parties, particularly the ability to fund full and complete contract performance to the contract specifications, remains one of the recurring root causes of large commercial disputes.

Rosengard: After an economic downturn, such as the US experienced in 2008, and with the recent debt crises both in the US and the EU, litigators usually see an uptick in commercial disputes. Apart from bankruptcy filings, however, many commentators have noted that the expected increase in commercial litigation has not occurred. Tightening credit markets, substantial increases in accounts receivable, and the presence of bad debts may discourage companies from entering into high stakes litigation because that course often involves taking on great risk and expense. Companies are instead looking for better, more efficient ways to resolve disputes, such as engaging in mediation and arbitration as an alternative to in-court litigation.

FW: Time is a critical factor in any dispute. Is it important for companies to properly assess risks and liabilities as soon as a conflict surfaces? What key points need to be evaluated?

Henein: From the lawyer's perspective, the speed needed for the response and the specific tasks which need to be dealt with depend on the type of claim at issue. With a larger type of claim, such as a class action or sizeable commercial dispute, often there is immediate work needed in managing publicity and expressing a consistent message to customers, clients and the world at large. Other types of actions need a quicker substantive response in the context of the litigation itself. It is important that companies in those situations have a strong reporting structure and that officers, directors and employees are swiftly mobilised and understand the need to cooperate with the lawyers, such as providing information, documents, background and contacts that would not otherwise be evident from the company's records.

Horrigan: It is critical for companies to properly assess risks and liabilities as early in a dispute as possible. Companies must evaluate whether a valid and enforceable dispute resolution clause exists. Absent a valid arbitration clause or other ADR mechanism, the dispute may only be heard in the local courts, where there may be concerns about lack of impartiality, lack of experience

with international transactions, and inability to take any resulting award into other jurisdictions for enforcement. All of these factors may cause a company to be more open to settlement options than might otherwise be the case. Whether the counterparty has assets that can be identified and attached must also be assessed. If the counterparty is only an assetless shell, a company in dispute with that counterparty will need to evaluate whether pursuit of an action against that counterparty makes sense, or whether there are any grounds for pursuit of action against a parent or other party in interest that may hold assets. Finally, companies must examine any defences that may be available to the counterparty, and the strength of those defences.

Venegas: First, a complete investigation of the debtor must be carried out, including the state of its facilities – leased or owned; its commercial reputation; outstanding agreements with governmental agencies; ownership of other lines of businesses; and integration of its shareholdings. In addition, we also recommend holding, as soon possible, meetings with the debtor representatives and attorneys to evaluate their attitude regarding the dispute and their willingness to negotiate a possible solution. In this regard, the seriousness of their approach and the sophistication of their attorneys always provide a good hint in assessing the situation and designing a fitting strategy.

Portwood: Two matters must be identified and investigated at the outset. The first is the competent jurisdiction to hear the case and the law applicable to the dispute. The second is the identification of the key facts of the potential case and an assessment of the ability to gather the evidence necessary to be able to make out that case at trial. Once the key facts have been established, the legal theory of the case needs to be developed ensuring that it is consistent with the key facts that can be proved with convincing supporting evidence. Once these two steps have been accomplished, the existence of any need to protect the ability to take the case to the final hearing and to make any favourable judgment or award effective needs to be evaluated and if so the steps that should be taken to achieve that end. This will require an investigation into the vulnerability of any evidence or sources of evidence and what steps need to be taken to preserve that evidence and the risk that the potential defendant may become judgment proof.

Oberdorfer: Companies need to assess risk at the outset of a dispute, but they also need to do so at the negotiation and drafting stages. Continual assessment of the evolving risks and liabilities associated with a project is essential to effective contract management and dispute resolution. Doing so effectively, however, can be a challenge. When a dispute arises, crystallising the points of dispute between the parties is one of the first and most important steps. What are the exact issues

in dispute and what are the actual points of difference between the parties as to each of those issues? Other questions that must be assessed are where those points of difference fit within the rubric of the contractual obligations and allocations of risk, and what the larger issues at stake are. Answering these requires synergy and effective communication between a company's legal team, management and front-line people.

Rosengard: Speed commends a technique called early case assessment (ECA). The process involves identifying and marshalling the key facts that drive the dispute; the significant players in the organisation whose input is necessary to evaluate the claim; the company's business issues that impact on responding to the claim; the costs and risks of continuing with the dispute; and the options moving forward, whether they be taking steps to reach an early settlement or litigating the matter to conclusion. The goal is to see disputes in the context of the enterprise's overall business. One cannot identify the core strategies of ECA within the separate contexts of ADR and litigation, however. Rather, the decision to use ADR or, alternatively, resort to litigation, is the outcome of an ECA process. ECA brings structure to the case assessment analysis by informing decision makers of the options available to them at the earliest stages of the conflict.

Friedman: In general, it is very important to get a handle on a matter at the earliest possible opportunity. A company cannot make good decisions if it does not have good information; a corollary is that if it does not have good information it will often make poor decisions. I have seen a lot of instances where a company has at an early stage missed opportunities, fumbled away possible advantages, or committed itself to some categorical but ultimately untenable position because it has essentially shot first and asked questions later. Getting a handle on a matter typically requires identifying potential sources of information, learning critical facts, understanding the applicable legal framework, identifying and prioritising the various issues that arise, and defining the client's real objectives so that a strategy can be developed to achieve them.

FW: Although the nature of the process will change depending on the circumstances of each case, what are the main considerations for companies when gathering background information on a dispute?

Horrigan: The main considerations for companies when gathering background information on a dispute would include whether the company has previously made any admissions or assertions concerning the subject matter of the dispute; the anticipated amount in dispute in the action; and

whether there are any counterclaims that might be raised. Companies must also find out who the individuals are within the company – or external to the company, such as external financial advisers, companies providing reserve calculations for oil and gas companies, and the like – who are aware of or have information about the facts and circumstances of the dispute. They must also determine whether those individuals are willing to testify on the company's behalf, and if so whether they are likely to be good witnesses; whether the company has internal documentation which might be detrimental to its claim and that might be the subject of a disclosure order; and whether the claim is still within any relevant statute of limitation provisions.

Venegas: You have to divide the process depending on the nature of the information you should gather. Public information should, and can be, obtained without alerting the other party, if done properly. Therefore, we recommend being careful in obtaining it. However, in general terms, the nature and amount of public information on average is never enough to evaluate a potential dispute. Consequently, in order to obtain more sensitive information, the hiring of a private investigator may be advisable. In this regard, it is important to emphasise the fact that the private investigator must come from a reputable private agency which guarantees the legality of its methods, in order to avoid obtaining information which may not be used in an actual litigation.

Portwood: The sorts of matters that companies should consider are the recovery of all key documentary evidence; the identification of the individuals with direct knowledge of the facts; and the likelihood that they will be prepared to make a witness statement and give evidence at trial and their credibility as a witness. Companies should also consider the likelihood of obtaining evidence held by third parties to the dispute; the true identity of the defendant and its location; the risks that the defendant may take steps to become judgment proof; the competent jurisdiction to hear the dispute; and the nature of the procedural system applicable.

Oberdorfer: It is important for legal counsel to get involved as soon as possible to ensure proper scope and protections for the information collected. Depending on the governing law and where the dispute ultimately will be decided, a party's discovery obligations can vary and dictate the scope of information that at least must be identified and preserved, if not collected. For example, in the US, electronic discovery is wide-ranging and preservation obligations begin essentially the moment a party is aware there is a dispute. Again, depending on where the dispute arises and the law governing it, involving counsel early on can also help to protect the privileges and other protections that may cover the knowledge transfers, particularly interviews, in turn ensuring that the

company obtains candid and full information from those with the most knowledge of the facts.

Rosengard: Litigation is protracted, thus, over time, a litigator comes to understand the varying internal interests of the client's business units. ADR is different, and, by design, less protracted. This presents a challenge to the ADR practitioner, who must learn about the client and its business in a shorter time frame. This can require early consensus among all representatives of the client whose agreement is required to achieve a mediated result, for example. There can be internal cost allocation disputes, which can be difficult to resolve. Where the mediated result involves more than just money, the varying interests of the affected business units can be diverse. Counsel must therefore move quickly to discern what directions to take, and from whom, to develop an acceptable ADR strategy. Forging cooperation among managers within a client's different business units is essential in ADR.

Friedman: The main substantive consideration when gathering information is that the company gather the information that it requires to achieve its objectives. Sometimes this may be accomplished with a narrowly focused review of a small collection of documents and a few interviews; in other matters, extensive data collection from dozens or even hundreds of custodians may be required, along with scores of interviews, consultations with outside experts, and other steps. There are also many complicated and important procedural considerations: is the evidence gathered admissible? Is the evidence lawfully obtained? Are there data privacy or state secrets limitations on information gathering? What legal or ethical obligations does the lawyer have to ensure the thoroughness of a search for potentially relevant material? Could information gathering interfere with some other process like a criminal investigation led by prosecutors and therefore potentially risk an obstruction of justice charge? Getting the information you need often turns out to be a lot more complicated and time consuming than many people would expect.

Henein: To quote Douglas Adams, "don't panic". The company needs to be level headed. When focusing on gathering background, it is important that key decision makers concentrate on the merits of the case and avoid becoming emotional; the longer the relationship the more likely that there is bad blood between the parties which has festered, and which will infect how companies respond to the litigation. In concentrating on the merits parties should consider the type of claim, which will inform what issues that need to be addressed. For example, if it is a contractual dispute, obviously you want to ensure you have copies of the contract itself, as well as other key documents – which, perhaps surprisingly, is not always the case. With intellectual property disputes you want to

make sure that if you have registrations of that intellectual property, you collect them, that you make sure they are all current, and that you update or re-register those properties if necessary – before you start focusing on how to respond to the litigation itself.

FW: What is your advice to companies on implementing an effective dispute resolution strategy, taking in the pros and cons of in-court versus out-of-court methods?

Venegas: Everything depends on the nature of the companies' commercial activities. We would say that a simple commercial business should be handled through in-court litigation. In this regard, the main advantage of court litigation in Mexico is that no court fees need to be paid, since litigation in Mexico is free of governmental charges. In addition, the average time for a procedure is within the international standard of three to five years. Finally, there are some specific legal procedures before courts which allow the creditor to secure assets from the debtor from the beginning. The disadvantage of litigation is that if the other party implements a 'blocking strategy' a litigation may take up to 10 years and the litigation expenses may become too high by the end of the dispute. In connection with out-of-court methods, mediation is not often used in Mexico, but it has slowly started to gain reputation as a good resolution method mainly because of the saving in time and expenses associated with it. However, it will take time to build a new culture around it.

Portwood: The key advice is that in general an average settlement is better than a difficult, long and often expensive litigation. How that settlement may be achieved is of less importance provided that a strategy to achieve it is developed early on in the proceedings to ensure the benefit of avoiding the time, cost and energy of pursuing the litigation. This could be direct negotiation, mediation, conciliation or some other form of out-of-court dispute resolution method. It is important, however, to involve persons in the out-of-court resolution strategy who are independent of the dispute itself. Settlement is far more difficult to achieve when negotiations are run by those close to the dispute itself. An objective view of the strengths and weaknesses of the case and the benefits of an average settlement is essential.

Oberdorfer: An effective dispute resolution strategy starts during the contract negotiation and drafting stage. Contrary to popular belief, a dispute resolution provision should be a business term that is negotiated by the parties, not left to lawyers to plug in after the business terms have been agreed to. While many arbitral institutions now have optional rules for the provision of interim relief, parties must specifically consent to the use of those rules and, in the event of non-compliance, a

party may find itself in court anyway to enforce an arbitrator's award of interim relief. In the US, courts also have the added benefit of predictability, assessment based on precedent, and full discovery if you need it, such as when there is an imbalance between the parties with respect to information relevant to a dispute.

Rosengard: What ADR has to offer is well known. Parties who elect to resolve their disputes in arbitration, rather than in court, are able to proceed at their desired pace, and not that dictated by a judge; to ensure that the decision-maker has special expertise, where needed; to keep their dispute confidential as appropriate, and so on. Consideration of these advantages at contract formation time can ensure that, if a dispute arises between contracting parties, it is resolved quickly and efficiently so as to minimise disruption of business. Companies exist to do things other than litigate; disagreements are inevitable, however, and ADR offers a more informal and less adversarial means of dispute resolution that can allow businesses to continue to operate while their disagreements are worked out.

Friedman: An effective dispute resolution strategy recognises that different strategies might be appropriate for different cases. There is no one-size-fits-all approach. For some disputes, resolution in court may be preferable, while others are better suited for arbitration or mediation. For example, if a bank is seeking to enforce a standard commercial loan in its home jurisdiction, the best option may be to go to a local court. The law is likely to be straightforward, and enforcement is likely to be effective. However, if the same bank has invested proprietary assets in a project in another country, via a shareholder agreement with a party from a third country, international arbitration may be the best option as it may offer a more neutral forum and superior international enforceability compared to a court judgment.

Henein: A key question in many commercial disputes is whether to arbitrate privately or litigate publicly in the courts. There are certainly pros and cons to both. When negotiating contracts and entering into other relationships, that is usually an opportunity to consider whether you wish to arbitrate or leave issues to the public court system. Companies should consider the question of publicity, their ability to control the timing of the process, and the cost. While arbitration is not always cheaper in the long run, the initial costs are higher because parties are paying a decision maker to work on the case, whereas the court process usually involves filing court papers at minimal cost.

Horrigan: The most important element of an effective dispute resolution strategy is to ensure, at the transaction structuring and drafting stage, that the contract properly reflects the full understandings

of the parties, with no undocumented side arrangements that might change the parties' deal. In the event the parties wish to avoid local courts, the parties should include in the contract a valid and effective arbitration clause calling for arbitration in an arbitration-friendly jurisdiction. Also, the real parties in interest in the transaction – those with real assets – should be bound by its terms. If the contract is signed by a shell entity for tax or other reasons, it is nevertheless important to have access to suit against the real party in interest in the transaction through a guarantee or other mechanism – otherwise, the contract is nothing but a piece of paper that provides little real protection in the event of breach.

FW: Are there any dispute resolution approaches which seem to work more successfully when applied in specific industries or sectors?

Portwood: The short answer is no. In certain industries, there may be a custom to use certain specific types of dispute resolution approach – I am thinking here of commodity disputes particularly in London and construction disputes on account of the framework agreements typically used – but apart from this, litigation is driven more by the character of the parties than the particular industry or sector.

Oberdorfer: Dispute resolution boards (DRBs) and dispute adjudication boards (DABs) are two approaches that have obtained traction in the construction industry over the past several years. Both provide parties with a faster route to a decision while performance continues, thus avoiding delays to the project and saving money. DRBs are standing boards of impartial professionals that are formed at the beginning of a project to follow construction progress, encourage dispute avoidance and assist in resolution of disputes for the duration of the project. DRB members are tasked with staying informed about a project and its progress, visiting the site regularly and making themselves available on short notice to facilitate resolution of disputes as they arise. A DAB is a five-tiered process that removes the engineer from any decision-making role. In a DAB process, the parties refer their dispute to the DAB, again an impartial panel of professionals, which then provides a reasoned decision on the dispute, usually in less than three months after referral of the dispute.

Rosengard: The Financial Industry Regulatory Authority (FINRA) is the largest independent regulator for all securities firms doing business in the US. FINRA operates a dispute resolution forum for the securities industry in order to assist in the determination of monetary and business disputes between and among investors, securities firms and individual registered representatives.

FINRA's arbitration approach to customer disputes with brokerage firms is particularly successful. For customers, it provides an expedited process to resolve their disputes. It also provides customers with a forum to resolve their grievances without resort to the court system. FINRA arbitration gives securities firms and brokers a streamlined, cost-effective process that minimises costs while promoting fair and prompt decisions on the merits.

Friedman: In general, for international transactions, arbitration often tends to be a desirable option. A number of industries have adopted specific approaches to arbitration with great satisfaction. For example, international disputes over internet domain names can be resolved by a highly efficient arbitration procedure administered by the World Intellectual Property Organization. Securities, commodities, maritime and sports enterprises all benefit from special and often expedited arbitration procedures. Parties engaged in a long-term relationship, such as a large-scale construction project spanning several years, have had success with procedures that permit a quick interim presumptive resolution of disputes so that the project can continue without interruption, subject to a more robust process down the road when time is less critical. What characterises these examples is that by choosing a voluntary process like arbitration the parties, or an industry organisation, affords itself more flexibility than courts typically allow, and that can open the door to all kinds of innovation and adaptation.

Henein: Arbitrations and private dispute resolution processes are more common in pure contractual disputes. Class actions are, almost by definition, part of the public process; they are deliberately designed to include class members who are not themselves active litigants in the proceeding, and therefore class actions are always going to be brought in the public realm. Similarly, intellectual property disputes are often brought through the public court process because litigants are claiming rights to certain intellectual properties against the world at large.

Horrigan: Cross-border investment into newer economies is generally best served through arbitration, given the limited possibility of international enforcement of judicial awards and concerns about unequal treatment in a party's domestic courts. In construction matters, arbitration is often preceded by a determination by a DAB or similar body with specialised expertise.

Venegas: Particularly in infrastructure related disputes, arbitration has proven to be the best possible dispute resolution method in Mexico. Arbitration has also become a much sought-after resolution method for international commercial disputes in which the real intent of the parties and

facts of the case play a relevant role for understanding a dispute, since those aspects are not usually analysed in detail in litigation before courts. Disputes arising from complex franchise agreements have also been successfully resolved in arbitration.

FW: If a commercial dispute is unavoidable, how can alternative dispute resolution (ADR), such as mediation, help to steer companies away from costly and time consuming litigation?

Oberdorfer: Litigation is not always more costly and time-consuming than ADR options. In some instances, particularly where preservation of the status quo among the parties is essential or the parties can avail themselves of a 'rocket docket' such as the District Court for the Eastern District of Virginia, it can be the fastest and most economical choice. Recall, too, that as a general matter, filing fees in court are nominal, particularly when compared to filing fees for most arbitral bodies and arbitrator's fees, which are in addition to counsel's fees. Many US courts have magistrate judges who are very adept at mediating settlements. Most require the presence of principals at conferences and impress upon them the costs of continuing litigation versus a negotiated settlement. That said, there are many types of ADR which have merits.

Rosengard: As a non-binding, voluntary process in which the parties determine the outcome, mediation affords parties vastly more control and flexibility than litigation. At the outset of any dispute, key decision-makers work with counsel to identify their needs and goals in light of the known facts and law. In litigation, this assessment often leads to full-scale discovery and motion practice before trial commences or a settlement is reached. Mediation, in contrast, discourages a paper war in favour of direct communications between the parties concerning their needs and goals in an effort to achieve a mutually agreeable resolution. For instance, litigating a breach of a long-term supply contract would result in a monetary award – or not, depending upon the fact-finder's decision; in mediation, however, the parties might explore the component business functions underlying the alleged breach and renegotiate the contract to strengthen and improve the parties' business relationship.

Friedman: Mediation is a great idea in theory and makes sense where parties have the will to settle a dispute but are having difficulty communicating directly with each other. Having an impartial person assist the parties in such circumstances can pave the way for a successful resolution. However, where there is little interest in settling a dispute, mediation may only serve to prolong the process. In my experience, a surprisingly large number of clients have resisted mediation.

Mediation may be kind of like religion – there are some very devout believers in it, but also a considerable number of people who rely on it only very rarely, along with a healthy number of agnostics and sceptics.

Henein: ADR will depend on the type of dispute. Mediation can work quite well with a limited number of issues on the table that need to be addressed. It is truly a negotiation process; parties are not advocating their positions in the same adversarial manner as they would in court or even in arbitration, so you need to approach mediation with the expectation that both sides are going to have to compromise. I often hear lawyers say that a successful settlement is one in which neither side is happy with the result. The more complicated the matter and the more complex the legal issues, the more likely parties will need to look to a judicial officer to arbitrate or act as the decision maker.

Horrigan: If the parties are willing to agree to mediation, the services of a skilled mediator can significantly assist in the resolution of the dispute. Often each party's interpretation of the facts and circumstances of the dispute is coloured by emotion; a skilled mediator can recognise and legitimise these emotional reactions while refocusing the parties back on the underlying strengths and weaknesses of factual and legal claims at issue. Once each party is confronted with an external, neutral perspective on the strengths and weaknesses of its respective case, it may become more likely for the two sides to reach agreement on resolution of the dispute.

Venegas: The main advantage of potentially saving time and costs is one of the main factors favouring the growth of ADR. However, a change in the mindset of businessmen in Mexico must occur for mediation to really become a factor. The general distrust of new methods which do not result in an enforceable ruling permeates the business market in Mexico and is one of the greatest obstacles that must be overcome. Seminars and continuous practice, however, would provide an incentive in the long run to the role of mediation in Mexico.

Portwood: To be successful, these ADR methods need the involvement on each side of an independent objective view of the strengths, weaknesses and enforcement risks of the case by a person who has the authority to govern the strategy. Whilst this person could be a legal adviser, he or she will need to have the authority over all those involved in the matter to take the key decisions. Otherwise, the person should be someone from inside the litigant party who has the necessary authority over those involved to take key decisions.

FW: How would you describe arbitration facilities and processes in your particular region, or regions, of focus? Are there any obstacles or challenges to the arbitration process that companies should bear in mind?

Rosengard: Arbitrations have begun to morph into litigation-like processes, with protracted discovery and robust motion practice. The biggest challenge to the ADR community is to not let arbitration, which is supposed to be faster and more cost-effective than litigation, become its cumbersome and unwieldy surrogate. An effective arbitrator can limit discovery, where appropriate, and require parties to make pre-motion submissions designed to allow the arbitrator to make informed decisions on whether to accept a motion. But parties need not rely on an arbitrator to ensure that their arbitration does not become litigation-like; in the first instance, they can draft these limitations into their arbitration agreements. Parties can often reach agreement on future discovery and motion practice at the contract formation stage, while such agreement is almost never possible once a dispute has arisen.

Friedman: New York is an excellent place for arbitration, and I don't believe there are any significant challenges or obstacles to arbitrating here. While there is no dedicated arbitration facility headquartered in New York, such as the LCIA in London or the SIAC in Singapore, New York offers a lot of advantages to arbitrating parties. The law in New York regarding arbitration is relatively stable and predictable and favours arbitration. Logistically, New York has plentiful accommodation, ample transportation connections, great restaurants, and is so compact that it is easy to see part of the city even when in the midst of an arbitration. To the surprise of many, in part due to the persistently weak dollar, it is also comparatively cheaper than many other alternatives.

Henein: Ontario is well served. We have a plethora of arbitration and ADR facilities. The challenge with arbitration is that if parties fail to choose the right person they can end up being in a worse situation than if they had gone through court. For smaller companies, one caution is that arbitration may not work as well because if you are up against a larger company or person with more money, they can make the process much more expensive. While that is always true with all types of litigation, in the case of a private arbitration, the parties have more control over the process and so a litigant can push the litigation forward more aggressively, forcing the smaller company to respond quicker than through the ordinary court process. Even though the parties chose the arbitrator, the smaller party may find itself scrambling to keep up with the litigation, which can draw its energies away from managing its business effectively.

Horrigan: In mainland China, arbitrations between two Chinese entities – even if both are subsidiaries of foreign companies – must, with limited exceptions, be heard within mainland China before a Chinese arbitral institution. In practice, this means that the majority of such disputes are heard pursuant to the CIETAC Rules, although the Beijing Arbitration Commission (BAC) is becoming increasingly active. Disputes with a 'foreign element', i.e. those involving a foreign party or a subject matter that is located outside of mainland China, may be heard either before a Chinese institution within mainland China, or outside of mainland China before an institution or ad hoc. Hong Kong is considered 'foreign' for this purpose. As with arbitration under the rules of any institution, the most important element is the selection of the tribunal – if the parties choose an experienced, neutral arbitration panel, they are more likely to obtain an arbitral award that is comprehensible and seems fair.

Venegas: In Mexico arbitration facilities and processes are, on average, very good. Particularly after NAFTA the growth and success of arbitration has been outstanding and many domestic arbitral institutions have shared this success. Currently, however, there are challenges ahead since the increase in arbitration requires more sophistication not only in the domestic centres of arbitration, but also in the Mexican regulations and the attorneys of the parties. Knowledge of the basic notions and concepts of arbitration is no longer enough; updating the recent developments in the field and adapting them to the Mexican practice have become a priority. Companies, therefore, should be very careful in selecting their attorneys and the arbitration institutions they would like to use for their particular disputes in order to avoid potential complications.

Portwood: Western Europe poses few problems and obstacles to an effective arbitration process. The laws of the different jurisdictions are arbitration friendly – many being based on the UNCITRAL Model Law – and the courts have in general a favourable attitude to arbitration. In the Near and Middle East, great strides are being made to render arbitration far more effective than in the past, and the courts are becoming more and more ready to take measures to assist arbitrations. In sub-Saharan Africa, local interests continue to prevail such that it is often difficult to render arbitration effective.

Oberdorfer: Over the last several years, the Persian Gulf has seen the creation of several well-respected, evolving arbitral institutions. At the Dubai International Arbitration Centre, for example, the number of cases handled annually has more than tripled since 2007. The Qatar International Arbitration Center, was established in 2006 and as of spring 2010 had a case load of 125 arbitrations

and 60 mediations. In Abu Dhabi, the Abu Dhabi Commercial Conciliation and Arbitration Centre has been operating for over 17 years and last year it had a significant number of cases, a handful of which were international in nature. These arbitral bodies present a viable option for arbitrating disputes locally, which can be significant, particularly where key personnel are located on-site and parties wish to resolve disputes with as little impact as possible on ongoing work.

FW: In terms of complex international, multi-jurisdictional disputes, what steps can companies take to manage the process and its associated costs to improve their chances of a positive outcome?

Friedman: For complex international, multi-jurisdictional disputes, it is critically important to have a centrally coordinated strategy and an effective leader of the process. Such disputes often proceed concurrently in different jurisdictions involving different courts, tribunals, witnesses, facts and applicable law. If someone is not coordinating and ensuring consistency of message, strategy and position throughout, it is very easy to make mistakes and score 'own goals'. I recall many instances where a party has taken a position in one proceeding that came back to bite them in another.

Henein: The most important thing to do is communicate. Depending on the number of jurisdictions, you want to retain local counsel and coordinate with them. Counsel from different jurisdictions need to work together effectively. Litigation is more geographically specific than, for example, corporate law. So you need to be working with a professional who has understanding and expertise of the type of court or ADR process in that specific region. When you look at the US, there are differences between state courts, federal courts and also the procedures from state to state. The same is true of Canada.

Horrigan: In terms of multi-jurisdictional disputes, it is important to have one team leader who is coordinating all of the actions in all jurisdictions, to ensure that consistent positions are being taken and that a consistent strategy is being pursued.

Venegas: For us, it all starts with two key elements: first, evaluating the best chances for enforcement considering the financial status of the adversary and time and cost expenses related to a particular forum; and second, designing an overall legal strategy with specific targets and tasks. In addition, in order to be successful, the evaluation, design and implementation of these two elements must be carried out by an experienced and trusted in-house or outside counsel. In this regard, we

recommend avoiding the usual practice of some companies of entrusting these matters to high level officers who are not lawyers, since it has proven in the past that when facing a complex legal dispute the lack of a leading lawyer always results in a waste of time and costs, and in many cases it seriously affects the likelihood of success.

Portwood: It is important to place management of the dispute in the hands of someone in-house who was not involved in the underlying facts and who has authority over those who were. Outside counsel, who has experience in the relevant jurisdiction, should be appointed early on. A detailed timeline with a cost assessment for each step should be established by outside counsel with the assistance of the person in charge of the litigation in-house early on to guide the process. The legal theory that is consistent with the background facts that can be proven at trial needs to be established as soon as possible, recognising that such theory may have to be modified as new facts are established, to remain consistent with the factual matrix of the case. Any enforcement risks need to be identified and an analysis of the steps that can be taken to avoid them should be carried out.

Oberdorfer: Especially in the context of international disputes, positive outcomes are increased by attention to the dispute resolution process during the negotiation and drafting stages. In addition to anticipating and continuing to monitor likely points of disputes, parties should assess at the outset the best location for resolution of the dispute, particularly with respect to where key personnel will be located and what the judicial and arbitral infrastructure are in place to support resolution of a dispute. Location of an arbitration and that country's arbitration law are going to be particularly relevant to whether the parties' chosen dispute resolution process is going to be subject to interference from local courts and whether an award ultimately will be enforceable.

Rosengard: Cross-border disputes can bring many uncertainties, including questions about the language applicable to the dispute, governing law, and recognition and enforcement of awards, among others. Outside the US, individuals and companies may be wary of American-style litigation with its attendant discovery rights and the potential for massive damages awards. For Americans doing business in other countries, there is the possibility of an unwelcome political and economic climate in the forum, which can affect business relationships and which can add uncertainty to the dispute resolution process itself. Selecting arbitration as an alternative to local courts thus makes even more sense in the international context, as the parties can ensure that, when a dispute arises, it can be resolved efficiently and without recourse to unfamiliar judicial surroundings. For the same

reasons, mediation plays an important role in cross-border transactions, especially where a US entity faces the prospect of delay that often confronts litigants in foreign courts.

FW: Are you seeing an increased use of expert witnesses to resolve complex disputes? What benefits can they bring to the process and how is their knowledge being applied?

Henein: In product liability cases, for example, experts are always key in resolving the case and much will depend on the strength of their evidence, especially if it is a niche technical issue. In class actions, both sides often inundate the court with expert evidence. However, there are too many moving parts in those cases for liability questions to rise or fall purely on the strength of one particular expert report. In terms of intellectual property disputes, these cases often come down to factual or legal questions rather than technical expert evidence. If you have an intellectual property registration, for example, you have certain statutory rights to the exploitation of that intellectual property, and that is more of a legal question. With securities litigation or other general disputes, expert evidence frequently goes to valuation questions, which are certainly an important part of the case.

Horrigan: Nearly all of the international arbitration cases in which we have been involved have included testimony from expert witnesses. Most frequently used are damages experts, who evaluate the losses suffered or alleged to be suffered as a result of the actions by the counterparty, and who then calculate the monetary compensation to be awarded to compensate for those losses. Such experts are often looking at DCF calculations and risk factors to come up with the net present value of the loss. In many complex cases, technical experts can also play an important role; examples include evaluation of available reserves and costs of production in oil and gas cases, or evaluation of defect claims in construction disputes. Some tribunals also like to hear from legal experts where the governing law is not the law of the site of the arbitration; however, we are finding that this is becoming less common, and that counsel are increasingly arguing these points themselves.

Oberdorfer: I'm not sure I would characterise it as increased use, but I think we are seeing how effective use of expert witnesses can facilitate resolution of complex commercial disputes, including in a mediation setting. A good expert has the ability to identify and crystallise – both for the parties and a mediator or adjudicator – points of agreement and points of difference as to what went wrong. Even when the parties are not listening to each other, they are usually able to listen to what a credible, well-respected expert has to say. Professional experts also have the benefit of being able

to provide bigger picture insights into the problems that are driving disputes within their industry, such as recurrent problems of contract administration failures or funding issues in the construction industry.

Venegas: The use of expert witnesses has become increasingly important. However, the level of success of these experts varies depending on their role. When used as experts in arbitration and litigation tutored by experienced lawyers, we have seen great benefits and positive results. In complex construction, IP, mining and even production agreements, the synergies obtained from complementing the legal arguments with technical opinions has proven to be the key for success. Notwithstanding the above, it is always important to limit the role of the expert witnesses and prevent them from overstepping the terms of their opinion and giving 'legal opinions'. Unfortunately, when experts channel their 'inner lawyers' in a dispute, we have seen dramatic failures which affect the credibility of a highly technical opinion.

Portwood: I am not aware of an increase in the use of expert witnesses other than in the area of quantum analysis where there is a trend towards the use of experts to help establish or attack the damages aspect of the case. If the services of a quantum expert are to be used, it is important to involve him or her early on in the process. All too often litigants leave the damages aspects of the case to the last minute only to find that their analysis of the case is inconsistent with their ability to prove their loss. The benefits of a quantum analyst can therefore be significant.

Rosengard: We see two growth areas when it comes to experts. First, parties are using experts more in complex commercial arbitrations, as arbitrators, more than juries, are familiar with this convention and are well-equipped to process and weigh information from expert sources. In appropriate cases, expert testimony can provide a shorthand for lengthy technical testimony, offering concise references to the necessary underlying facts and drawing targeted conclusions for the decision-maker's consideration. Second, judges are increasingly calling upon law firms' intellectual property lawyers to serve as special masters to assist the court in understanding complex processes where the competing parties before the court each have their own experts. The use of a 'neutral expert' helps judges digest opposing, often highly technical submissions, particularly in high-stakes cases where the judge is the finder of fact.

Friedman: The use of expert witnesses has been widespread for quite some time and continues to be vitally important to the resolution of complex disputes. Expert witnesses are often essential for a

variety of reasons, from the quantification of damages to explaining the standard of care operative in a particular context to the explication of foreign law that may be applicable. In the international arbitration field, there is the possibility for some greater flexibility about how experts contribute to resolving the dispute. For example, there are some avid proponents of expert witness conferencing, in which expert witnesses for opposing parties take the stand together and present evidence before the arbitral tribunal together. The idea is that professional colleagues, although engaged by opposing parties, will tend to temper unnecessary disagreement and act more responsibly when sitting side by side and reflecting on the reputational costs of taking absurd positions.

FW: Would you suggest that companies introduce dispute resolution mechanisms in contract clauses to reduce the impact of conflict that may arise in the future? What risk protection solutions might they consider when negotiating a new venture or deal?

Portwood: It is difficult to answer this question in the hypothetical. Each case depends on the identities of the parties, the jurisdictions in question, and so on. My advice is to keep dispute resolution clauses in contracts as simple as possible. Two tier clauses requiring parties to embark on ADR before they can begin a final and binding dispute resolution procedure such as arbitration or court litigation often are ineffective and can create more problems than they solve.

Henein: Companies should introduce dispute resolution mechanisms in contract clauses to reduce the impact of conflict on the operation of the company. Consider what you need. When you are dealing with multijurisdictional issues you want to consider what law should apply, whether one area of law should apply across the board to all disputes, or whether certain aspects should be dealt with in certain specific legal arenas or jurisdictions. You want to consider what needs to be public versus what needs to be private and so you should turn your mind to carve outs: are there things that you want to address specifically in the clause, do you want to address everything or limit certain aspects?

Friedman: Parties negotiating a deal can make all kinds of choices up front about the dispute resolution process they want to have. At the outset, the parties to some degree stand behind what the philosopher John Rawls called the "veil of ignorance", where they do not yet know about a particular dispute and how it might affect their interests. It is the optimal time to work out a dispute resolution process, before the existence of a dispute makes it less likely that the parties will agree and more likely that they will take positions opportunistically that suit them in the context of a particular dispute.

Rosengard: As a general matter, companies should include dispute resolution clauses in their contracts, with particular consideration given to stepped-up clauses. Stepped-up clauses offer parties an escalating set of dispute processes – for example, negotiation; then mediation; then arbitration or litigation – providing more opportunities to resolve conflicts earlier. Courts and arbitrators alike routinely enforce such conditions precedent because they are terms of the contract. When drafting a dispute resolution clause, the parties should state clearly their agreement to binding alternative dispute resolution, identify which disputes may require fast-track resolution, avoid being one-sided, and include as many details as possible, including locale, means of selecting the arbitrator, which rules are to apply, and the like. The contract formation stage is the best opportunity for parties to identify the type and scope of disputes that will be subject to the nominated ADR processes, as this is a frequent source of contention once a controversy arises.

Horrigan: Most complex cross-border transactions would benefit from inclusion of an arbitration clause in the transaction documents, since in such cases it is generally preferable to avoid local courts. In addition, at the transaction structuring stage the parties should ensure that a real party in interest is bound by the clause, and not just a shell entity. With the substantial increase in investment treaty cases in recent years, it is often also useful for an aspiring investor to structure the investment to take advantage of available investment treaty protections – which may entail making the investment through a holding company established in a country that has a favourable treaty with the country in which the target is located. Even more important than ensuring that the transaction documentation includes a dispute resolution clause, however, is ensuring that the transaction itself makes sense and that the parties have taken into account and planned for commercial risks.

Oberdorfer: Being realistic about the risks associated with a new venture or deal and thoughtful about the likely points of disputes go a long way to diminishing the ultimate impact of a dispute. Particularly in a long-term contract or complex, time-sensitive project, parties should consider specifying a dispute resolution process just for those issues that they know are going to arise from time to time. For example, if materials that are going to be required in a contract have a history of wide fluctuations in price, the parties might consider a price-escalation/de-escalation scale that resets the price according to an agreed-upon index. Parties should be cautious about using a gross inequities clause to protect against market changes. For large projects, particularly those in developing countries, political risk insurance from MIGA or OPIC can provide access to dispute resolution services that accompany such policies.

Venegas: We suggest including clauses containing at least two dispute resolution mechanisms and a term to negotiate any dispute beforehand. When the parties have the opportunity to talk and evaluate the time and costs related to a dispute, we have seen that in many cases a settlement has been reached, or at least many of the disputes have been resolved leaving only the more complex for litigation or arbitration. In connection with the risk protection solutions, in addition to the dispute resolution clauses, an exhaustive preventive due diligence should always be carried out. In addition, when it is feasible, obtaining a real estate guarantee to secure payment is the best way to protect a business deal. Finally, including in the agreement a right to 'monitor' the financial status of the debtor is always a good way to continuously evaluate the risk of a venture.

DECEMBER 2011

Rob Lambert, Richard Chalk, David Saunders, Dylan McKimmie and Silvanne Helle

FORUM: DEVELOPING A COMPREHENSIVE DISPUTE RESOLUTION STRATEGY

FW moderates a discussion on developing a comprehensive dispute resolution strategy between Rob Lambert at Clifford Chance LLP, Richard Chalk at Freshfields Bruckhaus Deringer, David Saunders at Navigant, Dylan McKimmie at Norton Rose Australia and Silvanne Helle at Oppenhoff & Partner.

FW: When a commercial dispute surfaces, there is no one-size-fits-all approach to resolving it. In determining the best course of action, how important is it to obtain an objective view of the strengths and weaknesses of the case?

Chalk: An objective view of the merits of the case is part of the job of a lawyer, and it is important to maintain your view, even though different players who are more personally or emotionally involved in the dispute may seek to persuade you to accept their more subjective points of view. That said, it is clear that we have moved beyond the days when a dispute resolution lawyer could afford to focus only on the merits of the dispute. The merits are only one factor in the mix, and the key role of a disputes lawyer is to work towards an appropriate resolution of the dispute. At times this may mean, for example, offering or accepting a settlement proposal because it offers a more expeditious resolution of the dispute, or because the parties wish to maintain their underlying long-term business relationship, even if such a settlement is not entirely in line with the strengths and weaknesses of the particular case.

Lambert: The rigorous pursuit of a well thought-out strategy is usually a prerequisite to a successful outcome. The first step will be to ascertain the client's commercial objectives and to develop a

strategy for achieving them as soon as possible. Forming a dispassionate view of the strengths and weaknesses of the case is a key element in that process. It may not always be possible to perform a full assessment straight away because all the facts may not be available or there may be urgent deadlines that preclude it. In those circumstances, the lawyer's professional judgment in determining the best way forward is at a premium.

Saunders: It is important to obtain an objective view both in regard to the legal issues within a case, but also on the quantification of damages. Often there is little point in pursuing a commercial dispute if there is no chance of any monetary damages being awarded at the end of the day. From the damages perspective it is also very important to get an early indication of the strengths and weaknesses of the arguments. This can assist with assessing the position in regard to settlement offers and negotiations as well as assisting the legal team in framing the overall strategy for the dispute. Often damages experts are brought in at the last moment and can find that the way a case is pleaded is not the best from a damages point of view, and also that the figures claimed are not supportable from an independent point of view.

McKimmie: Undertaking a robust objective assessment of the merits of the case is fundamental to developing a strategic approach to the dispute, and to setting realistic commercial goals for the outcome of the dispute. Disputes can be expensive and can cause significant damage to your reputation. Failing to appreciate that you are not in a strong position may mean you miss out on the chance to sensibly and quietly retreat from the dispute at an early stage.

Helle: German court proceedings require that a complaint is reasonably founded – schlüssig – otherwise the court may dismiss the complaint solely for that reason. Further, if one's own position is rather difficult, it could be of advantage to seek a pre-court or extrajudicial solution. A settlement or mediation may avoid long and cost intensive proceedings with an uncertain outcome. Each party should thus carefully consider its chances of success before deciding on the best course of action.

FW: Under what circumstances is it desirable to seek an out-of-court settlement? Should this be the first option to consider in most cases?

Lambert: The possibility of a settlement should be kept under regular review, as there are risks and uncertainties for both sides in any contentious legal proceedings. Some clients will consider making a 'nuisance payment' to the other side even if they have a strong case, because they want

to kill off the dispute quickly and to avoid the time and costs of contested legal proceedings. Conversely, there are instances where a client will be determined to proceed with litigation as a pressure tactic; in those cases, settlement may be the ultimate objective but it is a long-term rather than a short-term goal.

Saunders: Out of court settlements are desirable when there is a high level of agreement between parties and the monetary value of any disagreements between the two sides is small relative to the potential costs relating to the court or arbitration. Settlements can mean large cost savings, as the time in court, and all related costs, can be avoided. A 'prevailing party' clause, which awards the winning party the cost of their legal fees, encourages out of court settlements with both parties keen to avoid the risk of incurring the other side's legal costs.

McKimmie: In almost every commercial case the prospect of settling the dispute at an early stage, before formal arbitration or court proceedings have commenced, is something that should be seriously considered. It is one of the options that should be discussed when you are assessing the strategy for the dispute. There are some circumstances, such as the need to make a public statement, that might dictate pushing on with a dispute into formal proceedings but those circumstances are not common.

Helle: This depends on the circumstances of the case. If a party's position is very good or a party is not willing to accept a settlement, the first option for this party could be to initiate legal proceedings. The same applies where a party actually needs a binding judgement for political or strategic reasons, for example as a precedent. If the position of a party is rather poor, the first option could be to seek a settlement. In principle, parties will have to consider their chances of success and determine the cost risk resulting from court proceedings. Based on this, parties will generally decide whether or not a settlement is reasonable. In most cases an attempt at reaching an amicable settlement will be a viable option since in the fewest cases the chances of success for one party will – from an objective point of view – be totally clear.

Chalk: In many cases, disputes are best resolved privately and by agreement. In particular, in recent years, there has been increasing pressure for parties to avoid formal litigation proceedings, and to settle their disputes amicably if possible. Part of this is a result of the current economic uncertainty, but it is also driven by the increasing complexity, costs and delays experienced in litigation today and indeed by the requirement now in some jurisdictions that parties should try and mediate their

dispute first. As legal advisers, our role should always be to resolve disputes quickly and effectively, with as little disruption to our clients' businesses as possible and hopefully on terms which are commercially attractive.

FW: When negotiating a settlement for cross-border commercial disputes, how important is it to recognise the negotiation style and cultural aspects of the party on the other side?

McKimmie: International disputes almost invariably involve a clash of cultures. Sometimes, that clash is what is actually driving the dispute. For example, Australian and Chinese businesses typically adopt different approaches to the written contract. For many Chinese businesses, the contract is but a part of the overall commercial relationship, and the relationship itself is seen as the critical aspect. Australian businesses tend to focus on the black and white rights and obligations that arise under the contract. Understanding these differing cultural considerations and differences in negotiation style will help resolve the dispute at an earlier stage.

Helle: Negotiation styles and cultural aspects of the other party should be considered in all types of negotiations, irrespective of whether or not it is a cross-border dispute. Of course such aspects can potentially be of more relevance in cross-border disputes since the culture and style of the other party can be very different from one's own culture. Also, you will obviously want to make sure to avoid involuntarily giving offence out of ignorance of the other party's culture. Apart from this, it is not possible to state a general rule, since the impact of cultural aspects on negotiations depends very much on the individual circumstances of the case and the people involved.

Chalk: A successful negotiation often requires an appreciation of the negotiation style and cultural background of the party on the other side. Negotiators may be 'soft', focusing on agreements and cultivating relationships, and looking to avoid a contest of wills, or 'hard', focusing on victory and viewing participants as adversaries, with a greater likelihood to use threats and pressure. They also may 'negotiate on the merits', being open to reason and yielding to principles and not pressure.

Lambert: Differences in culture and negotiation styles may hinder the ability of negotiating parties to reach a consensus. For example, conduct which may be viewed by one party as being firm could be viewed by the other party as being obstinate or overly aggressive. Likewise, a friendly and open negotiating style could be misinterpreted as a demonstration of weakness. It is therefore part of the skill of a good negotiator to understand the negotiation styles and cultural behaviour of the

other party. Self-awareness is also important to minimise the chances of miscommunication and to increase the chances of securing a satisfactory compromise.

FW: Could you explain in general terms the elements required for a mediation process to be successful? Are there times when this form of ADR is not even worth attempting?

Saunders: From an expert point of view it is important that the parties arrive at a mediation having had their damages claim assessed by an independent expert. If a party believes that their damages are £40m, having had them prepared by someone internal to the company, then it is unlikely that mediation would be successful if the other party is offering £10m. However, if an independent analysis of the damages claim was undertaken and showed that the damages were closer to £20m then there would be more chance of success. It is often worth having your damages expert with you at the mediation so they can explain the details of the calculations to the mediator in more detail.

Helle: In principle the success of mediation proceedings depends – as in all disputes – on the specifics of the case and the willingness of the parties to settle the case by mediation. Parties can and should however give special attention to the selection of the mediator. A very experienced mediator could, for example, increase the chances for a positive outcome of the mediation. The same applies to the familiarity of the mediator with the field of business in which the dispute has arisen; the parties' might perceive such a mediator as more competent. In some cases it is recommended parties agree on a specific 'conflict team'. Such teams can be an advantage in long term business relationships or projects in which parties do not want to compromise the relationship or delay the project.

Chalk: As a starting point, both parties must have a genuine interest in settlement, and a willingness to act in good faith. In addition, positive attitudes, realistic expectations and an understanding of the process are all important. The effectiveness of the mediation process itself can be enhanced by choosing an appropriate location, date and length of the mediation, appointing a mediator with the necessary skill set and characteristics, and preparing thoroughly and knowing your bottom line. Unsuccessful mediations usually result from inter-party antipathy or animosity, using the process merely as a delaying tactic or simply to get a better idea of what the other party thinks about the strength of its case, and where there is a disparity between bargaining positions as a result of differences in wealth and resources.

Lambert: Unlike an arbitrator, a mediator does not have the power to impose an outcome on the parties. The mediation process can therefore only be 'successful' if the parties agree to a compromise. This requires the parties to be flexible and to enter into the mediation with an open mind. The personality and skill of the mediator will, however, be an influential factor in the success or failure of the mediation process. Despite the propaganda, mediation and ADR are not a universal panacea in all cases. There are a good number of cases where it may not be worthwhile attempting mediation, for example where a party has unequivocally expressed its refusal to settle.

McKimmie: I am a firm believer in the benefits of mediation. It is a formal process that provides a structure around which the parties can come together in a semi-adversarial environment and try to thrash out a resolution to their dispute. To be successful, mediation must have an experienced and well trained mediator who is knowledgeable about the underlying commercial drivers as well as the legal issues in play. Hosting the mediation at an independent venue also assists, as does ensuring the parties are not limited by time. Rarely is mediation not worth attempting, as even the most intractable disputes can be resolved by the process.

FW: Arbitration seems to be growing in popularity as a means of resolving commercial disputes, particularly on an international, cross-border scale. Could you provide some insight into why this is the case? In general, is it becoming easier to enforce court judgments or arbitration awards within different jurisdictions?

Helle: Generally speaking, foreign court judgements are being enforced in Germany if a respective bilateral or multilateral treaty on the recognition and enforcement of such judgements is in place. This is obviously the case within the EU but not, for example, as regards the US. Otherwise foreign judgements are enforced in Germany if reciprocity is established, that is, if the judgment state is known to also enforce German judgments. Consequently, there might be foreign judgments whose future enforceability is at least questionable. In particular – but not only – in these cases you may wish to go for arbitration because the New York Convention 1958 provides an international treaty on the recognition and enforcement of foreign arbitration awards to which more than 140 states are a party.

Chalk: From an international, cross-border perspective, arbitration offers various advantages. It is often thought that the primary benefit of arbitration is the international enforceability of the resulting award – something that is not readily available with court judgments. The ability to choose

the tribunal and the arbitration procedure are also often useful, given the different background of parties to the dispute. Appeals or other recourse to national courts by a losing party are also relatively limited, and may also be excluded or restricted, either by law or by prior agreement between the parties.

Lambert: Arbitration is now arguably the predominant means of resolving cross-border disputes. Parties are likely to be very wary of throwing themselves upon the mercy of the courts of the country in which their counterparty is situated. They will prefer disputes to be referred to an independent arbitral tribunal, often seated in a neutral third country. The relative ease of enforcing arbitral awards internationally is certainly a factor in the increasing popularity of international arbitration as a means of resolving disputes. The New York Convention provides a mechanism for the international recognition and enforcement of arbitral awards which – in terms of geographical scope – has no equivalent in terms of the international enforcement of court judgments. Also, national courts are, in general, increasingly adopting a supportive and arbitration-friendly approach to international arbitration. The international business community can have a high degree of confidence that arbitral awards will be upheld and enforced around the world.

McKimmie: Put simply, there is no other reliable way of resolving cross-border disputes than by international arbitration. However, some countries are more difficult than others when enforcing arbitral awards and parties must take special care when contracting if there is any risk an arbitration award will be difficult to enforce. India and China are two New York Convention jurisdictions that spring to mind as having their own issues when it comes to enforcing international arbitration awards.

Saunders: It has become commonplace to see clauses in contracts that commit the parties to resolving their differences by arbitration under a specified country's law. Arbitration rulings are also becoming easier to enforce under the 1958 New York Convention, now signed by more than 150 countries. The scale of globalisation means that cross-border disputes are becoming more and more prevalent. Arbitration offers a binding outcome to disputes that can be held in a neutral venue, and be overseen by experts in what can be very complex fields.

FW: What are the pros and cons of taking a dispute all the way to formal litigation?

Chalk: One of the key advantages of taking a dispute to formal litigation is that the resulting decision is final and binding on all the parties – unless, of course, there is a right of appeal. This

helps to provide finality to the process, although if your counterparty refuses to comply with the court judgment, then it may also be necessary to commence enforcement proceedings. Other advantages of formal litigation include the fact that the procedural rules which govern the process are relatively well settled in many jurisdictions; the courts, especially those in mature jurisdictions, will often have considerable experience with many ordinary commercial disputes; and the fact that in many jurisdictions, previous court judgments are readily and publically available, allowing parties the opportunity to understand how the courts have decided on previous occasions.

Lambert: This issue depends on what success looks like for the client. Is it to win and to win well? Or to limit the damage? Will the judgment or award be capable of enforcement? What are the longer term implications of success or failure for the client's business, or its relationship with the opposing party?

McKimmie: The obvious advantage of formal litigation is you get a structure for the resolution of the dispute. The dispute is actually being resolved, rather than being stuck in endless rounds of negotiations. This is particularly so when your counterparty is avoiding the issue or refuses to negotiate in good faith. There are, however, many disadvantages including cost, reputational damage and the risk that the outcome might not go your way. A negotiated resolution is almost always a safer way to approach the resolution of a commercial dispute.

Helle: As regards the pros of a formal litigation by means of regular court proceedings, in comparison to pre-litigation amicable settlements, it must be noted that, in principle, out-of-court settlements are not enforceable. In contrast court decisions or arbitration awards are usually enforceable for the prevailing party. Impending legislation will clarify that the same applies in respect of settlements reached in mediation. Especially in cases where the payment morals of one party are questionable, it is recommended that you obtain a formal title as soon as possible to be able to enforce the claims if necessary. Compared to arbitration proceedings, court proceedings usually have the advantage of being cheaper, at least with regard to first instance proceedings.

FW: Do the procedures for gathering evidence for a dispute differ between jurisdictions? If so, what problems and challenges does this create, and what strategies can be used to overcome them?

Lambert: The process of gathering evidence for the purpose of litigation or arbitration proceedings

can vary from case to case and from country to country. However, the real differences lie in the manner in which evidence is deployed in the proceedings themselves. Each jurisdiction will have its own rules and procedures regarding the admissibility of evidence and its presentation in legal proceedings. In many common law jurisdictions, for example, the national courts operate a system requiring the production of documents through a process of disclosure or 'discovery', whereas the concept of discovery is alien to many civil law jurisdictions. Also, many common law jurisdictions adopt an adversarial approach to trial hearings, whereas civil law jurisdictions typically adopt an inquisitorial approach. These differences in procedures and ideology are thrown into the melting pot in international arbitration proceedings, where it is not unusual to have parties, legal advisers and tribunal members all from different countries and legal traditions. Skilled practitioners in international arbitration will adapt their approach to take account of those differences in order to achieve the best outcome for their clients.

Saunders: Evidence is always going to take the same form: people and documents – most of which is electronic nowadays, irrespective of where it may reside. However, how you are able to gather, interrogate and present, will differ from jurisdiction to jurisdiction. Factors for all types of evidence include: the purposes for which it is being obtained; where the evidence is and where the dispute is being held; how it will be obtained – whether consent is obtained, and if it is targeted; and conflicting legislation – for instance privacy, data protection, and blocking statutes.

McKimmie: Fundamentally there are only three things to consider when gathering evidence. First, what did people see, hear, say, and do. This is your lay witness evidence and the process is the same the world over – sit down with your witness and take a statement from them. Second, what does an expert say about the issues in dispute. Again, this process is basically the same the world over, although each jurisdiction will impose its own formalities to ensure the independence of the expert's evidence. Third, what documents are relevant to the dispute? Once again, the process for identifying and gathering documents is the same in every jurisdiction. Increasingly, we are seeing the use of technological solutions to search for and gather up potentially relevant documents. You can be sitting with your client in Paris while your technology person in Perth is remotely accessing the client's servers and searching for documents. Technology is a wonderful thing.

Helle: There is a big difference between gathering evidence in Germany and gathering evidence in common law countries such as England and the US. The concept of pre-trial discovery or disclosure is alien to German law and, even in the further course of the proceedings, a party's chances of

obtaining documents from the opponent are very limited. This is due to the fact that German law does not allow for so-called exploratory offers of evidence, or Ausforschungsbeweis, which involves the attempts of one party to obtain knowledge of certain details or information relevant to their case by offering evidence in order to prove allegations for which there is no factual basis otherwise.

Chalk: The location of documents and witnesses in foreign jurisdictions can present a range of legal and practical obstacles. Multinational companies often face competing, sometimes even contradictory, disclosure requirements and restrictions. For example, discovery in the US might, and often does, call for broad disclosure of documents by companies headquartered in foreign jurisdictions, but this may conflict with European blocking statutes specifically intended to curb the reach of the US courts. To ensure that the evidence-gathering process is a smooth one, parties should make use of locally-qualified, multi-lingual lawyers on the ground, who understand disclosure, data protection and privilege issues within a particular jurisdiction, and when and how judicial assistance is available and appropriate.

FW: To what extent should a dispute resolution strategy begin from the outset, when a commercial agreement is being drafted? Do parties pay enough attention to negotiating the finer points of such clauses in their contracts?

Saunders: In the disputes that we have been involved in there has been a wide range of standards of clauses within contracts that affect damages. Some contracts have very tight restrictions on damages that could be claimable, whereas others do not and allow a claimant much more leeway in putting together their damages claim. Obviously specific thought needs to be paid to liquidated damages clauses in contracts, ensuring that there is documentary evidence showing the nature of the calculations and assessments that have been made in arriving at the liquidated damages amount.

McKimmie: Parties generally do not pay enough attention to the drafting of their dispute resolution clauses, which is why dispute resolution lawyers are often so busy. It is astonishing how infrequently parties think about their exit strategy if the transaction turns sour. Sensibly resolving an international dispute is, in many instances, only possible if the contractual framework for the resolution of the dispute has been properly thought through well in advance of the actual dispute arising. Some jurisdictions in particular require very careful attention to the drafting of the dispute resolution clause, with India being one such jurisdiction.

Helle: When negotiating a commercial contract, parties should discuss whether they want to bring a possible dispute to a regular court or whether they prefer alternative dispute resolutions, for example arbitration or mediation procedures. Alternative dispute resolutions are only possible if parties have expressly agreed upon them. In this case, all details, conditions and circumstances of the arbitration or mediation proceedings should already be stipulated in the respective contract to avoid any later disputes about formal and procedural issues. Besides the general decision between 'regular' court proceedings and arbitration proceedings, parties should decide on the applicable law as well as the place of jurisdiction.

Chalk: It is important that a dispute resolution strategy is formulated from the outset, and increasingly, companies are realising the importance of this. The dispute resolution clause is as important as any provision in the main agreement, and it represents an opportunity to reach the best possible overall deal through informed negotiating. In complex transactions, the dispute resolution strategy can also have an important impact on how the transaction should be structured. The drafting process can be complex and should consider a number of factors, including where assets are located, the perceived need for interim remedies, and confidentiality issues. Regrettably, one still encounters cases where dispute resolution clauses are left to the tail end of the transaction negotiation process.

Lambert: A contract is only as good as the disputes clause. If mistakes are made in drafting the disputes clause, a party may be left with no effective remedy in the event of a breach. Sophisticated clients devote considerable attention to the dispute resolution provisions in their commercial arrangements, particularly in complex transactions where difficulties are foreseen in enforcing any judgment or award in the jurisdictions where the counterparty has assets. Where parties are making substantial investments in emerging markets, there is a discernible trend of clients engaging in careful 'BIT planning' when they draft their contracts. This involves structuring the transactions in such a way as to take advantage of applicable Bilateral Investment Treaties (BITs) that may offer protection to the foreign investor where there is wrongful interference in the investment by the host state. Typically, those BITs allow for such disputes to be determined by international arbitration.

DECEMBER 2011

Christian Knutson

PROACTIVE MANAGEMENT OF DISPUTE FACTORS CAN HELP TO MINIMISE POTENTIAL IMPACTS

The strategy of most companies rightly focuses on what they believe to be their competitive advantage, whether it is their ability to meet customers' needs, innovate, or achieve operational excellence. Given the aspirational necessity of such strategies, it is unlikely that many organisations proactively focus on how to deal effectively with potential disputes or how to avoid them altogether. It is more likely that disputes are considered simply an unfortunate derivative of doing business. With effective planning, monitoring, and management strategies, however, this need not be the case.

Dispute avoidance

The best method to deal with a dispute is to avoid it altogether. This may sound like an obvious statement, but in practice this strategy is rarely given the attention it deserves.

Most commercial disputes hinge broadly on two main areas of grievance: (i) an alleged breach of a contractual obligation; and/or (ii) a disagreement over the price to be paid for the goods or services provided. When discussing best practice in dispute avoidance, we need to address potential weaknesses in both areas.

In our experience, the key to addressing point one is for the company to develop a clear strategy to understand and assess the scope of the contracts it enters into, such as what it is obligated to do and by when as well as the responsibility of third parties, such as subcontractors or information

providers, in the process. To address point two, a proactive approach to managing the performance of the contract is imperative.

The best dispute avoidance strategies are incorporated into each commercial step, from the initial business case and resulting due diligence, to the negotiation and documentation of the transaction, to the contract performance and completion.

Due diligence, contract scope, and documentation

When buying a new company, investing in a new product, or entering a new geography, most companies perform a significant amount of due diligence to ensure that all avoidable risks are identified and mitigated. Unfortunately, this robust level of review and analysis is rarely done when entering into a new contract, even though the cost of litigation can be very expensive from both a monetary and reputational point of view. It is therefore important that a company include a detailed section on dispute risk and any necessary mitigation steps when undertaking transactional due diligence.

Once the transaction has been approved, more often than not those negotiating and documenting a transaction/contract are not those involved in its actual performance. This segregation of duties often results in the unintentional breakdown in communication between those departments – resulting in a dispute in the future. As a best practice, an organisation should focus on overcoming or climbing this unintended 'Chinese wall'.

Dispute avoidance requires a clear and conscious effort to document the scope of the transaction from negotiation through to signing. It is here that the intentions of the parties are initially set out. Having terms clearly documented and available can be an excellent reference when discussing a potential issue in the future.

There is no better example of the need to adopt this strategy than large construction projects, where key clauses and their respective remedies can dramatically impact the timing and price of the final project. It is prudent for construction project stakeholders to commission a contract review to ensure that all parties have a clear understanding of contract terms and conditions prior to starting actual field work.

In many cases, the day a contract is signed is the last time it is looked at – until a potential dispute

arises. A contract summary with key performance obligations and required timeframes should be available to those in the company tasked with managing its delivery. Any subcontractors or other third parties involved in the delivery process should have their specific clauses included in the summary as well. Having all of this information in one place not only allows managers to ensure they are on track to deliver as promised, it also allows them to see any potential gaps in the process such as conflicting subcontractor timetables.

Active management

Once a company has collated all pertinent information into a contract summary that is accessible to the managers responsible for delivery, the next step is to actively manage this process. Whilst such managers have always been responsible for this delivery phase, actively managing it within the context of the contract, including the necessary timings, notices, and other contractual milestones, is key to avoiding future disputes. This type of active management is particularly important in long-term contracts, such as in construction, and those involving third parties as part of the supply chain, such as in electronics manufacture.

One of the most common issues we see raised in disputes is the failure of a counterparty to fulfil its notice requirements under the contract. Active management of the delivery phase, coupled with a contract summary setting out the required timeframes, would help avoid most of these issues.

Dispute mitigation

During the course of business, issues and disagreements inevitably arise. It is important that the next stage is to take the necessary mitigation steps to prevent these disagreements from escalating to formal disputes. Such mitigation often requires a blend of practical steps and proactive negotiation. The key is to implement a company-wide dispute mitigation 'mindset'.

Whilst contracts often prescribe a number of steps that need to be taken before a full-blown dispute process can be started, these steps are often paid lip service only. A more proactive process, whereby the commercial department of a company identifies potential disputes early and engages with the other party (often through its legal department) to resolve them, would help avoid long and expensive litigation.

Dispute management

Despite best laid plans, some disputes are still sadly unavoidable. At this stage, whilst it is clearly

important for a company to vigorously defend its rights, there is a tendency for many companies to abandon the risk-based approach employed to great effect in the steps above. A proactive approach to dispute management helps a company focus on the key issues and ensures it reaches the best commercial result for it as a whole.

Most disputes have two main parts: liability and quantum. To that end, it is important that a company involve both its legal and financial advisers (internal and external) as early as possible. The liability question is usually assessed first, as it should be. However, more often than not, the answer to that question is not clear cut; in such instances, companies should start to perform 'cost-benefit' analyses based on the quantum and reputational risks of each claim to help prioritise resources and promote efficient management of the process going forward.

Performing this cost-benefit analysis requires clear financial data; significant time and money is often spent looking for, reviewing, and rebuilding financial data to support claims made in disputes. As such, organisations with well maintained and organised financial systems and records are typically in a better position when disputes arise.

Conclusion

Whilst no amount of proactive preparation can guarantee a company will not be involved in a dispute in the future, following the best practice detailed above can help ensure it minimises its exposure and ultimately the potential financial impact.

Christian Knutson is the Europe, Middle East and Africa (EMEA) Leader of Marsh Risk Consulting's Financial Advisory Services (FAS) Practice.

DECEMBER 2011

Richard Chalk, Peter Yuen and Adam Silverman

MANAGING THE COMPLEXITIES OF CROSS-BORDER DISPUTES

Consider the following scenario: a company whose principal operations are in China is sued before the Commercial Court in London, under a contract governed by New York law, while insolvency proceedings against it are continuing in its jurisdiction of incorporation, the BVI. At the same time, senior management is locked in complex settlement discussions with a number of different third parties with competing interests. A typical multinational business now operates within a complex matrix of jurisdictions and political and legal regimes. And the realities of today's global economy are such that large multinational companies are facing increasing levels of risk across many jurisdictions. As business has become more international, threats often arise in new and unfamiliar areas. With these myriad factors at play, how can in-house counsel most effectively manage these multi-faceted cross-border dispute scenarios?

There is no simple answer but a key task should be to manage disputes on a global level, through centralised coordination and well-informed, strategic decision-making, in order to ensure that the desire to achieve a short-term goal in one jurisdiction does not jeopardise broader, multi-jurisdictional strategic objectives. This begins at the drafting stage, where parties should choose the forum of their dispute carefully, that is the process by which the parties to the contract will have their disputes resolved and the venue for such, so as to pre-empt difficulties which may arise later. The forum in which a case proceeds frames the entire dispute and can significantly impact the pace of proceedings and the procedural toolkit available, and often lays the foundation for any settlement talks or negotiations. Smart selection of forum can mean the difference between an early settlement/dismissal and a protracted proceeding (with attendant costs in terms of both legal fees and business interruption).

From the very outset, when it becomes clear that a dispute with cross-border elements is headed towards litigation or arbitration, it is essential that early evaluation and strategic decision-making is carried out. While also true in domestic disputes, the need for quick, decisive and informed action is even more acute in the cross-border context due to the often fundamental differences between the law and procedure of different countries. Disputes lawyers need to consider a number of issues, including jurisdictional battles (i.e., the 'race to the court'), negative declarations/anti-suit injunctions, challenges to forum, interpretation of complex agreements and freezing assets.

Aside from the legal complexities arising from the involvement of multiple jurisdictions, cross-border disputes also present management difficulties, particularly with respect to evidence collation and discovery. This complexity arises as regimes relating to evidence vary across the globe – from the gathering of pre-trial evidence by oral deposition in the US, to the more limited discovery procedures of certain Asian jurisdictions. Take for example, the PRC, which has no direct equivalent to US style discovery practices. To complicate matters further, 'blocking statutes' and other restrictions exist between jurisdictions which may significantly impede or prevent one party from obtaining evidence for use in proceedings in another jurisdiction; for example, personal data. One further complication is that the sheer volume of documents can often present a formidable challenge in terms of the time and cost of locating and collating evidence, and subsequently sorting through it for relevance or privilege. In addition, discovery is not limited to physical documents but may also include electronically stored information. Although 'e-discovery' is gaining increased recognition across jurisdictions, it is particularly difficult to manage where the evidence is in two or more languages, and where the respective lawyers and parties are unfamiliar with e-discovery practices, or are using different e-discovery systems.

The evidentiary complexities of cross-border disputes therefore create both legal and practical problems. The legal problems may be solved by the use of judicial assistance of the courts in other jurisdictions to serve papers and gather evidence where this avenue is available. Further, reference to or use of international conventions or guidelines may bridge the gap between evidential regimes, or at least limit the inherent difficulties; the Hague Convention on the Taking of Evidence Abroad in Civil or Commercial Matters, and the IBA Rules on the Taking of Evidence in International Arbitration are two such examples. The solution to the practical problems is often to instruct local lawyers to conduct document reviews or witness interviews, drawing on their expertise in local law, language and customs. Where expert evidence is required, local lawyers can help to find experts with the necessary expertise and gravitas in one jurisdiction, who will prove persuasive in another

jurisdiction (this often requires a sophisticated understanding of the legal issues in play and the manner in which experts give evidence in different jurisdictions).

In some jurisdictions, such as the PRC and India, foreign law firms are not permitted to give opinions on the law, or appear in the courts, of that jurisdiction; they are only allowed to give general guidance to clients on the legal and regulatory environment of that jurisdiction. Where necessary, local lawyers have to be instructed. Due diligence over potential new local counsel should always be conducted and local firms may be invited to participate in a 'beauty parade'. Local counsel needs to be competent and experienced in cross-border matters; the skill set differs between domestic and international disputes lawyers. For example, good domestic litigators may be overly focused on the minutiae of domestic law, a skill which is of much less importance when seeking to oversee a large cross-border dispute, where local actions may have implications on other jurisdictions. The solution, depending on the nature of a particular cross-border dispute, is to look for local counsel who are familiar with cross-border matters and/or properly manage good domestic litigators so as to prevent any success at the local level being at the expense of proceedings in other jurisdictions. Where cooperation with a local law firm has proved to be successful, cultivate and foster the relationship.

Cross-border disputes often encompass parties (and legal advisers) from a range of cultural backgrounds; each party will bring to the dispute its own attitudes and approaches to dispute resolution, which, aside from intrinsic character traits, is often driven by culture. This is particularly true in Asia, where cultural gaps are larger than in other relatively more homogeneous areas of the world and where the idea of private settlement of disputes by agreement is embraced and can be traced back centuries. Seeking to understand the general cultural dynamic of a cross-border dispute may avoid unnecessary conflict and result in disputes being settled in a timely and satisfactory manner for both sides. Where a dispute does not settle, but moves to litigation or arbitration, cultural awareness and sensitivity may allow for significant advantages during the proceedings, particularly when deciding whether to adopt an aggressive or adversarial stance and being able to adapt the tone of the litigation as it progresses to your advantage. However, when managing and conducting a cross-border dispute, common sense, judgment and experience are to be preferred to any overly complicated analysis of cultural significance in terms of how to deal with the other side or strategies employed.

Analysing, pre-empting and dealing with threats has become a critical aspect of modern management of cross-border disputes, as they are complex and difficult to oversee. This article

outlines only some of those difficulties; others include adopting systems to keep a check on costs (centralised coordination and strategic decision-making minimises 'wheel-spin' and duplication of effort; and the attendant costs this entails), the handling of mass media and public relations across countries, and the enforcement of any court judgments or arbitral awards. From our experience, as legal teams, clients and third parties often work across the globe and within different time-zones, effective planning and coordination of a cross-border dispute requires clearly defined communication channels, so that the dispute management team and all involved are able to march to the beat of a single drum.

Richard Chalk and Peter Yuen are partners, and Adam Silverman is an associate, at Freshfields Bruckhaus Deringer LLP.

CHAPTER 6

ARBITRATION PROCESSES

in association with:

FEBRUARY 2011

Hernando Diaz-Candia

TRANSPARENCY VS. CONFIDENTIALITY IN INTERNATIONAL ARBITRATION

Confidentiality is often mentioned as an advantageous quality of arbitration and, in fact, it is widely sold as one of the foremost benefits of arbitration. It is considered a given or an implicit characteristic of alternative dispute resolution mechanisms, perhaps understandably so. When arbitration was first used by merchants in medieval Europe, and later on in New York and England in the late 18th and early 19th centuries, part of their rationale was that merchants knew their own market rules, practices and reputation better than judges. Hence, merchants embraced the notion that keeping matters among themselves was desirable. Confidentiality, meaning not disclosing information and resolutions, was considered essential to keep strangers outside and their system autonomous.

Now, it is said that the mere commencement of a case involving allegations of bad faith or negligence in the course of commercial disputes can irreparably damage business reputations, even if the case is ultimately dismissed with prejudice. Hence it is understandable that business people may prefer to air allegations in private, away from the public eye.

Over centuries, as commercial arbitration developed and formal rules were progressively adopted with the globalisation of commerce, confidentiality was naturally embedded and included in those rules. The most widely used and better known arbitration rules, like the Rules of Arbitration of the International Chamber of Commerce, deem confidentiality as fundamental. Similarly, the United Nations Commission on International Trade Law (UNCITRAL) Arbitration Rules provide for the confidentiality of the arbitral award and the privacy of hearings. Arbitration centres generally ensure that case information is accessible only to those expressly authorised to have access. The existence of an affirmative duty of confidentiality for the parties themselves is, however, still debatable and

answers to that issue vary depending upon local laws and the arbitration rules selected by the parties.

Because commercial arbitration is, in one way or another, the mother of all arbitrations, it is understandable that all types of arbitrations tend to embrace the main characteristics of commercial arbitration, including confidentiality. But since a system of bilateral investment treaties containing a relatively uniform body of international investment law was created in the 20th century (mostly under the umbrella of the Convention on the Settlement of Investment Disputes between States and Nationals of Other States) and as states have – some more timidly than others – started to accept that arbitration may be legally acceptable to adjudicate cases involving public-law issues, 2011 is probably a good time to revisit whether confidentiality should continue to be essential for arbitration in general.

Confidentiality is opposed to, or at least competes with, transparency. And leaving aside commercial arbitration, for which confidentiality can be rationalised partially as mentioned above, in investment arbitration and state-to-state arbitration transparency should be a default and trump confidentiality, albeit not by exacerbating disputes or compromising the integrity of the arbitration proceedings. Commercial arbitration may also benefit by easing strict confidentiality mantras that may have been inherited for centuries without much analysis, recognising that annulment or setting-aside recourses against arbitral awards in the 21st century are, by and large, litigated in judicial courts where confidentiality is not fundamental.

Transparency should facilitate trust. Transparency and publication of awards should also facilitate uniformity and predictability of cases and hence the law. Uniformity and self regulation of international trade law, lex mercatoria, which are in general deemed as positive, are not well served by keeping in confidence legal decisions that apply that law to actual cases. Confidentiality of awards does not favour consistency of decisions in similar cases. How can a precedent decision be followed if it is not well known? It is true that all cases should be decided on their own particular facts, and that arbitration is ideal to recognise that a strict separation between law and facts can sometimes be artificial, but that can be dealt by the fact that arbitral awards will in the foreseeable future continue to be non-binding for similar cases. In other words, stare decisis does not exist, and will very likely never exist, in arbitration.

The International Centre for Settlement of Investment Disputes (ICSID) already publishes most

arbitral awards. But in investment arbitration, transparency must imply openness, communication and accountability. Transparent procedures must include open meetings, disclosures and freedom of information. UNCITRAL Arbitration Rules, on the other hand, should not make confidentiality of awards the default in investment arbitration. Modern commercial arbitration rules may relax strict confidentiality rules, providing for a systematic and orderly institutional publication of arbitral awards, in cases where all parties have not expressly agreed to total confidentiality, even if not providing for public submissions and hearings. Access to international commercial arbitration case-law must not continue to be limited to excerpts and summaries prepared by privileged former staffers of arbitration centres.

Arbitrators, particularly in all investment arbitration contexts, including but not only in ICSID and UNCITRAL, should be fully empowered to balance, on a case by case basis, competing considerations of confidentiality, transparency, consistency, public information, equality of the parties, and proper conduct during the arbitration. The risk of incorrect public impressions from the disclosure of party submissions or public hearings may be sufficient, in some cases, to impose restrictions on openness or publication. But absent the agreement of the parties, confidentiality (of proceedings or awards) should be substantiated on a real and credible risk of aggravation of a specific dispute or compromising the arbitration.

It can be argued that some luminary arbitrators may be doubtful about accepting appointments if their every move is going to be under scrutiny and their decisions criticised in newspapers. That is a risk worth taking in order to facilitate the creation of coherent body of case law as well as legal certainty and confidence, particularly in the system of investment arbitration. Commercial arbitration may as well benefit from less confidentiality of awards, and more transparency, in the future. Keeping alleged strangers outside is no longer a valid justification for confidentiality – or is it?

Hernando Diaz-Candia is a partner at Squire Sanders & Dempsey.

MAY 2011

Timothy G. Nelson

THE VALIDITY OF 'CLASS ACTION ARBITRATION' WAIVERS IN CONSUMER CASES

Many credit card companies and other service providers, faced with the ongoing threat of class action litigation from consumers and other customers, have sought to offset that risk by including, in their standard-form contracts, a requirement that any disputes should be arbitrated. Where an arbitration clause exists and is subject to the Federal Arbitration Act (FAA), US.courts will generally enforce the arbitration agreement and refer disputes to arbitration, meaning that an arbitration clause is a potentially useful means of avoiding the risks associated with litigation.

Over the decades, however, a complication has emerged in the form of 'class action arbitration'. Some courts, particularly in California, have only been willing to allow arbitration of consumer contract claims on condition that the consumer/claimant is permitted to bring such claims as a 'class action' in arbitration on behalf of all similarly-affected consumers. In Keating v. Superior Court, 545 P.2d 1192 (Cal. 1982), the California Supreme Court held that the "adhesive" nature of these contracts, combined with the typically small amount of claims arising under them, means that it would be unfair to enforce the arbitration clause unless the arbitration could proceed on a "classwide basis" – indeed, if a class action was not available, this might "effectively foreclos[e] many individual claims", leading to an "oppressive" result. Other state courts later embraced this concept of class action arbitration, sometimes justifying their approach by reference to the relative 'economics' of bringing a class claim as against an individual consumer claim.

In 2003, the concept of class action arbitration received what appeared to be a significant boost

from the United States Supreme Court's decision in Green Tree Financial Corp. v. Bazzle, 539 U.S. 444 (2003). In Bazzle, which involved a mortgage loan agreement, the Supreme Court held that it was up to the arbitrator (and not the courts) to decide whether the borrower was entitled to bring its claims in the form of a class action arbitration. This decision prompted several arbitration organisations (including the American Arbitration Association) to adapt their procedures to facilitate the prospect of class action arbitration.

In the aftermath of Bazzle, two broad strategies were adopted to oppose class action arbitration. One strategy was for companies to insert class action arbitration waivers in their standard-form contracts. These waivers usually consist of a clause unequivocally waiving the right to pursue arbitral claims on a class basis.

Meanwhile, some defendants have mounted a direct challenge to the concept of class action arbitration. This strategy was seemingly vindicated in April 2010, when the Supreme Court issued its decision in Stolt-Nielsen S.A. v. Animalfeeds International Corp. (2010). Stolt-Nielsen held that the right to pursue class action arbitration is not generally to be inferred where an arbitration clause is silent on the issue. Arbitration, it observed, is a creature of contractual consent, under which "parties may specify with whom they choose to arbitrate their disputes". Class action arbitration "changes the nature of arbitration to such a degree that it cannot be presumed the parties consented to it by simply agreeing to submit their disputes to an arbitrator". Thus, to infer that, in the absence of express language, parties had agreed to class arbitration was "fundamentally at war with the foundational FAA principle that arbitration is a matter of consent".

Even after Stolt-Nielsen, class action arbitration and class action arbitration waivers remain a vitally important issue in consumer law. Consumer plaintiffs have argued that, if class action arbitration is unavailable, the entire arbitral clause should be regarded as invalid and unconscionable, leaving a consumer free to pursue class action litigation in the courts. Epitomising such cases is the recent Second Circuit decision in In re American Express Merchants' Litigation, 2011 U.S. App. LEXIS 4507 (2d Cir. Mar. 11, 2011) (also known as the Italian Colors case). In that case, certain merchants had brought antitrust claims against a major credit card company in the United States District Court for the Southern District of New York, claiming that the credit card fees had been established in a manner constituting an illegal 'tying arrangement', in violation of the Sherman Act, 15 U.S.C. § 1. Relying upon the terms of its 'Card Acceptance Agreement', providing not only agreement on binding arbitration but also precluding the signatory from having any claim arbitrated on anything

other than an individual basis, the credit card company sought to dismiss the class action and compel individual arbitration.

In 2009, the Second Circuit declared the Italian Colors class action arbitration clauses to be unenforceable, holding that the inability to pursue class action arbitrations for antitrust claims rendered the arbitration process "prohibitively expensive". In 2010, the Supreme Court vacated this holding so that the Second Circuit could consider the intervening Stolt-Nielsen decision (discussed above). In 2011, the Second Circuit reaffirmed its prior view that the arbitration clause containing a class action waiver was unconscionable. It concluded that "the cost of plaintiffs individually arbitrating their dispute ... would be prohibitive, effectively depriving plaintiffs of the statutory protections of the antitrust laws". For these plaintiffs, the Second Circuit considered that "the only economically feasible means for enforcing their statutory rights is via a class action".

In reaching this holding, the Second Circuit relied heavily on the prior Supreme Court case of Green Tree Financial Corp.-Alabama v. Randolph, 531 U.S. 79 (2000)). In Randolph, the Supreme Court ordered that claims under the Truth in Lending Act and the Equal Credit Opportunity Act should be arbitrated, but added the caveat that it might not have allowed this if the record had shown that "the existence of large arbitration costs could preclude a litigant ... from effectively vindicating her federal statutory rights in the arbitral forum".

The Second Circuit in Italian Colors also drew support from dicta in Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614 (1985), that warned against the use of arbitration clauses that might deny litigants the chance to vindicate a "statutory cause of action" in an "arbitral forum". The Second Circuit in Italian Colors interpreted this to mean that "an agreement which in practice acts as a waiver of future liability under the federal antitrust statutes" was unenforceable as against public policy.

At the same time, the Second Circuit in Italian Colors specifically eschewed any per se rule concerning the enforceability of class action arbitration waivers. It stressed that its refusal to enforce the credit card company's proposed waiver was case-specific. Finally, it noted that the credit card company had indicated that it would withdraw its motion to compel arbitration if the waivers were declared invalid, thus leaving open the possibility that the Italian Colors class actions may now take the form of litigation before the district court.

The Second Circuit's decision in Italian Colors is the latest in a series of cases adjudicating the validity and effectiveness of class arbitration waivers. Different Circuit courts (and state appellate courts) across the country have reached different views on the issue, often based on state contract laws concerning unconscionability. In one such case, AT&T Mobility LLC v. Concepcion, the Supreme Court has granted certiorari to determine whether state law can be allowed to operate in this manner, or whether instead the FAA preempts state contract unconscionability law in this arena. A decision in AT&T Mobility is expected in mid-2011.

Unless the Supreme Court revisits its decision in Randolph (or, indeed, reverses Italian Colors) it appears that other Circuit Courts may adopt the approach in Italian Colors. If so, this may have a potentially dramatic impact on the ability of companies to preclude consumer class actions by including appropriate language within their standard-form contracts. It is also possible that federal or state legislatures may weigh in on the issue. Already in one state, Utah, there exists a state statute that expressly permits class action waivers. The views of federal or state courts in that state (or others that enact similar laws) may prove vital in the years ahead.

Timothy G. Nelson is a partner at Skadden Arps.

MAY 2011

Tim Portwood

INDEPENDENCE AND IMPARTIALITY OF ARBITRATORS

Arbitration is an edifice built on at least two cornerstones of legitimacy. One is 'the autonomy of the parties'. Another is the 'recognition of arbitration as an alternative means of dispute resolution to the courts' within the national legal orders of the majority of States. At their extremes, these two cornerstones rub against each with tectonic force. The resulting erosion is no better seen at work than in the realm of conflicts of interests affecting arbitrators.

The independence of judges is inherent in the system by which they are appointed. The appointment process is unrelated to any given case. Once appointed, the allocation of cases to any given judge is entirely foreign to the disputing parties. This in-built independence of the judiciary is a source of the confidence and trust in which any given judicial system is held.

The system by which arbitrators are appointed is antithetical to the system just described above. Indeed, an oft-lauded attribute of arbitration is the ability of the parties 'to choose their own judge'.

The anathema of the special place accorded to arbitration in most legal orders despite the parties' autonomy over the appointment of the tribunal is resolved (partly at least) by the universal principle that arbitrators are, at all times, to be independent of the parties and the dispute.

This principle is found in the UNCITRAL Model Law (which is the basis for the legislation on arbitration in over 80 countries) in most institutional rules, and forms part of the codes of ethics for

arbitrators of the IBA and the AAA. What this principle means in practice is, however, becoming an area of seismic activity.

Objectively, arbitrators should be independent. This means asking the hypothetical reasonable person what they think about the relevant circumstances. Subjectively the parties should be asked what they think. Are there any circumstances that cause the parties to have doubts as to the arbitrator's independence? Thirdly, what the arbitrators themselves think is elemental attaching to which is an obligation of inquiry. Finally, there are the requirements of the national legal orders in which the arbitration is to take place or produce its effects. Inevitably, there is a constant shifting between these different aspects of the question. At present, the impression is that the objective viewpoint is enjoying a certain predominance. Whilst this approach provides for a degree of efficiency and certainty, it is not without its problems.

The ongoing annulment proceedings before the French courts of Tecnimont v Avax in respect of an ICC arbitral award provides an example. The arbitration began in 2002. In summer 2007, by the time the merits phase was coming to a close, but before a partial award had been issued, Avax raised doubts over the links between the global law firm (JD) of which the Chairman of the Tribunal (Mr SJ) was a partner and the Tecnimont group of companies. Avax requested in September 2007 the removal of Mr SJ before the International Court of Arbitration of the ICC. The request was dismissed in October 2007. Avax reserved its rights as to Mr SJ's independence when continuing to participate in the arbitration. The partial award on the merits, condemning Avax, was rendered in December 2007.

Avax brought annulment proceedings against the partial award before the French courts. The Court of Appeal of Paris upheld Avax' application and annulled the award on 12 February 2009. Tecnimont appealed that decision to the Cour de Cassation which upheld the appeal on the sole grounds that the Court of Appeal had ruled on facts which had not been invoked by Avax and had thus modified the nature of substance of the case. The Cour de Cassation has thus remitted the case to a different Court of Appeal (this time of Reims) to retry the annulment application.

The Paris Court of Appeal's decision remains, nevertheless, an interesting source of debate. The problem faced by Mr SJ was one of objective independence. Indeed, he himself had never worked for either of the parties or their groups. His global law firm had and indeed, unbeknownst to Mr SJ, continued to do so during the course of the arbitration. Although Mr SJ had argued before the ICC

Court that what matters is the arbitrator's independence and not that of his law firm, the Court of Appeal considered that such structural conflicts are the stuff by which objective independence may be attacked. Notably the Court's finding was expressly stated in terms of the existence of a conflict of interests rather than a lack of independence (the existing provision of the Civil Procedure Code does not specifically refer to an obligation of independence – Article 1452).

Whilst the links between JD and one of the parties (or its group) were found to have been varied (advice, representation and assistance) and extensive (more than 100,000 billed over the relevant time), the idea of structural independence is not without its problems. The growth of independent boutique firms of arbitrators over Europe is often cited as a result of 'too many conflicts of interests'. This means, however, that the already relatively small world of experienced arbitrators is becoming smaller if counsel in multijurisdictional firms are effectively disqualified. Although this trend may eliminate the problem of structural conflicts it bears another, namely a risk to subjective independence. Whilst Mr SJ knew no-one in Tecnimont or its group, the chances of one of the limited circle of experienced arbitrators knowing the counsel by whom he is proposed both professionally and socially are high. Much greater care may, at least in some cases, need to be taken when probing this type of 'conflict'.

Another focal point of the challenge to Mr SJ before the Paris Court of Appeal was his performance of the obligation to declare matters that may give rise to doubts over his independence. It seems that Mr SJ's answers to questions made by Avax prior to the challenge before the ICC Court regarding the links between Mr SJ's law firm JD and the Tecnimont group were incomplete. We learn from the Appeal Court's decision that whilst an arbitrator is not required to declare matters of which he is ignorant, his initial declaration of independence carries with it an obligation of investigation that must be undertaken thoroughly and thereafter at the very least when probed by a party during the course of the arbitration, the arbitrator must investigate and answer such questions diligently. Further, it is not for the arbitrator to pick and choose as to what he should disclose. The answers must be complete. A failure to do so may give rise to a reason to challenge the resulting award (if not in and of itself a problem of independence).

Another question, not considered in the Tecnimont case, is the extent to which the parties can themselves waive an arbitrator's lack of independence. From the point of view of party autonomy, they obviously should be able to do so. From the point of view of the legitimacy of arbitration within any given national order, the answer is by no means so obvious. The principle of estoppel

by which a party is prohibited from contradicting its earlier conduct on which the other party has relied, militates against allowing challenges of this nature to succeed. There may well come the day, however, when the European Court of Human Rights is seized of a claim of this nature and a wise man would be wary to second-guess how that Court may rule.

Tim Portwood is a partner at Bredin Prat.

JULY 2011

Lord Goldsmith QC, Mark W. Friedman and David W. Rivkin

CHOOSING THE ARBITRATION YOU WANT: POSSIBILITIES AND PITFALLS IN ARBITRATION AGREEMENTS

The champagne is chilling, and spirits are high – the deal is about ready for signature. Then some pedantic killjoy lawyer insists that the parties finalise the dispute resolution clause, which has consistently called for international arbitration but otherwise has lingered in successive drafts of the undeveloped 'boilerplate' sections 'to be added'. Nothing could be further from everyone's minds; they are optimistically imagining the bright future when all goes as anticipated, not what happens if something goes badly wrong. "Let's just use whatever we agreed for the last deal," someone suggests. "Good idea. Now pop the cork!"

That decision could be a big mistake. International arbitration is often an excellent choice for international deals. It offers many benefits over local courts: a neutral forum, ability to choose decisionmakers, and superior international enforcement of awards. However, failure to appreciate the extraordinary range of options associated with arbitration can lead to missed opportunities and potentially serious risks.

Take a simple example. The contract is to be governed by New York law. However, you have had trouble convincing your counterparty to waive the possibility of seeking punitive damages. Proposing to arbitrate under the rules of the International Center for Dispute Resolution (ICDR) could be the answer. Those rules, uniquely, contain a punitive damages waiver. If the clause from the last deal, thoughtlessly added to the new deal, specified arbitration under any other rules, the prospect of punitive damages would remain.

Choice of the arbitration's seat provides another example. Many people choose a seat solely for geographic convenience. The choice of seat is, however, potentially significant. It is the arbitration's juridical base. It supplies the background law under which the arbitration will take place. Issues such as the inherent confidentiality of the arbitration procedure, the timing and scope of judicial intervention in or assistance to the arbitration, and even the bases for challenging the award (or the ability to waive such challenges) are established principally by the law of the seat. For example, in England awards may be subject to review by courts on points of law unless the parties agree otherwise; in the United States parties could not – even by agreement – authorise such a review by Federal courts. This example also illustrates interplay between choice of seat and choice of rules: if the parties agreed to arbitrate in England under the London Court of International Arbitration rules they would have thereby agreed to waive right to appeal on points of law; in contrast, the ICDR rules contain no such waiver.

There is in fact a wide range of choices available that may also justify a further delay in popping the cork. As most of these choices concern arbitration procedure, they might seem unimpressive to the deal negotiators. However, they can have a substantial bottom line impact. For example, a 'standard' commercial arbitration that follows a typical procedural trajectory can take two years to resolve completely. That may be a lot faster than courts in many places (especially taking into account rights to appeal), but it can still seem like a long time to businesspeople who need to move on with their business and have some final resolution. The parties can reduce this time by, for example, appointing a sole arbitrator, limiting discovery, or establishing presumptive time limits for the arbitration or certain phases of it.

Alternatively, there might be circumstances where it is important to specify the use of additional procedures. For example, a company acquiring a minority position in a corporation may be at a disadvantage in a dispute with the majority shareholder if the majority shareholder is in exclusive possession of key documents. Unless the minority shareholder negotiates for an arbitration clause providing expanded rights of discovery, it may be frustrated in obtaining those key documents by arbitrators uncomfortable or unfamiliar with American and English discovery.

If the deal contains a network of related contracts or multiple parties who contribute to the deal under different contracts, it is worth devoting some attention to how an arbitration might work in practice. For example, an agreement to provide financing to one company may call for a guarantee by a second company, perhaps the borrower's corporate parent. If the parent company is not

a party to the financing agreement and provides the guarantee as a separate legal instrument, then the lender may have to commence two separate proceedings – possibly doubling the legal costs and even risking inconsistent decisions from two different panels. This could have been avoided if the arbitration clauses of both contracts had been coordinated with each other and permitted consolidation. Similarly, one should not assume that a guarantor signing the contract in that capacity is automatically bound by the contract's arbitration clause. That would depend on the wording of the contract and the law applied to it. To avoid uncertainty and potentially time-consuming litigation over the issue, it is worth taking the time to specify in the arbitration clause or in the guarantor's signature that the guarantor has also agreed to arbitrate in the same arbitration as the principal.

For investors in foreign countries, choices about aspects of deal structure may also be the difference between having certain substantive rights against foreign State destruction of investments and not having them at all. Bilateral investment treaties (BITs) protect investments (broadly defined) in a 'host' State by investors from another State. If the host State expropriates or interferes with those foreign investments, the foreign investor may be able to assert international law claims before an international arbitration tribunal. But the existence of these protections depends entirely on nationality. For example, Venezuela and the United States are not currently signatories to a BIT, hence a US investor will not have the possibility of asserting BIT claims.

However, if the US investor made the investment through a Barbados company, it would have protection under the Barbados-Venezuela BIT. Corporate structure should therefore be evaluated not only for governance and tax implications, but also for investment protection.

It is prudent always to keep in mind that one deal may not be exactly the like another. Hence 'cutting and pasting' an arbitration clause may save a bit of time, but it entails risk. If a specific provision designed for one deal is unthinkingly inserted into another, it may produce unintended consequences and even imperil the effectiveness of the agreement to arbitrate altogether. The counterproductive result can even be court litigation over the meaning of an arbitration clause – the complete opposite of what the parties hoped to accomplish by agreeing to arbitration in the first place.

There is ample guidance available to help quickly and sensibly evaluate the wide range of arbitration options available to parties negotiating a deal. A modest investment of time at the outset thinking

through those options is likely to pay rich dividends if the unthinkable happens and a dispute later arises, and will permit you to pop the cork and begin the celebration with even greater confidence and enthusiasm.

Lord (Peter) Goldsmith QC, PC, Mark W. Friedman and David W. Rivkin are partners at Debevoise & Plimpton LLP.

JULY 2011

Tim Portwood

WHAT IS CONSENT?

Gatecrashers can ruin a party. And just as a party is reserved to its invitees so, in principle, is an international arbitration. Arbitration is built around consent. It is not surprising therefore that as a matter of jurisdiction, an arbitral tribunal has its remit limited to the parties to the arbitration agreement from which it derives its authority.

The absence of third parties from an international arbitration proceeding is one of the major differences between arbitration and court litigation as dispute resolution processes. Whilst a court has its jurisdiction limited territorially (with many exceptions), an arbitral tribunal has its jurisdiction limited in personam. Yet situations arise frequently when one or other of the parties to an arbitration may wish to involve a non-signatory to the arbitration agreement. This may be because the claimant considers that a parent company of its contracting party is more solvent and should be held liable for the faults of its subsidiary; it may be because of the involvement of a disclosed or undisclosed agent in the commercial relationship between the parties; it may be because the harm has been caused not only by a contracting party but also by the tortious acts of a third party; it may be because a third party holds vital evidence; and so on.

What may be seen as inroads to this principle are in fact no more than extensions of what is meant by 'consent'. Where that consent is express, there is obviously little difficulty in allowing a non-signatory to the arbitration agreement to join a pending arbitration proceeding as a party. When that consent is to be inferred, however, is where the problems start. Firstly, there is the factual dimension – as a matter of fact, did the three persons consent? Two other dimensions surround the factual scenario: in which legal framework is the factual matrix to be analysed – a question of applicable law

to be determined by the applicable rules of private international law; and by whom? – a question of jurisdiction.

The recent and much commented saga over a contract for the construction of accommodation for pilgrims in Mecca in Dallah v Pakistan that has passed through the hands of an ICC arbitral tribunal sitting in France, of the United Kingdom Supreme Court and of the Court of Appeal of Paris has shed a somewhat variable light on when gatecrashers may don an invitee's clothing.

Dallah was a member of a Saudi group of companies. It signed a memorandum of understanding with the Government of Pakistan pursuant to which Dallah agreed to acquire land in Mecca, to build pilgrim accommodation on it, and then to lease the land to the Pakistani Government. Dallah acquired the land. The Pakistani Government established a Trust for the purposes of implementing the project. Dallah and the Trust entered into a formal and full agreement to which the Pakistani Government was not a signatory whether as a party, a guarantor or otherwise. The agreement contained an ICC arbitration clause in Paris. After a change of government in Pakistan, the project broke down.

The Trust issued proceedings in the Pakistani courts against Dallah for repudiation of the agreement. Dallah commenced an ICC arbitration against the Pakistani Government. The Pakistani Government challenged the jurisdiction of the arbitral tribunal claiming that it was not a party to the arbitration agreement. The arbitral tribunal issued three awards. In June 2001 it issued a partial award finding that it had arbitration to determine Dallah's claim; in January 2004 it issued a second partial award holding that the Pakistani Government had repudiated the agreement and directing that damages were to be assessed; in June 2006 it issued its final award ordering the Pakistani Government to pay Dallah almost US$19m in damages plus almost US$1.7m in costs.

Dallah sought to enforce the final award in the English courts. The Pakistani Government objected under the English enactment of the New York Convention 1958 (section 103 of the Arbitration Act 1996) on the ground that there was no arbitration agreement. When the case came to the Supreme Court in 2010, the Court asked five questions:

First, was the enforcing court entitled to conduct its own examination of jurisdiction – in this case, whether the Pakistani Government was a party to the arbitration agreement? The Supreme Court answered yes, it being a fundamental aspect of the New York Convention that the arbitral tribunal's

finding on jurisdiction is not final. The enforcing court is entitled and indeed required to conduct a full investigation.

Second, which law governed the arbitration agreement? The Supreme Court answered under the New York Convention that this was French law as the place of arbitration since there had been no specific choice of law by the parties – the arbitration agreement being autonomous from the main agreement and the choice of law to the main agreement not necessarily applying to the arbitration agreement.

Third, what was the test under French law to determine whether Pakistan was a party to the arbitration agreement? Having heard expert evidence on French law, the Supreme Court answered that there must be an investigation of the objective evidence to discern whether the subjective intentions of all three persons (Dallah, the Trust and the Pakistani Government) was for the non-signatory party to be bound by the arbitration agreement.

Fourth, on the basis of those answers, could the Supreme Court uphold the arbitral tribunal's finding that it had jurisdiction over the Pakistani Government? The Supreme Court answered no because the tribunal had applied what was called the 'alter ego theory' rather than the subjective intentions theory and that on the basis of the evidence there were no sufficient grounds to find that the Pakistani Government consented to arbitration.

Finally, did the enforcing court have a residual discretion to uphold the award despite a finding that the arbitral tribunal did not have jurisdiction. The Supreme Court answered no, not here.

No doubt emboldened by this ruling, the Pakistani Government moved before the Court of Appeal of Paris to have the award annulled (the tribunal having its seat in France).

Its swagger, however, turned into a stumble.

Although the Paris Court of Appeal did not explicitly adopt the same five step analysis, its judgment can be reviewed by asking the same questions. In answer to the first (applying mutatis mutandis given that instead of being a question of enforcement the case was one for annulment in the place of arbitration), the Court of Appeal came to the same conclusion as the Supreme Court: namely that under the French rule (modelled on the New York Convention), a de novo examination of the issue

of jurisdiction is to be undertaken by the reviewing court. It was in answer to the second question on applicable law that the Paris Court of Appeal diverged from the UK Supreme Court. Instead of finding that French substantive law should apply, the Paris Court of Appeal applied the rules developed by the French Cour de Cassation in Dalico (1993) to the effect that the conflicts rules applicable in international arbitration are less strict than those applicable before the courts such that no specific national law has to be applied to the question of jurisdiction and thus consent. When answering the third question, the French court undertook an objective review of the facts to see whether from an economic standpoint the third entity was and had behaved as a party to the contract without expressly seeking a manifestation of subjective common intent. When it applied that test and in answer to the fourth question, the Paris Court of Appeal found that on the facts (including the involvement of the Pakistani Government in the pre-contractual negotiations) the creation of the Trust was purely formal and that with Dallah's consent it was the Pakistani Government that was the true Pakistani party to the agreement. The fifth question was thus no longer applicable, the Court of Appeal having found reason to uphold the award on jurisdiction rendered by the arbitral tribunal.

The difference between these two judgments on precisely the same question goes further, therefore, than a simple disagreement on the facts. It lies in an understanding of the conflict of laws rules applicable (at least in France) to the question under the New York Convention of which law is to be applied to the issue of jurisdiction. It was here that the proponents of the transnational or a-national concept of international arbitral law were more persuasive before the French courts than they had been before the UK Supreme Court.

Another issue raised by this difference of findings between the UK Supreme Court and the Paris Court of Appeal is the solidity of one of the bedrocks of international arbitration: namely that of consent. Two high level instances experienced in issues of international arbitration law in two advanced and civilised jurisdictions each steeped in a different legal tradition came to the opposite conclusion on exactly the same issue of consent applying exactly the same rules. This singular fact is a salutary reminder that arbitration is not only dependent upon the consent of the parties but also on the acceptance of that very institution by each legal regime within which it operates. The terms of that acceptance continue to differ from one jurisdiction to another despite the continuing and laudable moves towards harmonisation personified in instruments such as the New York Convention, the UNCITRAL Model Law and the like.

Tim Portwood is a partner at Bredin Prat.

JULY 2011

Tim Portwood, Ben Knowles and Timothy G. Nelson

FORUM: USING ARBITRATION TO RESOLVE INTERNATIONAL DISPUTES

FW moderates a discussion on international arbitration between Tim Portwood at Bredin Prat, Ben Knowles at Clyde & Co, Ashley Bell at O'Melveny & Myers and Timothy G. Nelson at Skadden, Arps, Slate, Meagher & Flom LLP.

FW: Are you seeing more companies seek to resolve their disputes through arbitration? Is this trend prevalent on the international stage?

Knowles: Arbitration is one of the tools available to resolve disputes. Post the credit crunch there has been a rise in disputes – although not necessarily in the sectors where it might have been most expected – and most forms of dispute resolution have been busy.

Bell: Without doubt we are seeing more companies in Asia seeking to resolve commercial disputes through arbitration. The figures speak for themselves – each of the major arbitral institutions in Asia has reported a steady growth in caseload over the past few years. The caseload of the SIAC for example has increased from 99 new cases in 2008 to 198 new cases in 2010. This trend can be attributed to a number of factors, perhaps most importantly the degree of control which parties can assert over the arbitration process and the fact that parties in Asia are usually keen to avoid the local court systems due to perceptions of local bias and the difficulties associated with enforcing court judgments in foreign jurisdictions. The active promotion of international arbitration by institutions such as the SIAC and HKIAC has also served to increase awareness of the advantages of arbitration. Anecdotally, we are now more often asked to opine on a preferred seat or arbitral institution than we

are to opine on whether arbitration should be preferred over other dispute resolution methods.

Nelson: Arbitration certainly continues to be a much-used means of resolving business disputes, especially in cross-border disputes. There are a few factors that may be prompting an increase in the use of arbitration clauses in both domestic and international transactions. One domestic factor driving this is the widespread cutbacks in government spending, both within the US and other OECD countries. Even during the good times, courts were always supportive of arbitration as a means of reducing court congestion and delays. Shrinking budgets, however, decrease the resources available to courts in handling large, complex disputes and make arbitration more attractive. Another driving force has been the involvement of BRIC countries in international commerce. Like many businesspeople involved in cross-border transactions, parties involved in BRIC-related transactions often do not want to submit disputes to the national courts of their contracting counterparty, so they insist on international arbitration, usually in a 'neutral' venue.

Portwood: I am not aware of a current trend towards or away from arbitration. What is clear today is that arbitration remains the prevalent means of dispute resolution whenever parties from different jurisdictions are involved in a commercial operation. The only area where this remains untrue is the banking and financial services area, where the historical predominance of the ISDA contract and its default London/New York choice of courts clause mean that arbitration is little developed. This is, however, changing with a move afoot in ISDA itself to investigate the use of arbitration as an alternative means of dispute resolution.

FW: What types of disputes lend themselves particularly well to the arbitration process?

Bell: Most cross-border commercial disputes lend themselves well to arbitration because of the ease of enforcing awards, as opposed to court judgments, in foreign jurisdictions. Disputes of a technical nature are another obvious example because of the ability of the parties to appoint arbitrators with expertise in a particular field, thereby greatly enhancing the prospects of an efficient and satisfactory resolution of the dispute. Disputes where confidentiality is of the utmost importance also lend themselves well to arbitration. Confidentiality may be necessary to preserve trade secrets or simply to control any publicity which is likely to arise from the dispute.

Nelson: Usually, commercial arbitration involves contractual issues. A wide variety of disputes can be arbitrated, for example, post-closing disputes in a sale of business agreement, pre-emptive

rights in a shareholders agreement, the pricing formula in an oil and gas offtake agreement, the rent formula in a lease agreement, or a dispute over attempted termination of a pharmaceutical distributorship agreement. Another form of arbitration is 'investor-state' arbitration, often a claim by an investor that a sovereign state has improperly expropriated its property – Iran's wholesale seizure of US assets in 1979-80 being a prime example such of an 'expropriation'. Nowadays, this kind of arbitration typically occurs under so-called 'bilateral investment treaties' in which foreign governments promise to submit to arbitration of future investment disputes concerning seizure of investors' property.

Portwood: It is easier to answer this question by considering those types of dispute that are not suited to arbitration. Any dispute where urgent relief is required is likely to be hindered by the arbitral process which requires the time to constitute the arbitral tribunal, and then, once constituted, to arraign the different members of the tribunal to hear and deliberate on the issues. This hurdle is raised even higher when certain institutions such as the ICC are involved with their process of the administrative review of arbitral awards before they are issued. This problem with arbitration can be alleviated by selecting a single person tribunal, although such a choice raises its own series of issues including the true freedom of the parties to choose their judge – one of the major benefits generally perceived of the arbitral process. Almost any other dispute lends itself to arbitration with the ability of the parties to model their tribunal to fit the technical aspects of the dispute. It should be noted in this regard that modern arbitration laws, whether based upon the UNCITRAL Model Law or not, include provision for the assistance of the courts to deal with issues where the private nature of the arbitral tribunal renders the tribunal armless – including with respect to requiring disclosures by third parties.

Knowles: In cases where the domicile of the respondent does not enforce foreign judgments, or only does so with difficulty, then arbitration may be the only adversarial form of dispute resolution that may succeed. Disputes involving very high levels of confidentiality – for example, disputes concerning the application of new technology – are also particularly suitable for arbitration.

FW: In your opinion, how should companies weigh up the benefits of arbitration against other options such as mediation and litigation?

Nelson: In purely 'domestic' cases, you need to weigh up the speed, quality and efficiency of the local courts, and the extent to which you want your commercial disputes to be publicised – as will

often be the case in litigation. Arbitration, by contrast, is generally private and in many situations it can be more efficient and quicker than court litigation. And generally, there is no appeal on the merits from an arbitration award – this is sometimes perceived as an advantage in that it brings finality to an award once rendered, but it places a premium on selecting the right people to serve as arbitrators. If you're doing a deal with a cross-border element, the choice can be starker. If you're not comfortable submitting to the courts of a particular foreign jurisdiction, international arbitration can sometimes be the only acceptable option. Conversely, even if you have the bargaining power to extract a submission to the 'home court', this might not be a good idea in any event because the resulting judgment might not be as readily enforceable in other counties as an arbitral award. Arbitral awards are governed by two specific conventions – the 1958 New York Convention and the 1975 Panama Convention – which provide for recognition and enforcement of arbitral awards in the courts of each member state. Mediation, which is essentially a structured form of settlement dialogue, is usually available as an option when a dispute arises. But settlement talks don't always succeed, and to cover that possibility, businesses need to decide whether they prefer the courts or the arbitral process.

Portwood: Arbitration and litigation are very different animals from mediation. Mediation is an assisted process of negotiation that does not result in an enforceable title for one or other of the parties. It results in an agreement on which either party will have to sue if it is subsequently breached. Mediation is therefore often used as a precursor to a final method of dispute resolution such as arbitration and litigation. As between litigation and arbitration, in an international context arbitration has the significant benefit of presenting a neutral forum. Another major benefit of arbitration over litigation is the widespread ability, in over 140 jurisdictions, to enforce the arbitral award as if it were a local judgment with only very limited bases of challenge available under the New York Convention of 1958. In the absence of a multilateral or bilateral treaty for the recognition and enforcement of judgments, litigation comes a very poor second. It is also easier to ensure the confidentiality of arbitration than litigation before the courts. Otherwise, much depends upon the court system with which arbitration is being compared – the cost/benefit analysis differing in particular as between common law and civil law systems.

Bell: The advantages of arbitration are well known. In short, they include the enforceability of awards thanks to the New York Convention; the finality of an award thanks to the limited grounds of challenge; the ability of the parties to control the process – and, in particular, choose a neutral seat; the procedural rules and the language and venue of the arbitration; and the confidential

nature of the process. However, alternative methods of dispute resolution may be more appropriate in certain circumstances. Mediation for instance might be useful where parties need to maintain a healthy commercial relationship, either due to the length of the project or transaction which forms the subject of the dispute or because they regularly work together. Litigation might also be considered in jurisdictions where there is a strong court system or where there might be a need for a precedent to be established.

FW: When preparing for arbitration, what practical steps and considerations should companies make to help reach a satisfactory outcome?

Portwood: The first practical step should focus on evidence gathering – a process that should be coordinated with counsel and include the taking of witness statements and recovery of documentary evidence. The earlier this is done the better. Second, once the primary evidence has been gathered, a theory of the case that is viable under applicable law, and that is consistent with the evidence, should be developed and thereafter continually tested as the evidence gathering process continues. It is important always to keep an eye on the opposing theories that might exist and to be sure that they can be defeated. Another key step to be taken early on is the damages assessment which may require the early involvement of damage assessors. All too often this aspect is left to the last minute, the fundamental legal requirement of the existence of provable loss being forgotten.

Knowles: It is very important to preserve and collate all of the necessary evidence. This includes ensuring that good relations are maintained with key employees. Arbitration can be a slow process and evidence may well need to be deployed some years after the events in question.

Bell: Dedicating an appropriate level of internal resources to a dispute at an early stage is important – all too often clients underestimate the demands involved. The preparation of a list of issues in dispute early in the process also helps parties to focus on the key issues and is usually of assistance when the time comes to select arbitrators with appropriate experience. Ensuring that all relevant documents are collated and reviewed and that preliminary discussions are held with factual and expert witnesses is also crucial.

Nelson: Get experienced counsel. Make sure you and your counsel get a complete understanding of the facts as early as possible. Don't allow decisions to be rushed – don't

appoint your party-appointed arbitrator until you've conferred with counsel and have an idea of the right candidates. If you're defending a claim, get active early and don't miss deadlines. If you're the claimant, you shouldn't miss deadlines either, but equally, you shouldn't file a claim prematurely and you should consider whether you need to take further steps – for example, mandatory negotiation periods – before filing your claim. There are traps for the unwary in this field but most of them can be avoided through early consultation and planning. In short, get 'all your ducks in a row'.

FW: How much bearing does the commercial and technical expertise of the arbitrator have on the credibility and efficiency of any case? Are you seeing improvements in this area?

Knowles: The quality of the arbitrator is indeed important. Some of the very best arbitrators are effective whether they are dealing with matters they are familiar with, or not. However, recent attempts to speed up the arbitration process have led to miscarriages of justice where the tribunal has simply not set aside enough time to understand and listen to a technical case. Technical cases take more time, and time must be made available.

Portwood: An arbitrator's experience, whether commercially or in the specific technical area in question, is of course a key factor to take into account whenever marshalling and presenting a case. The more specific knowledge that the arbitrator has, the more difficult it will be to convince him or her of the weak elements in a case. It is important, however, not to go overboard and consider that persons with a more generalised knowledge cannot be appointed as arbitrators. There is a risk with overly experienced persons bringing too many of their own prejudices to bear on a case when such prejudices should in fact be challenged. I am not aware of a particular need for improvement in this area.

Bell: Appointing arbitrators who possess appropriate commercial and technical expertise usually serves to ensure a smoother, more predictable and more efficient arbitration process. In many instances it also provides the parties with comfort that their dispute will be determined by people who understand the nature of their industry, not just the specific legal matters in dispute. Of course, appointing arbitrators with technical expertise will not guarantee an efficient process – much will depend on the attitude of the parties and the courage of the tribunal to, for example, limit discovery and reject unnecessary interlocutory applications and submissions. Parties should also seek assurances from arbitrators as to their availability prior to appointment.

Nelson: Preserving the 'credibility and efficiency' of a case is, first and foremost, the responsibility of counsel and the parties. Arbitrators evaluate credibility, however, and it's important, when selecting arbitrators, to find people who are experienced enough in commercial cases to cut through the distractions and grasp the real issues. An experienced arbitrator will also know how cases are properly managed, which should ensure the efficiency of the process. 'Technical' expertise, in the sense of having an arbitrator with industry or sector-specific experience, can be useful too, particularly in cases where a particular discipline is involved. In large commercial cases, however, technical experience, while often usual, is rarely the only criteria in choosing an arbitrator. What is often as, if not more, important is to appoint arbitrators with experience in adjudicating large, complex commercial disputes. Almost all experienced arbitrators in the international field are lawyers who possess these credentials.

FW: To what extent are arbitration processes being shaped by common principles around the world, such as the UNCITRAL Model Law? Is this enhancing the experience of multinational companies in cross-border disputes?

Bell: In Asia, the majority of international arbitration regimes – including those in Singapore, Hong Kong, Malaysia, Korea, Japan, India and the Philippines – are heavily influenced by the principles of the UNCITRAL Model Law. From the perspective of both clients and practitioners, this 'harmonisation' of arbitration regimes increases the predictability of the process and provides a level of familiarity and comfort. However, the adoption of the Model Law alone will not enhance the arbitral process. It must be remembered that courts in each of these jurisdictions may interpret the provisions of these regimes differently. The courts in jurisdictions such as Singapore and Hong Kong are known to be 'arbitration friendly' in that they have interpreted the law in a manner which restricts interference in the arbitration process and leads to the regular enforcement of awards, while courts in some other jurisdictions may not be held in the same esteem.

Nelson: Several features of international arbitration are governed by 'common principles' regardless of where the arbitration is based, or which law governs the dispute. For example, most legal systems recognise the doctrine of 'severability', or 'separability' – that is, that the arbitration agreement is regarded as a standalone agreement, independent of the other parts of the contract – which, in turn, means that one usually cannot avoid arbitration simply by claiming that the agreement, as a whole, is somehow 'invalid' due to pre-contractual fraud or misrepresentation. Another common feature, reflected in the UNCITRAL Model Law as well as the New York Convention, is 'non-appealability',

that is that courts, while possessing the power to recognise and enforce arbitral awards as final judgments, can only refuse to do so on very limited grounds – for example fraud, corruption or denial of fundamental due process. Based on this principle, courts and judges cannot overturn an award simply because they disagree with the arbitrator's reasoning. Assuming these principles continue to gain acceptance in the international legal community, this will enhance the value and efficiency of international arbitration.

Portwood: Modern arbitration laws are being increasingly shaped on common principles, whether as expressed in the UNCITRAL Model law that has been adopted in over 80 jurisdictions, or in other forms such as the Decree that came into force in May of this year in France. This ad hoc harmonisation of arbitration laws should be seen as an advantage for arbitration and for its users since, both at the arbitrating phase and at the phase of enforcement, parties can legitimately expect similar treatment in an expanding region that covers much of the world.

Knowles: There is a tension between the common and civil law approaches. Principles from both these schools are applied. There is also a hybrid jurisprudence in international arbitration, which seems to be taking on a life of its own. This is difficult for a common law lawyer because it tends to be much less certain than we would like, and rather difficult to pin down. The time might be right for the common law lawyers to take a more active role in the framing of the arbitration process.

DECEMBER 2011

Timothy G. Nelson and Gregory A. Litt

WORLDWIDE ENFORCEMENT OF INTERNATIONAL ARBITRATION AWARDS: POTENTIAL CHALLENGES FOR THE WINNING PARTY

In most countries, the enforcement of international commercial arbitration awards is governed by the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, known as the New York Convention, or its Latin American counterpart, the 1975 Inter-American Convention on International Commercial Arbitration, known as the Panama Convention. Under these treaties, a 'winning' party may take an award rendered in a signatory country and enforce it in the courts of any other signatory country where the losing party's assets are located.

Due to the widespread adoption of the two treaties, it often is easier to enforce a foreign arbitral award than a foreign court judgment. Moreover, Articles V and VI of the New York Convention (and the corresponding sections of the Panama Convention) narrow the grounds upon which a court may refuse enforcement of a foreign award to a discrete number of concerns, including a violation of fundamental due process, the absence of an arbitration agreement or a breach of international public policy.

Also among the grounds to refuse enforcement under the New York Convention is Article V(1)(e), which empowers a court to decline enforcement of an award that had been "set aside ... by a competent authority of the country in which, or under the law of which, that award was made". The Panama Convention has a similar provision. Over the years, cases have arisen where an arbitration award has been enforced worldwide, even at the same time as it was being challenged – sometimes

successfully – in the courts of the country where the award was rendered. Indeed, a spirited debate has raged, within both professional and academic circles, over the status of an award that has been annulled in the courts of the country in which it was made, particularly where it is believed that this resulted from one party's 'home court advantage'.

Within the United States, this debate is sometimes known as the 'Chromalloy issue' after a 1996 decision of the United States District Court for the District of Columbia, Chromalloy Aeroservices, Inc. v. Arab Republic of Egypt, 939 F. Supp. 907 (D.D.C. 1996). In that case, Chromalloy Aeroservices, Inc., a US company, entered into a contract with the Egyptian Air Force for the maintenance and support of a fleet of Sea King helicopters. After a contractual dispute arose, arbitration was commenced pursuant to the contract's arbitration clause, which provided for arbitration in Cairo, Egypt. In 1991, the Cairo-based tribunal issued an award of $17m in Chromalloy Aeroservices's favour. In 1995, the Egyptian Court of Appeal annulled the Cairo award on the grounds that the tribunal had improperly "applied the rules of the Egyptian Civil Code to the exclusion of the administrative law" of Egypt.

The United States District Court for the District of Columbia nevertheless held that the Cairo award – even though annulled in the courts of Egypt – was entitled to be enforced in the United States. While noting its power under Article V(1)(e) of the New York Convention to decline enforcement of an award that had been set aside by the courts of Egypt, the Court held that this simply gave it 'discretion' to decline enforcement. This power, it held, needed to be read jointly with Article VII, which stated that "[t]he provisions of the [New York] Convention shall not . . . deprive any interested party of any right he may have to avail himself of an arbitral award in the manner and to the extent allowed by the law . . . of the country where such award is sought to be relied upon". Among the 'rights' held by Chromalloy Aeroservice was the specific provision in the arbitration clause providing that the Cairo award was not subject to 'appeal', which the US court interpreted as meaning that "the arbitration ends with the decision of the arbitral panel". Because the Egyptian Court of Appeal had acted in derogation of this clause, the US court declined to follow its decision, and the Cairo award remained fully enforceable in the United States. Egypt ultimately paid the award in full.

By contrast, in Baker Marine Ltd. v. Chevron Corp., 191 F.3d 194 (1999) the United States Court of Appeal for the Second Circuit held that an award rendered in Lagos, Nigeria, which was later annulled in the Nigerian courts, should not be enforced in New York. It held that because the parties contracted for arbitration in Nigeria pursuant to Nigerian law, it should respect the Nigerian courts'

decision to set aside the award. More recently, in TermoRio S.A. E.S.P. v. Electranta S.P., 487 F. 3d 928 (D.C. Cir. 2007) a US-owned utilities company brought arbitration against a Colombian state-owned enterprise before an ICC tribunal in Colombia, and won a $60m damages award for breach of contract. The Columbian Consejo de Estado later vacated the award, finding the arbitration agreement to be invalid. The D.C. Circuit refused enforcement.

The TermoRio court found Chromalloy distinguishable, on the basis of the particular arbitration clause in the Chromalloy case barring 'appeal' from the Cairo award (which meant that "an express contract provision was violated by pursuing an appeal to vacate the award"). In TermoRio, by contrast, the state party "preserved its objection that the panel was not proper or authorized by law, promptly raised it in the Colombian courts, and received a definitive ruling by the highest [Colombian] court on this question of law". The D.C. Circuit thus held that, once annulled in Colombia, the award should not be enforced.

The Dutch courts took a different approach in 2010, in Yukos Capital S.a.r.L. v. OSJC Oil Company Rosneft. Yukos Capital, a Luxembourg company, commenced four arbitrations to recover loans it had made to Russian company Yuganskefnegaz, Rosneft's predecessor, leading to four final awards of over $400m in Yukos Capital's favour. In 2007, the Russian courts annulled the Moscow awards, but Yukos Capital persevered and obtained enforcement of the Moscow awards in The Netherlands.

In a 2010 decision, the Amsterdam Court of Appeal held that the Dutch courts should uphold the Moscow awards, even though they had been set aside in the Russian courts.

Although the Dutch courts were permitted by Article V(1)(e) to refuse enforcement of the Moscow awards on the ground they had been 'set aside' in the Russian courts, the Amsterdam Court of Appeal held that there was no rule requiring the Russian courts' annulment to be accepted. Instead, it held, "[t]he question whether the decision of the Russian civil court to set aside the [Moscow] arbitral awards can be recognized in the Netherlands must be answered on the basis of the rules of general private international law".

Using this approach, the Amsterdam Court of Appeal held that the Russian courts' decision vacating the Moscow Awards would not be recognised if it "[did] not satisfy the principles of due process" and "conflict[ed] with Dutch public order". It considered that the Russian courts had not acted in an "impartial and independent manner". Part of Rosneft was state-owned, leading to a "close

interwovenness of Rosneft and the Russian state", creating a risk that the Russian judiciary was too deferential to the needs of the executive branch of Russia's government. Accordingly, it held, "the setting aside of the [Moscow awards] by the Russian courts should be ignored".

While the Amsterdam Court of Appeal had reached the same result as in Chromalloy, it did not do so on the basis of the parties' agreement. Instead, it directly rejected the procedure and result in the foreign court. It should be noted that Rosneft took strong exception to this analysis, arguing that there was no 'direct evidence' of partiality or misconduct by the Russian courts.

Significantly, many of these cases arose from contracts with government entities that called for arbitration in the government's own country – thereby making any award potentially subject to review and annulment in the courts of that country. For companies entering international contracts, this demonstrates that it is often wise to choose a 'seat' of arbitration in a neutral country if such terms are achievable. At the same time, the lesson for state actors is that sympathetic rulings by their own national courts will not necessarily be recognised in other countries, and private parties may have recourse outside their borders.

Timothy G. Nelson is a partner and Gregory A. Litt is counsel at Skadden, Arps, Slate, Meagher & Flom LLP.

DECEMBER 2011

Cedric C. Chao

PLANNING FOR DISCOVERY IN AN INTERNATIONAL COMMERCIAL ARBITRATION

International arbitration has emerged as a primary means for resolution of commercially significant cross-border disputes. The popularity of international arbitration has grown over the past couple decades as corporations and their lawyers become more educated about its features. This article will explore one of the more controversial issues among users of international arbitration, namely, the scope of discovery, or, in international arbitration parlance, the scope of 'disclosures'.

The 'traditional' approach to discovery

The 'traditional' view in international arbitration circles has been that each party comes to the dispute with the documents it believes will prove its claims or defences. There is little or no exchange of documentary evidence. And there is no provision for taking oral testimony prior to trial via a deposition. This minimalist 'traditional' approach reflects the continental European civil law roots of international arbitration. Each party shows up at trial, called the 'merits hearing' in international arbitration parlance, prepared to prove its case based on its own documents, on the written direct testimony of its witnesses, and on the testimony elicited on cross-examination of the other side's witnesses. There is no obligation to produce documents that harm or undercut one's case. This 'traditional' approach has been seen as promoting three overarching objectives of international arbitration, i.e., that it be quick, simple, and cheap. Not surprisingly, the rules of the international arbitration providers typically offered little guidance on the subject of discovery, which gave arbitrators great discretion as to whether to allow document discovery and, if so, the extent of such discovery. This, in turn, meant that the scope of discovery was heavily influenced by the choice of arbitrators.

The common law and US approach to discovery

In contrast, the courts of common law countries, and the courts of the United States in particular, have developed elaborate rules of discovery that spell out in detail the devices for learning the facts of the dispute prior to trial; the parties' respective rights and obligations to demand and resist discovery requests; the timelines for propounding, responding or objecting to, discovery; and the parties' access to the court to resolve disputes such as whether discovery demands are irrelevant, overly burdensome or invasive of protected privileges or confidences. Very importantly, a party is prohibited from destroying or concealing evidence that is harmful to its case. The penalties for intentional destruction of evidence, called 'spoliation', or for concealment or tardy production of evidence are severe, including monetary penalties that could include the other side's attorney's fees; 'issue sanctions' such as barring the offending party from asserting claims or defences; issue sanctions whereby factual issues are deemed proven against the offending party; and, in egregious cases, professional discipline of the offending lawyer. Advocates in the US are taught that they may act zealously for their clients but that they simultaneously are 'officers of the court'. Officers of the court do not mislead the court, or destroy or conceal the evidence necessary for the court to arrive at a just result based on the evidence.

Under US discovery rules, the parties are entitled to take the oral testimony of the other side's employees and witnesses as well as of third parties with knowledge of facts material to resolving the dispute at hand, utilising a device called a 'deposition'. In complex commercial disputes, the costs of discovery can be substantial, sometimes approaching the cost of the trial itself. The rationale for this elaborate discovery structure is the elimination of 'trial by ambush', the promotion of early settlement of disputes, and ensuring transparency.

An initial attempt to harmonise the civil law and common law approaches

Cross-border disputes involve corporations headquartered in different countries, often with very different legal traditions. The arbitrators hearing such a cross-border dispute, and the arbitration centre administering the dispute, have been challenged to satisfy the differing expectations and goals of the parties and their counsel.

Nowhere is the contrast between civil law and common law traditions more striking than in discovery. Parties and advocates hailing from civil law countries can be heard decrying 'US style discovery', 'fishing expeditions', and 'the creeping Americanisation of international arbitration'. Conversely, parties and advocates trained in the US legal system and new to the world of international arbitration

are surprised to learn that they have no right to depositions or written interrogatories, and often only limited document discovery. And, US parties and advocates are dumbfounded to learn that there is no general obligation to produce harmful evidence in one's possession.

In an attempt to harmonise the contrasting legal traditions concerning discovery, the International Bar Association published guidelines entitled 'Rules of Taking Evidence in International Commercial Arbitration' ('IBA Rules'), which attempt to balance common law-style discovery and the traditional international arbitration approach. Although the IBA Rules have not been incorporated into the rules of any major arbitral organisation, it is becoming more common for arbitrators and parties to look to them for guidance. Although the IBA Rules do not diverge significantly from the current norms of international arbitration practice, they are helpful because they establish the base line presumptions that there will be document exchange and that the scope of such exchange will be broader than was previously the case in 'traditional' arbitrations, although still narrower than in US litigation.

The importance to corporate executives and general counsel of considering their desired discovery regime while negotiating the contract

Why should a corporate executive or general counsel concern himself or herself with the details of discovery when negotiating a deal? Because, a significant percentage of business deals ends up in a dispute, and the scope of discovery can materially affect the outcome of the dispute.

In simpler times, a common dispute would revolve around a sale of goods contract, with issues of timely delivery and payment, and manufacturing per contract specifications. Such a sale of goods contract could largely be resolved with the documents in each party's possession. However, the world of global business has grown considerably more complex.

As one example, consider a patent licence agreement, where a US bioscience company whose scientists invented a new drug, licences its patent and associated intellectual property to a European pharmaceutical company. It is common in such licence agreements for the licensee to be responsible for some portion of the clinical trials, regulatory approvals, and the subsequent commercialisation of the drug, and to be required to pay royalties based on the future revenues. If the licensee pharmaceutical company does not execute the company's responsibilities in a diligent and timely manner, the sales will be delayed or will be less robust than expected, with the ultimate consequence that the licensor's royalty stream will be lower than it should have been. For blockbuster drugs, hundreds of millions of dollars could be at stake. In such situations, the licensee pharmaceutical company may have sole

possession of critical documents that would prove or disprove its due diligence.

As a second example, consider a US or European company making a substantial investment in a joint venture ('JV') in a developing Asian or Latin American country. If the offshore investor is a minority shareholder – a common scenario given the sensitivities of many developing countries to 'foreign' control of industry – the local partner typically hires the local manager. If a dispute arises concerning mismanagement of the JV's factory, or if there are suspicions that the local partner has diverted the JV's funds, the offshore investor needs access to the JV's records which are under the control of the local manager who in turn may be beholden to the local partner.

As a third example, consider a contractual relationship where one party suspects that the other party has defrauded it. Typically, evidence of the suspected fraudulent behaviour, and of the planning and implementation of the fraud, will be under the control of the fraudster.

Under any of these three scenarios, access by the aggrieved party to the documents needed to resolve the dispute is not guaranteed under the 'traditional' approach to discovery. Thus, while negotiating the underlying contract, corporate executives and their counsel should discuss what discovery procedures they most likely would want in the event of a dispute. That will require them to 'fast forward' in their minds to the dispute itself, and to predict their likely position (aggrieved or respondent), predict the type of dispute (pure contract or tort and fraud), predict which party will have control over what sources of evidence, and predict whether they will be seeking or resisting discovery.

As a starter, a party should consider whether its likely posture in a future dispute argues for it to negotiate for inclusion of the IBA Rules in the dispute resolution clause to guide the arbitrators and parties. And, if a corporate executive or general counsel believes they are most likely to be the party searching for evidence in a future dispute, or if the party is simply more comfortable with a more robust discovery regime than is provided in international arbitration, the time to raise the inclusion of special discovery procedures is while the contract is being negotiated, as opposed to several years later after a dispute has erupted. The arbitrators must honour the parties' wishes that are included in the dispute resolution provision.

Cedric C. Chao is co-chair of the international litigation and arbitration practice at Morrison & Foerster.

CHAPTER 7

REGIONAL ARBITRATION

in association with:

VON WOBESER Y SIERRA

FEBRUARY 2011

Matthew Gearing, Paul Starr and James Kwan

TALKINGPOINT : ARBITRATION PROCESSES IN ASIA

FW moderates a discussion between Matthew Gearing at Allen & Overy LLP, Paul Starr at Mallesons Stephen Jaques and James Kwan at Simmons & Simmons about arbitration processes and facilities in Asia.

FW: Can you outline some of the major trends related to corporate disputes in Asia over recent months?

Gearing: Increasingly parties based in Asia are selecting a seat of arbitration in Asia, rather than looking to historic centres such as London. We have seen an increase in disputes arising from insolvency proceedings following the global financial turmoil of recent years. At the same time we have also seen an upswing in the number of clients seeking advice on possible claims against states arising under bilateral investment treaties.

Kwan: There continues to be work driven by the economic crisis, including disputes and litigation relating to the sale of complex financial products, investigations arising from increased regulatory oversight, labour disputes, and breach of contract matters. There has been a dramatic growth in international commercial arbitration in Asia and a rise in the number of cases administered by arbitral institutions based in Asia. More recently, as Asian economies rebound from the financial crisis, this has caused a surge in exports and outbound investment, which has led to a greater appreciation of the value of arbitration clauses in contracts. As Asian economies recover, companies

are likely to arbitrate their disputes as opposed to in 2008 when parties were interested in a quick settlement due to the time and costs involved.

Starr: A major trend is the increasing number of corporate disputes relating to Mainland China. This is natural given the significant amount of foreign investment in Mainland China. The increasing faith in the enforcement of judgments and arbitral awards in Mainland China also provides parties with the confidence to assert their legal rights. In November 2010, we had a Hong Kong judgment recognised by a Shanghai court; we believe the first ever such recognition. There was no protectionism or obfuscation by the Shanghai court, even though the enforcement was by a foreign company against a PRC counterparty. The basis for enforcement is the Arrangement on Reciprocal Recognition and Enforcement of Judgments in Civil and Commercial Matters (REJA), which was signed in 2006 and finally became effective in August 2008.

FW: Are you seeing more Asian companies turning to arbitration to resolve their disputes?

Starr: As Asian companies develop a better understanding of and confidence in the arbitration process, we find that our clients are attracted by the degree of control they can have on issues such as the venue and the arbitration panel if they chose arbitration over court proceedings to resolve disputes. Also, where parties do business in Mainland China, there is a preference for arbitration as a method of dispute resolution.

Gearing: Arbitration has been a popular method of dispute resolution in cross border transactions in Asia for some time. Most of the regional arbitration centres have reported an increase in their caseload in recent years. This has fuelled healthy competition between institutions and jurisdictions vying to attract international arbitrations.

Kwan: There are an increasing number of Mainland parties arbitrating in Hong Kong. The willingness of Chinese corporations in taking their disputes to overseas arbitral venues is also an increasing trend. This reflects the amount of Chinese outbound investment which increases year by year, and increased sophistication by Chinese users. Chinese national oil Companies have been investing in areas where international oil Companies have been prohibited from investing or hesitant to do so. There is an increasing amount of Chinese investment in Africa, Central Asia and Latin America where political and commercial risk is high.

FW: In your opinion, which centres in Asia offer a premium forum for conducting arbitration, and why?

Kwan: A survey by Queen Mary University of London, found that the most important factor in choosing the seat of arbitration is the formal legal infrastructure: the statutory framework for arbitration, court support of the arbitral process, and its neutrality and impartiality. This allows arbitrations to be conducted with minimum interference and delay. Both Hong Kong and Singapore fall into this category. Historically, for parties based in Asia, London, Paris or Stockholm have been the preferred locations for arbitration, but increasingly, arbitration clauses now provide for a seat in either Singapore or Hong Kong. For contracts with two Asian parties, Singapore or Hong Kong is the place of arbitration for 90 percent of the time.

Starr: The question assumes a 'one size fits all' for arbitrations whereas the real answer lies in the concept of 'horses for courses'. For example, Hong Kong is most attractive to those doing business in Mainland China and is an acceptable alternative to the Mainland as a forum for arbitration, particularly given the Supreme People's Court's clarification on 5 January 2010, that, with certain exceptions, ad hoc arbitral awards and arbitral awards made in Hong Kong by the ICC and other foreign arbitration institutions are enforceable in Mainland China in accordance with the Arrangement concerning 'Mutual Enforcement of Arbitral Awards between Mainland China and Hong Kong' (1999) (MEAA). This, together with the shared cultural heritage with Mainland China, an ability to understand Western ways, independent judiciary, excellent arbitration expertise and infrastructure, and liberal jurisdiction which allows foreign lawyers to conduct arbitrations enhances Hong Kong's value as a venue for arbitration for both foreign and Chinese parties.

Gearing: The most popular seats in Asia are Hong Kong and Singapore. The courts in both are considered pro-arbitration: they are generally reluctant to intervene in arbitration proceedings and have an excellent reputation for upholding and enforcing arbitral awards.

FW: Have there been any significant legal and regulatory developments affecting arbitration over the last year or so?

Starr: I have already mentioned the clarification by the Supreme People's Court of the MEAA. Another significant development is the new Arbitration Ordinance in Hong Kong which will replace the current one when it comes into effect sometime in 2011. It will abolish the distinction

between domestic and international arbitrations which currently exists by creating a unitary regime of arbitration for all arbitrations, based largely on the UNCITRAL Model Law. This will make arbitrations in Hong Kong more user-friendly and accessible to lawyers and the international business community from civil and common law jurisdictions who are already familiar with the Model Law. The new Ordinance also contains provisions additional to the Model Law such as express prohibitions against the disclosure of information relating to arbitral proceedings and awards and the power of an arbitrator to act as a mediator. These developments enhance Hong Kong's attractiveness as a forum for arbitration.

Gearing: A number of jurisdictions in the region are in the process of updating their arbitration legislation. A new Arbitration Ordinance was enacted in Hong Kong in December 2010 which establishes a unified regime for domestic and international arbitrations under the UNCITRAL Model Law. In India, amendments have been proposed to the Arbitration and Conciliation Act 1996 and consultations are ongoing. It is hoped that if the reforms are implemented this will provide a platform for improving the reputation of India as a seat and the prospects of enforcing awards in the local courts.

Kwan: The Hong Kong Arbitration Ordinance was enacted on 10 November 2010, with a commencement date tentatively set for 1 June 2011. The purpose of the reform of the Hong Kong arbitration law is to unify the domestic and international regimes on the basis of the UNCITRAL Model Law. There will be one arbitration regime without any distinction between international and domestic arbitration. The Ordinance is aimed to be more user friendly for local and international users. Under the previous bifurcated regime, domestic awards were subject to judicial review and appeals on a point of law. The new regime allows recourse to the courts for the setting aside of an award in very limited circumstances. Other jurisdictions such as Vietnam and Australia also updated their arbitration legislation based on UNCITRAL Model Law.

FW: Compared to other forms of dispute resolution, what are the benefits of the arbitration process for the parties involved?

Gearing: The main advantages of arbitration include, first of all, extensive enforceability. The New York Convention provides for the enforceability of arbitral awards across territorial boundaries subject to limited grounds for the local courts to refuse enforcement, and there is no equivalent global regime for the mutual recognition and enforcement of court judgments. Second, it provides

finality. In general, awards are binding and final and there is no automatic right of appeal on the merits. Third, arbitration allows flexibility. The parties are free to choose the seat, venue, procedural rules and language of the arbitration. Fourth, it allows neutrality –the parties can choose a neutral venue. Fifth, arbitration provides privacy and confidentiality – the proceedings are usually confidential. The sixth benefit is disclosure. The scope of disclosure in international arbitration tends to be narrower than in English or US litigation proceedings.

Starr: Control, choice and confidentiality are the main benefits. Subject to negotiation, parties have control and the ability to choose matters such as the venue, the arbitration panel, the arbitration rules and the language of the arbitration. They don't have to wait for a court date and can even control the length of the arbitration by agreeing on a guillotine or chess clock method, thereby minimising the tendency in some arbitrations to chase every rabbit hole. Confidentiality is a big plus since some parties do not like their disputes aired in public.

Kwan: However, arbitration is not always the best option. Litigation should be considered when there are strong courts for the dispute and enforcement, efficient court procedures, purely domestic issues, the 'dispute' is likely to be a simple issue that involves debt collection, and the need for precedent.

FW: Are there any downsides to pursuing arbitration in Asia? How can the challenges be reduced or overcome?

Kwan: Delays in the constitution of the tribunal can be mitigated by choosing institutional as opposed to ad hoc arbitration. Parties can agree on a set of rules to regulate the disclosure of documents such as the IBA Rules on the Taking of Evidence in International Arbitration. The IBA Rules can also be incorporated into the arbitration clause to import a familiar regime in arbitral proceedings if parties are required to conduct their arbitrations in unfamiliar settings, such as arbitrations in the PRC. Parties can also reduce delays by minimising written submissions and the length of hearings, and choosing arbitrators wisely.

Gearing: Despite the continuing and growing popularity of arbitration in Asia, challenges remain. There is a propensity for court intervention in certain Asian jurisdictions. In addition, the courts in certain jurisdictions have refused to enforce arbitral awards on grounds which go beyond the terms of the New York Convention. The pool of suitably experienced arbitrators based in the region is

comparatively small compared to the market in Europe.

Starr: The downsides of pursuing arbitration are not necessarily limited to Asia. A major negative confronting all arbitrations, regardless of location, is the increasing cost. Globalisation has given rise to complex commercial arrangements so arbitration is no longer the quick cheap fix that it once was. Instead, arbitrations can be as costly as court proceedings because of the complexity of modern disputes, which can involve parties from different countries, documents in several languages, the need to engage a large team of experts and the cost of enforcement in a foreign jurisdiction. Costs can be reduced if parties become more proactive in managing disputes from the start of their commercial relationship.

FW: Does the region need to address ongoing problems with regard to enforcement and/or appeal of arbitration awards?

Gearing: The courts in some jurisdictions have displayed a willingness to engage in a review of the merits. It is therefore particularly important to choose a good seat in order to minimise the risk of an award being set aside by the courts of the seat. When it comes to enforcement, this remains problematic in a number of Asian jurisdictions, including the PRC and India. Delay in enforcement of awards is another problem in many Asian jurisdictions, because often enforcement proceedings are stayed pending the outcome of any challenge to an award.

Kwan: There is a lack of empirical evidence concerning the enforcement of arbitral awards in Asia, especially in the PRC and India. Although most states in the region have acceded to the New York Convention, courts in the region adopt different approaches and interpretations on enforcement, leading to different results. There should be more conferences on the enforcement of arbitral awards involving judges in the region, and judicial training on the application of the Convention.

Starr: The issue of enforcement in the region is a work in progress for not only arbitration awards but also court judgments, particularly given the increase in cross border disputes. However, instead of only focussing on the problems of enforcement, we also need to recognise positive steps taken by countries such as Mainland China to increase confidence in its system through its actions of actually enforcing a recent Hong Kong court judgment, and clarification of the enforceability in Mainland China of ad hoc arbitral awards and arbitral awards made in Hong Kong, as discussed above.

FW:Is the rise of arbitration in Asia affecting the way commercial contracts are drafted, such as the nature of certain clauses relating to potential disputes?

Starr: Most definitely. There is an increasing trend in commercial lawyers seeking advice from dispute resolution lawyers about arbitration clauses. There is more awareness and recognition that the dispute resolution clause should form an integral part of the commercial negotiations and that is something of value. Previously, the focus was on the deal, and the dispute resolution clause was something that was 'tacked on' if someone actually thought about it, which sometimes gave rise to the validity of the clause, especially when it was poorly drafted.

Gearing: Arbitration clauses require careful drafting, and it is often advisable to include jurisdiction specific provisions in the region and take local advice if you're considering a seat outside Singapore or Hong Kong. For example, when contracting with Indian counterparties it is advisable to exclude Part I of the Indian Arbitration and Conciliation Act, and when selecting a seat in China parties are required to use a local institution to administer the arbitration such as CIETAC.

Kwan: Drafters should specify a single arbitration commission with matching arbitration rules. We have seen many clauses that specify more than one Chinese arbitration commission, provide for the option to appoint arbitrators outside the CIETAC panel, and provide for a national of a country which is not of the parties to be the presiding arbitrator. Drafters should not specify the ICC or other foreign arbitral institutions to administer the arbitration or include a jurisdiction clause, undermining the arbitration agreement. They also should not specify an arbitration venue and institution outside the PRC for domestic disputes which do not contain a foreign element, or specify a split clause, which provides for one party to have the option to arbitrate while the other party can only litigate.

Matthew Gearing is a partner at Allen & Overy LLP, Paul Starr is a partner and head in Asia for dispute resolution and construction practices at Mallesons Stephen Jaques, James Kwan is partner in the Hong Kong office of Simmons & Simmons.

MAY 2011

Kumkum Sen

INDIAN ARBITRATION AND CONCILIATION ACT, 1996: PROPOSED REFORMS

The Indian Supreme Court as early as 1981 had observed that "the way in which the proceedings under the existing law are conducted and without an exception challenged in Courts, has made lawyers laugh and legal philosophers weep", deprecating the unending prolixity at every stage.

Against this backdrop, three consecutive ordinances were passed so that the new law, the Indian Arbitration & Conciliation Act, 1996 (Act) – which is currently in its fifteenth year of providing a regime based on the UNCITRAL model aimed at party autonomy, minimum judicial intervention and maximum judicial support – in consolidating the existing diffused and outdated law relating to domestic and international arbitrations, was enacted. Over the years, the Indian Supreme Court, which had initially taken a non interventionist position in the case of Konkan Railway (2002) 2 SCC 388, has widened the scope of judicial intervention, effectively diluting the protection to International Arbitrations, as in the cases of Bhatia International (2002) 4 SCC 105, Venture Global 2008(1) SCALE 214 and recently Sony TV (2010) 112 BomLR 4292, by applying Part I of the Act (applicable where the place of arbitration is in India) in granting injunctive reliefs, intervening primarily on the ground of bifurcation of cause of action, in spite of the existence of an arbitration agreement and the Act providing for unconditional reference to arbitration, and even setting aside the award – something which was not envisaged under the New York and Geneva conventions, or the Act itself.

In spite of the Act arming tribunals with powers to grant injunctive reliefs to minimise judicial intervention, no enforcement mechanism is available. Parties therefore continue to approach the courts for such reliefs, even though there are several rulings to the effect that courts should not intervene once the tribunal is constituted.

In 2001, the Law Commission of India undertook a comprehensive review of the working of the Act and recommended several amendments, on the basis of which the Arbitration and Conciliation (Amendment) Bill 2003, was introduced. At that point in time, the disillusion had not fully set in, and as some amendments, such as empowering courts to fix a timeframe for delivery of the award by the Tribunal, appeared unduly onerous, though not entirely unwarranted, the bill was unceremoniously dropped.

In order to address increasing disenchantments with the above interpretations, a consultation paper was released by the Ministry of Law, proposing extensive amendments. For instance, instead of making the provisions of Part I of the Act uniformly applicable to international arbitrations or restricting its applicability to domestic arbitrations, as originally intended, it is proposed that Part I will apply to the extent parties can approach Indian courts for interim reliefs, including appeals arising therefrom and seek assistance of the courts in taking evidence of witnesses. The Supreme Court in SBP Co. v Patel Engineering Ltd. (2005) 8 SCC 618 had held that the court has the right to decide preliminary aspects such as the existence of an arbitration agreement, the existence of a live claim, etc. Taking this approach further in the case of India Household and Healthcare Ltd. v LG Household and Healthcare Ltd (2007) 5 SCC 510), the Supreme Court held that if a question in regard to the validity or otherwise of the arbitration agreement arises, under Section 8 of the Act, a judicial authority would have the jurisdiction to go into the said question. In Sukanya Holdings Pvt. Ltd. vs Jayesh H Pandya (2003) 5 SCC 531, the Supreme Court permitted third parties and others, strangers to the Arbitration Agreement, to challenge arbitrability. Although this section is based on clause 8 of the UNCITRAL Model Law, there is a major deviation insofar as the power of such authority to decide the existence and/or validity of the arbitration agreement is concerned. The outcome has been inordinate delays with disputes which are arbitrable being routinely entertained and adjudicated by the courts and quasijudicial bodies such as the Company Law Board.

To minimise judicial intervention, it is proposed that the court while appointing an arbitrator can only decide prima facie the existence of an arbitration agreement and all other preliminary

issues shall be determined by the tribunal, i.e., a return to the Konkan Railway approach.
A legal position which is a fallout of judicial pronouncements (2010)1SCC 72 that serious or complicated questions of law and fact, or allegations of fraud, are not treated as arbitrable disputes, has also been sought to be removed.

Clearly the amendments are aimed at empowering tribunals and minimising judicial intervention. Going forward, orders of tribunals granting interim relief are proposed to be enforced in the same manner as that of a court, taking recourse to court mechanisms.

The Supreme Court in the case of ONGC (2003) 5 SCC 705 had held on a challenge to an award on grounds of being opposed to the public policy of India that a wider meaning be given, so that a "patently illegal award" could be set aside. The Court had held that "giving limited jurisdiction to the court for having finality to the award and resolving the dispute by speedier method would be much more frustrated by permitting an illegal award to operate. A patently illegal award is required to be set at naught, otherwise it would promote injustice".

With the intention of curtailing this interpretation, a restrictive definition of public policy is proposed, whereby an award could only be said to be in conflict with the public policy of India if it is contrary to the fundamental policy of India, or the interest of India or justice or morality. Additionally, it is also proposed that a new ground of challenge namely, "patent and serious illegality, which has caused or is likely to cause substantial injustice to the applicant", may be provided for recourse in case of purely domestic awards. Whether the proposed amendment would indeed nullify the effect of the ONGC decision will be proved in its implementation.

The Supreme Court (2004) 1 SCC 540 had also taken a view owing to the mandatory language used in the Act under Part I that once an award is challenged (and entertained) within the stipulated time, i.e., three months, it would be deemed un-executable.

This caused considerable hardship and prejudice to the awardee as the court had no discretion to grant or refuse a stay, whether conditional or otherwise. This infirmity is proposed to be removed.

On balance, the proposed amendments definitely take India a few steps closer to what was initially aimed for when the 1996 Act was enacted on the UNCITRAL law and rules, i.e., to

have minimal judicial intervention and maximum judicial support, and to make arbitration the preferred mode of alternate dispute resolution, leaving courts free to administer justice.

Kumkum Sen is a partner at Bharucha. She can be contacted on +91 11 4593 9300 or by email: kumkum.sen@bharucha.in.

MAY 2011

Allan I. Young

NY APPELLATE COURT ALLOWS PRE-AWARD ATTACHMENT IN AID OF FOREIGN ARBITRATION

In a case of first impression, a New York intermediate appellate court has ruled that a foreign creditor can attach the New York assets of a foreign debtor, for security purposes, in anticipation of an award in a foreign arbitration proceeding, even though New York has no subject matter jurisdiction over the dispute or personal jurisdiction over the parties.

The facts of Matter of Sojitz Corp. v. Prithvi Information Solutions, Ltd., 2011 Slip Op. 01741 (NY App. Div. 1st Dept., March 10, 2011) are fairly straightforward. Sojitz, a Japanese company, contracted with Prithvi, an Indian company, to supply Chinese-made telecommunications equipment to Prithvi in India. The $47m contract between the parties provided that the laws of England governed, and that disputes would be settled by arbitration in Singapore. Prithvi did not have offices, bank accounts or employees in New York and was not licensed to do business in New York. Neither party regularly engaged in business in New York, nor did the dispute arise out of the transaction of business in New York. Prithvi did, however, have three or four customers in New York from whom Prithvi derived only about 1.4 percent of its annual revenue. One of those customers owed Prithvi the relatively small sum of $18,480.

When Prithvi failed to pay the $40m balance due on the goods delivered, Sojitz moved in New York for an ex parte order of attachment against Prithvi for $40m. Sojitz's petition alleged that it intended to commence arbitration in Singapore within 30 days of the order of attachment, but because it would take time to constitute the arbitral tribunal, there was a risk that Prithvi would dissipate the

assets. The lower court granted an order of attachment to secure the amount of $40m and ordered Sojitz to post a $2m bond.

Prithvi moved to vacate the order of attachment, arguing that it was not subject to jurisdiction in New York. The lower court vacated the $40m attachment, but confirmed the $18,480 attachment and reduced the bond to $900 or 5 percent of the amount attached, whichever was greater. Prithvi appealed.

In an opinion that discusses the seminal due-process cases, Pennoyer v. Neff, International Shoe Co., v. Washington, and Shaffer v. Heitner, the Appellate Division held that CPLR 7502(c) – the New York statute governing provisional remedies upon which Sojitz relied – provides the necessary "substantive and procedural safeguards to permit attachment consistent with due process." CPLR 7502(c) states, in pertinent part, that a court may issue an order of attachment "in connection with an arbitration that is pending or that is to be commenced inside or outside this state ... but only upon the ground that the award to which the applicant may be entitled may be rendered ineffectual without such provisional relief." One of the safeguards in the statute is that if the arbitration is not commenced within 30 days, the order of attachment "shall expire and be null and void with costs, including reasonable attorney's fees, awarded to the respondent."

The language referring to arbitrations "inside or outside this state" was added in 2005. Until this amendment, the statute, as interpreted by judicial decisions, did not provide courts with the authority to issue provisional remedies where the arbitration was outside of New York.

Noting that New York courts have "approved attachments used to execute foreign judgments against judgment debtors who have no contacts with the forum other than ownership of property there that can be used to satisfy the foreign judgments", the Appellate Division in Sojitz opined that "we perceive no reason why local assets belonging to a party should not also be attached prejudgment to secure payment of an eventual judgment against that party, provided that the party seeking the attachment demonstrates its entitlement to the provisional relief." Thus, the Appellate Division affirmed the order granting the pre-award attachment of $18,480 in aid of foreign arbitration.

Until and unless New York's highest court, the Court of Appeals, reverses this decision, it is now clear that, even in the absence of any New York presence or business activities, a foreign debtor's

New York assets can be attached in New York, for security purposes, in anticipation of an award to a foreign judgment creditor in a foreign arbitration proceeding.

Allan I. Young is counsel at Porzio, Bromberg & Newman P.C.

MAY 2011

Rogério Carmona Bianco, Alexandre Domingues Serafim and Fábio Peixinho Gomes Corrêa

ARBITRATION IN COMPLEX FINANCIAL INSTRUMENTS AND GUARANTEES IN BRAZIL

As international transactions increase in Brazil, banks and financial institutions have been encouraged to rethink their aversion towards arbitration. Indeed, bankers and their counsel no longer rely on the 'arbitration versus litigation' approach since it fails to access the courts, costs and procedures available in each country. Rather, a case by case approach may point to the kinds of transactions that justify a choice of arbitrating issues related to complex financial instruments and guarantees, leaving the enforcement measures to the state courts. In this article, we will argue that litigation is not necessarily the only choice in Brazil to solve controversies over sophisticated financial instruments and guarantees. In fact, the Brazilian Arbitration Law facilitates a healthy coexistence between arbitration and litigation, offering investors the best of each method of resolving disputes.

The Brazilian Judiciary Branch routinely enforces payment claims that do not involve complex legal questions or fact finding. Since the court proceedings are tailored to provide a summary judgment whenever possible, most creditors find them more efficient and cost effective than arbitration. However, such rationale should not be extended as a general rule beyond the basic financial instruments and guarantees. If a bank or financial institution tries to enforce a SWAP agreement against a Brazilian national, they will most likely find judges that have never come across a similar transaction and it will become a case of first impression. Although control of decisions by higher courts on appeal in some situations may offer more legal certainty, the absence of consolidated

jurisprudence on this matter can easily turn such case into a lengthy and expensive dispute in Superior Courts. In the end, the abusive loan agreements often discussed in court by customers might become an improper ground for a decision in this case.

Instead of choosing judges that are more likely to find themselves in the position of debtors, arbitrators in Brazil tend to have great expertise in the financial field as they also act as counsel for financial institutions and corporations on financial matters. Since most arbitrators have already oriented their clients in building contractual structures to allow a natural performance of the agreement, their experience as lawyers comes into play in favour of preserving – at first sight – the validity of complex financial instruments and guarantees, leaving aside any predisposition against creditors. Nowadays arbitrators' commitment to making arbitration a quick and effective form of solving disputes creates a more welcoming environment for agreements in which both the value and its liquidity are at stake. The mere fact that appeals in Sao Paulo, for instance, may take three to four years to be ultimately decided weighs in favour of a swift and well grounded arbitral award. Thus the arbitration clause may play a decisive role in preventing and solving these disputes.

The bargaining power of major banks' in international transactions can be seen up front in financial instruments and guarantees due to their great concern with the substantial aspects of the agreement. Nevertheless, all this effort can become void if the forum choice clause is focused only on assuring a jurisdiction that is considered bank-friendly and not in overcoming obstacles to enforce foreign judgments in Brazil. If the counterparties have assets only in Brazil, similar effort should be spent in finding the jurisdiction that would render a final decision more acceptable to enforcement courts. When the Brazilian Supreme Court recognised the constitutionality of the Brazilian Arbitration Law in 2002, arbitral awards gained a clear advantage over foreign courts' decisions. Now arbitrations seated in Brazil produce awards that are equally valid and effective as the decisions of national courts, allowing the winning party to enforce them without previously submitting them to a scrutiny process before the Superior Court of Justice. Even when such a scrutiny process cannot be waived – as in international arbitral awards – a valid arbitration clause is a giant leap towards its enforceability under the New York Convention.

In both scenarios, the arbitration clause may be inserted into the agreement to refer decisions on their merits to arbitrators, along with a forum choice clause providing for enforcement measures before Brazilian courts. This two-tiered structure grants to the creditor the opportunity to file a lawsuit to collect the payment due by the debtor and obtain the court's decisions regarding the

attachment of assets. Irrespective of the attachment of assets to guarantee the payment, it is up to the debtor to file an arbitration request before the arbitration institution chosen in the clause seeking an award on the merits. This coexistence of arbitration and litigation do not change the ordinary course of the proceedings since in Brazil debtors can only raise their defence arguments through a distinct lawsuit. Consequently the main difference in this two-tiered structure is not related to the enforcement proceedings per se, but to the defence mechanism which would be entrusted to arbitrators, not judges, to rule on the merits of the case. Without the arbitration agreement, debtors would be completely free to bring a lawsuit to discuss the validity of the financial agreement before the court.

The Brazilian Superior Court of Justice has ruled in favour of such coexistence (See e.g., Special Appeal n. 944.917-SP, Reporting Justice Nancy Andrighi, Judgment on 18 September 2008), dismissing motion against courts' jurisdiction over the enforcement measures. In such award, the Justices have unanimously agreed that it would be useless to commence arbitration proceedings in pursuit of an award that would only confirm the debt admitted in the agreement. Nonetheless, according to the Brazilian law, arbitrators lack power over the debtor assets, in which case only court judges could issue attachment orders and satisfy the debt through the auction of the assets attached.

In arbitrations seated in Brazil, its final award will be immediately enforceable, in which case the parties will resume the enforcement proceedings and, depending on the arbitrator's ruling, proceed with the auction of the assets without an appeal on the merits to the higher courts. The Brazilian court system has experienced some improvement in recent years, which have increased the judge's power of coercion over debtor's assets, including the seizure of financial assets. It can be thus said that the suggested two-tiered structure would provide the best of the two worlds for banks and financial institutions. While creditors will have immediate access to enforcement measures before state courts, they will rely on commercially-minded and fair arbitrators to decide on the merits of sophisticated financial instruments. On one hand, arbitration works as a safe and efficient way to solve disputes involving financial instruments; on the other hand, the power of the court to enforce such an agreement remains intact.

These advantages and disadvantages can only be determined on a case by case basis, taking into account the type of the transaction and the counterparty's assets. Such assessment will not seek to define if litigation in court is preferable to arbitration, but if litigation in court should come first then

coexist with arbitration. In an emerging market such as Brazil, the two-tiered structure explained above is crucial in the fight against delay in the legal process, making the most of the banks' and financial institutions' day in court and in arbitration.

Rogério Carmona Bianco, Alexandre Domingues Serafim and Fábio Peixinho Gomes Corrêa are partners at Lilla Huck.

JUNE 2011

Nish Shetty, Randolph Khoo and Richard Chalk

TALKINGPOINT: ARBITRATION IN SINGAPORE

FW moderates a discussion covering arbitration in Singapore between Nish Shetty at Clifford Chance, Randolph Khoo at Drew & Napier, and Richard Chalk at Freshfields Bruckhaus Deringer.

FW: What are some of the recurring themes behind corporate conflicts being resolved in Singapore?

Chalk: The arbitrations which we have come across in Singapore typically involve, in broad terms, commercial and corporate disputes, insurance, construction, and shipping. Many of these are multi-jurisdictional in nature, and the parties typically agree to arbitrate in Singapore because it is considered to be a neutral venue. In the past two years, one major trend we have seen is a significant increase in the number of cases commenced due to the financial crisis. A large number of these cases appear to have been commenced for strategic reasons, in an attempt to pressure the respondent to address delays in payment, and to renegotiate their deals, rather than because there was necessarily a 'genuine' dispute between the parties. As a result, quite a few of these cases settle relatively early, rather than proceed all the way to a full hearing.

Shetty: Perhaps the single biggest recurring theme is the diversity of the corporate conflicts being resolved in Singapore. Singapore is a venue for resolution of disputes across the board, from commercial/trade to maritime and construction, and so on. Not only is Singapore being designated as a seat for SIAC arbitrations, but it is also increasingly a seat for arbitration under a number of the

European institutional rules such as the LCIA Rules and ICC Rules. A number of institutions such as the ICC, WIPO, ICSID, and the PCA – to name but a few – have acknowledged the shifting focus towards Asia, and in particular Singapore, by taking up residence in the new Maxwell Chambers.

Khoo: A broad enduring theme for corporate conflicts resolved here would be quintessential contractual disputes. A closer look at these would disclose a growing number of such commercial conflicts arising out of deals going bad, funding or business drying up, or projects going wrong. Other discernible trends reflect the current intensity and dynamism of foreign direct investment in Asia, leading to legal issues arising from international trade, financing, infrastructure, construction, and maritime work.

FW: Are more companies using the Singapore International Arbitration Centre (SIAC) to resolve their disputes, and if so from what countries?

Shetty: SIAC is one of the fastest growing arbitral institutions in the world in terms of disputes, and has enjoyed 10 consecutive years of growth. If you look at the SIAC 2010 annual report, the number of disputes referred to SIAC increased by 24 percent from 2009. Parties from 45 different countries were involved in SIAC arbitrations, from Panama to Norway to Mongolia, demonstrating that SIAC not only caters for referrals from the Asia region but has global appeal as a forum for resolving disputes. Perhaps the most notable user of SIAC is India, as Singapore is being widely regarded as a proximate and neutral venue for resolution of India related disputes.

Khoo: The SIAC administered 198 new cases in 2010, up from 160 new cases in 2009, and 99 new matters in 2008. The SIAC 2010 Report mentions that "[t]he number of disputes referred to the SIAC in 2010 rose for the tenth consecutive year". A review of the new cases referred to the SIAC in 2010 would give an idea of the geographical diversity of the arbitrating parties that span 45 jurisdictions. Most disputes were from Singapore, followed by India, Hong Kong, Indonesia, Vietnam, China, the US, Malaysia, Korea, and Japan. The cases handled by the SIAC in 2010 also involved parties from as far afield as Liberia, Mongolia and the British Virgin Islands.

Chalk: In the past two years in particular, the SIAC has seen a very significant increase in its caseload, from 99 new cases in 2008 to 198 new cases in 2010. Unsurprisingly, the largest single group of users comprise Singapore companies. However, given that Singapore is the regional headquarters for many multinationals, a significant proportion of these are in fact Singapore subsidiaries of

foreign companies. Perhaps more surprisingly, the second largest group of users now comprises Indian companies, and in recent years, Indian arbitrations have certainly become a significant part of SIAC's portfolio. Other significant parties include those from Hong Kong, Indonesia, Vietnam, China and other jurisdictions in South Asia. The challenge for Singapore is to attract more users from Europe and the US.

FW: Has the government been instrumental in promoting Singapore as a venue of choice for arbitration? How do new facilities such as Maxwell Chambers emphasise this commitment?

Khoo: The government has been consistently cultivating a legislative framework supportive of arbitration. The Attorney General appointed a law reform sub-committee in 1991 to conduct a major review of Singapore's international arbitration laws. A major impetus behind this was Singapore's aim of being, at least, a regional centre for arbitration, having laws governing arbitrations in line with most international standards and practices. A major step taken in that direction was the adoption of the UNCITRAL Model Regime under the Singapore 1994 International Arbitration Act. The Legal Profession Act in Singapore was also amended in 2004 to remove all restrictions on foreign lawyers representing clients in arbitrations within Singapore. Prior repealed legislation allowed foreign lawyers to participate in arbitrations in Singapore only where the law 'applicable to the dispute' was 'not the law of Singapore'. in those days, a foreign lawyer only could appear at arbitrations of disputes governed by Singapore law jointly with a Singapore qualified lawyer. Recent legislative amendments have also opened Singapore's shores to international law firms to setting up practices in Singapore. The Singapore government has also reiterated it will constantly review the legal regime to ensure that Singapore remains arbitration friendly.

Chalk: I have little doubt that the growth of arbitration in Singapore in recent years is very much due to the efforts of the government, and the very focused and deliberate approach in which it has promoted Singapore as a leading venue in the region. The increase in the number of India-related arbitrations, for example, is clearly the result of these efforts. Similarly, Maxwell Chambers which opened to great acclaim in 2009, has certainly raised the bar for international arbitration infrastructure, and it has also further raised Singapore's profile, particularly beyond the region and onto the international stage. I know from personal experience that many international arbitrators, and not just those based in the region, have been very impressed by the facilities there, and are very happy to accept arbitral appointments in Singapore. This has had good knock-on effects, as we have seen some other countries in the region more prepared to follow Singapore's lead, and to

also invest further in improving their own arbitration-related infrastructure.

Shetty: The Singapore Government has played a critical role with its focus on fostering business through internationalism and efficiency. This focus has permeated into its policy on international arbitration. It is extremely responsive to legal developments in the Singapore courts and further afield, with an enviable reputation throughout the arbitration community for its ability to update and improve arbitration legislation within a matter of months. It's most recent full scale overhaul of the arbitration legislation – which was specifically aimed at maintaining and enhancing Singapore's competitiveness in the field of arbitration – came into force in January 2010. The Singapore Government's investment in the state-of-the-art Maxwell Chambers dispute resolution facility is a tangible demonstration of its commitment to making Singapore the leading venue for international arbitration in Asia. The number of international arbitral institutions and foreign arbitrators that have taken up 'residence' at Maxwell Chambers, and the number of Maxwell Chambers-style facilities that are now being opened up in other jurisdictions, is a testament to its success.

FW: Could you note some of the advantages of conducting an arbitration process in Singapore?

Chalk: Many of the advantages of arbitrating in Singapore are well known. On the legal side, these include the fact that it has a strong rule of law; excellent arbitration legislation based on the UNCITRAL Model Law; a pro-active legislature which constantly seeks to ensure that Singapore's arbitration laws remain 'state of the art'; an efficient and supportive judiciary; and of course, Singapore is a signatory to the New York Convention. As for the infrastructure, Maxwell Chambers brings with it top notch facilities; and Singapore also has a central location, strong transport links and many excellent hotels. Furthermore, Singapore has a strong multicultural society, a wide range of counsel is available, and there is freedom of representation by foreign counsel in international arbitrations. It is really this strong combination of factors which makes Singapore stand out as a leading arbitration seat for Asian arbitrations.

Shetty: As well as modernised legislation and state-of-the-art facilities, Singapore offers a number of other advantages. Both the courts and the legal profession have embraced arbitration. For example, the courts have consistently upheld arbitral awards and the courts may grant interim relief not only in support of Singapore arbitration but also in support of arbitration conducted abroad. There is no restriction on foreign law firms advising on arbitration, which gives parties the

flexibility to shop around for their preferred counsel. Another advantage of conducting arbitration in Singapore is its geographical proximity to many emerging markets and its transport connections. Last but not least, the convenience, efficiency and hospitality of Singapore, makes it an obvious choice as a venue for hearings.

Khoo: Singapore is an independent neutral third-country venue currently top-rated in the world for neutrality in the Corruption Perceptions Index. Its reputably efficient national institutions, including a well-regarded Court system, foster confidence in support for and supervision of arbitral proceedings in the country. The internationally familiar UNCITRAL Model Law is the cornerstone of Singapore's international commercial arbitration legislation. Parties have full freedom of choice of counsel in arbitration proceedings regardless of nationality. Parties arbitrating can use any governing law and agree on any set of arbitral rules if so desired. Non-residents do not require employment passes or permits to carry out arbitration services in Singapore. Income earned by foreign arbitrators is tax exempt and there is a tax incentive scheme for arbitration work for law firms. SIAC's arbitral administration costs are lower than almost any other major centre of arbitration. As a party to the 1958 New York Convention on enforcement of arbitration awards, 'made in Singapore' arbitration awards are enforceable in over 140 countries worldwide. Logistically, Singapore's central location in Southeast Asia at a major East-West intersection makes access to and from Singapore relatively easy.

FW: To what extent does Singapore's well-developed legal system give participants additional confidence and assurance, compared to certain other jurisdictions in Asia?

Shetty: Whilst cross-border business and investment has been growing in the Asia region, many companies with operations in the region do not have full confidence in receiving an impartial hearing in the courts of jurisdictions with relatively less sophisticated and less developed legal systems. In contrast, Singapore has a strong rule of law culture; is ranked first in the world for neutrality under the Corruption Perceptions Index, and enjoys a reputation of having a neutral and impartial judiciary. In addition, parties concerned with reaching a timely resolution may be able to fast-track their dispute in accordance with the 'expedited procedure' introduced in the 2010 SIAC Rules, rather than having to be subjected to potentially prolonged and uncertain processes in other jurisdictions. Moreover, Singapore's arbitration-friendly courts mean that parties do not need to worry about undue judicial interference in the arbitral process, and can have confidence that this attitude is carried over into the court's approach to enforcement of arbitral awards in Singapore.

Khoo: The Singapore courts have evolved views on arbitration consistent with other leading centres for arbitration. The courts will therefore pay full heed to party autonomy and uphold parties' agreements to arbitrate even where that intention may be poorly or ambiguously expressed. In a 2008 case, the parties provided an apparently self-contradictory clause calling for arbitration 'before' the SIAC 'in accordance with' ICC Rules. The High Court decided that this hybrid clause did indeed provide for the SIAC to administer an arbitration governed by the ICC Rules, notwithstanding differences between how the two institutions administer arbitrations. By contrast, foreign courts in the last decade are known to have declared void and labelled as 'pathological' similar tortuously worded arbitral clauses. In a 2006 decision, the Singapore Court of Appeal also declined to follow the lead of the Supreme Court of India in its 2003 decision of SAW Pipes Ltd, which decided not to enforce an award on the footing of it being held to be wrong in law, and therefore being in conflict with Indian public policy. The Singapore court adopted a much narrower view of 'public policy', confining it to the most basic tenets of morality and justice like corruption, bribery and fraud, not encompassing mere errors of law.

Chalk: In this area, I think Singapore has two clear advantages which are not found in most other jurisdictions in Asia. First, it has a very proactive legislature which has resulted in Singapore consistently having 'state of the art' arbitration legislation. Secondly, not only is the legal system first rate, but the courts themselves are very efficient and they are strongly supportive of arbitration. In the region, this combination is not common. In particular, even though a number of jurisdictions in Asia have modernised their arbitration legislation, the actual attitude of the courts towards arbitration is sometimes still quite tentative. So I think these are clearly areas of strength for Singapore.

FW: How would you describe the commercial and technical expertise of arbitrators in Singapore?

Khoo: The SIAC maintains an international panel of accredited arbitrators comprising professionals and experts with a broad range of knowledge and expertise – currently with over 330 arbitrators from 33 jurisdictions. Allowing for a definition of 'arbitrators in Singapore' to encompass those who actively and frequently arbitrate here irrespective of their nationality or country of origin, one can find a number of luminaries amongst the ranks of the arbitrators here including Dr Michael Pryles, David W. Rivkin and others, who also sit on the board of directors of the SIAC. The emerging popularity of Singapore as a leading arbitral venue is perhaps the best testimony to the acknowledged commercial and technical expertise of arbitrators here.

Chalk: When we consider arbitrators in Singapore, I think it is important to recognise that this comprises not only arbitrators based in Singapore, but also leading regional and international arbitrators who are happy to sit in Singapore arbitrations. I think that on both fronts, they are excellent. First, as far as the Singapore arbitrators are concerned, Singapore has placed a strong focus on developing their technical skills. As a result, there is now a critical mass of Singapore arbitrators who have a range of skills and experience, and who are able to take on appointments across a range of disciplines. This, coupled with their cultural and linguistic familiarity with the region, means that they are often excellent choices for appointment as arbitrators. As for the foreign arbitrators, many of them are very happy to accept appointments in Singapore, and we have almost never seen a case where a leading international arbitrator has turned down a Singapore appointment, on the basis that he or she does not wish to arbitrate there. In contrast, our experience with certain other arbitral seats in the region has been more mixed.

Shetty: Skills, knowledge and experience are important factors in the selection of arbitrators for parties. With many arbitrators sourced from the Singapore offices of leading international and local firms, the level of skills and knowledge offered by Singapore arbitrators is outstanding and is a key reason for Singapore's growth in popularity as a centre of arbitration. Singapore arbitrators are also becoming increasingly experienced, given the growing number and diversity of disputes resolved in Singapore. Language skills and multiculturalism are other benefits brought by Singapore arbitrators.

FW: Where does Singapore stand relative to Hong Kong in terms of choice as an arbitration venue in Asia?

Chalk: Both Singapore and Hong Kong are undoubtedly the two leading international arbitration seats in the region. Although much has been made of a supposed rivalry between the two, I think that view is simplistic. Instead, it has become increasingly clear that Singapore is the leading choice for South Asian arbitrations, including India-related arbitrations, whereas Hong Kong still remains very much the pre-eminent choice for China-related arbitrations. This is borne out by the statistics. In 2010, for example, Singapore handled 14 cases involving mainland Chinese parties. In contrast, over the same period, Hong Kong handled 91 cases involving mainland Chinese parties. Instead of focusing on the supposed competition between Singapore and Hong Kong for arbitrations, I think the broader and more important trend is that Asia is increasing its overall share of arbitrations. In particular, even for very substantial international contracts, we are seeing many instances where

parties agree to arbitrate in Asia – typically in Singapore or Hong Kong, whereas in the past, these contracts would have provided for arbitration in Europe or the US.

Shetty: Singapore has caught up with, and some would say surpassed, Hong Kong as the choice of arbitration venue in Asia. It is without doubt one of the top choices in Asia. Having said that, Hong Kong appears to be a popular venue for arbitrations that have a connection with China, and Hong Kong is certainly an arbitration-friendly jurisdiction.

Khoo: The proximity of Hong Kong to China and economic integration of the two economies in 2003, has led to Hong Kong being a popular venue for arbitration of international disputes. These also encompass PRC-foreign party arbitrations with foreign parties wary of disputes being resolved in China. While Hong Kong has been widely considered an attractive and leading arbitration centre in Asia, many practitioners now discern a clear trend of arbitration disputes moving to Singapore. A collaborative survey done by White & Case LLP and the School Of International Arbitration, Queen Mary University of London in 2010 ranked Singapore as the 'most popular Asian seat'. The survey described Singapore as an emergent 'regional leader in Asia', on the backbone of favourable scores in three main factors of having a good 'formal legal structure', governing law and convenience – in terms of location, access to counsel, language/culture and efficacy of court supervision. Anecdotal evidence suggests that parties seem to feel more comfortable with Singapore than Hong Kong, especially when the counterparty is Chinese.

FW: Are there any specific issues that participants should know about the arbitration process in Singapore, which perhaps differ from other regions?

Shetty: Perhaps the key issue that differentiates Singapore from other regions is the supportiveness of the courts towards arbitration and the speed at which courts will act. The experience of Singaporean judges in handling arbitration related issues and their non-interventionist/pro-arbitration approach, as well as the fact that all proceedings are conducted in English, makes it the stand-out neutral venue for arbitration within the region. The Singaporean Government's support of arbitration is also worth bearing in mind. In addition to its proactive approach to ensuring that the relevant legislation remains up-to-date with developments in the field, and the establishment of Maxwell Chambers, it also offers a favourable tax regime for the conduct of arbitrations in Singapore.

Khoo: Singapore has a dual track arbitration regime, with separate statutes governing international

and domestic arbitration respectively. The main distinction between the two is the degree of intervention by the courts. For instance, the domestic arbitration statute gives parties the right, with leave of court, to appeal on questions of law, reserves allegations of fraud for the courts to decide and gives the court discretion whether or not to stay an action brought in breach of an arbitration clause. In contrast, there is no right of appeal on questions of law in international arbitrations in Singapore, no rule that an arbitrator may not decide on questions involving fraud and the powers of the court to stay an international arbitration are far more limited compared to domestic arbitrations. Parties to an international arbitration may contract out of parts of the international arbitration statute or the UNCITRAL Model Law. Conversely, it is also open to parties to a purely domestic arbitration to apply the Model Law.

Chalk: Singapore's arbitration legislation is based on the well-known UNCITRAL Model Law, and the SIAC's arbitration rules are based on a number of well-established international arbitration rules. I will highlight just two features of its current rules, which came into effect on 1 July 2010. First, the new rules allow a party to apply for emergency relief from an emergency arbitrator, at the same time as filing the notice of arbitration. Under this procedure, the SIAC will seek to appoint an emergency arbitrator within one business day of receiving the application; and the emergency arbitrator will, within two business days, establish a schedule for considering the application. The emergency arbitrator has the power to order or award any interim relief he deems necessary, but he will have no further power to act after the tribunal is constituted. To date, this procedure has been used in a few cases and the applications have been dealt with promptly. Secondly, the new rules address the current concerns over delays and cost in international arbitrations. They provide for an expedited procedure that applies where the amount in dispute does not exceed S$5m – about US$4m; the parties agree to it; or the case is one of exceptional urgency. Where the procedure applies, the case will be referred to a sole arbitrator, unless the SIAC chairman decides otherwise; the award should in general be rendered within six months; and the tribunal only has to give its reasons in summary form.

FW: Does Singapore lend itself to arbitration involving multi-jurisdictional disputes? Do you expect its appeal to grow further over the months and years ahead?

Khoo: The responsive governmental, legislative and judicial policies to arbitration are undoubtedly going to continue to make Singapore conducive to arbitration of multi-jurisdictional disputes. For instance, the Singapore Court of Appeal in 2007 ruled that the existence

of the Singapore court's personal jurisdiction over a defendant per se, did not allow a court to grant a mareva injunction in aid of foreign arbitration. A legislative amendment tabled in 2009 and coming into effect on 1 January 2010, empowers the Singapore courts to grant injunctions in aid of foreign arbitrations. The increase in multinational corporations doing business in Asia and countries surrounding Singapore having confidence in the legal infrastructure, convenience and cost-effectiveness of resolving cross-border disputes by arbitration in Singapore, is also likely to contribute to Singapore taking the lead in Asia in resolving multi-jurisdictional commercial conflicts. The SIAC's steady increase in its caseload is indicative of the country's increasing popularity and the SIAC's emerging success as an arbitration centre for the resolution of international disputes. As such, I would certainly expect Singapore's appeal as an international arbitration centre to be ascendant in the months and years ahead.

Chalk: Last year, for example, about 70 percent of the SIAC's cases were international arbitrations, which are typically arbitrations and multi-jurisdictional in nature. I think this is an important point to highlight about the SIAC's caseload, because even though we are seeing a steady increase in the number of arbitration cases in Asia when it comes to international arbitrations, it is really only Singapore – and Hong Kong – which stand out from the rest. From our own personal experience, what is striking is that in many cases, parties agree to arbitrate in Singapore, even though the contract itself has little or no connection with Singapore. That, I believe, is the hallmark of a true international arbitration centre, and Singapore is clearly a leader here. This is similarly reflected in the figures from the ICC, where in recent years, Singapore has been the most popular seat for ICC arbitrations seated in Asia. For the immediate future, I think the impetus is definitely very much in favour of Singapore and it is certainly doing all the right things to attract more arbitrations. Looking further ahead, there are a number of other arbitral jurisdictions which are also promoting their services actively, although we will have to wait for at least a few years to see if they continue to grow in importance.

Shetty: Singapore is an attractive seat for arbitration involving multi-jurisdictional disputes. It has long been a hub for world trade, which means that the familiarity of its legal practitioners and judiciary with disputes in a cross-border context is unrivalled. It is a signatory to all of the key conventions that facilitate international arbitration, notably, of course, the New York Convention. Singapore has grown to be the Asian regional leader in arbitration and as increasing levels of capital flow east its attractiveness as a centre for arbitration is likely to only increase.

Nish Shetty is a partner and head of International Arbitration and Dispute Resolution, South East Asia, at Clifford Chance, Randolph Khoo is a director in the dispute resolution department of Drew & Napier LLC and Richard Chalk is head of the Asia dispute resolution practice at Freshfields Bruckhaus Deringer.

JULY 2011

Sidhartha Srivastava

ENCOURAGING TREND IN ARBITRATION LAWS IN INDIA

The Supreme Court of India in its judgment dated 11 May 2011 in the matter of Videocon Industries Limited (Civil Appeal No.4269 of 2011, arising out of SLP(C) No.16371 of 2008) has clarified the applicability of the Indian Arbitration and Conciliation Act, 1996 (Indian Act) in relation to the jurisdiction of India's courts to pass interim orders in contracts where the arbitration clause is subject to law other than Indian law.

The government of India owned petroleum resources within the area of India's territorial waters and exclusive economic zones. On 28 October 1994, a Production Sharing Contract (PSC) was executed between Respondent No. 1 on the one hand and a consortium of four companies consisting of Oil and Natural Gas Corporation Limited, Videocon Petroleum Limited, Command Petroleum (India) Private Limited and Ravva Oil (Singapore) Private Limited (hereinafter referred to as 'the Contractor') in terms of which the latter was granted an exploration licence and mining lease to explore and produce the hydrocarbon resources owned by Respondent No. 1.

In 2000, disputes arose between the Respondents and the Contractor with respect to correctness of certain cost recoveries and profit. Since the parties could not resolve their disputes amicably, the same were referred to the arbitral tribunal under Clause 34.3 of the PSC. The arbitral tribunal fixed 28 March 2003 as the date of hearing at Kuala Lumpur (Malaysia), but due to an epidemic outbreak the arbitral tribunal shifted the venue to Amsterdam in the first instance and, thereafter, to London. On 31 March 2005 the partial award came to be passed. Respondent No. 1 challenged the

partial award by filing a petition in the High Court of Malaysia at Kuala Lumpur. On being noticed, the Appellant questioned the maintainability of the case before the High Court of Malaysia by contending that in view of Clause 34.12 of the PSC only the English Courts have the jurisdiction to entertain any challenge to the award.

Respondent No. 1 then approached the Delhi High Court seeking inter alia the stay of the arbitral proceeding under Section 9 of the Indian Act. The Appellant objected to the maintainability and pleaded that the courts in India do not have the jurisdiction to entertain a challenge to the arbitral award. The Delhi High Court relying on the judgment of Bhatia International ((2002) 4 SCC 105) exercised its jurisdiction and entertained the petition.

The question before the Supreme Court of India was whether the Delhi High Court has the jurisdiction to entertain such a petition, especially in view of clause 34.12 of the PSC.

The arbitration clause before the Supreme Court included the following provisions. First, under Article 33.1: "Subject to the provisions of Article 34.12, this Contract shall be governed and interpreted in accordance with the laws of India". Second, under Article 33.2: "Subject to Article 17.1 nothing in this Contract shall entitle the Contractor to exercise the rights, privileges and powers conferred upon it by this Contract in a manner which will contravene the laws of India." Third, under Article 34.12: "The venue of sole expert, conciliation or arbitration proceedings pursuant to this Article, unless the Parties otherwise agree, shall be Kuala Lumpur, Malaysia, and shall be conducted in the English language. Insofar as practicable, the Parties shall continue to implement the terms of this Contract notwithstanding the initiation of arbitral proceedings and any pending claim or dispute. Notwithstanding the provisions of Article 33.1, the arbitration agreement contained in this Article 34 shall be governed by the laws of England".

In answering the proposition of whether the Delhi High Court had the jurisdiction to entertain the petition, the Hon'ble Supreme Court relied upon the Judgment rendered in Bhatia International (Supra), Venture Global ((2008) 4 SCC 190) and Hardy Oil and Gas Limited v. Hindustan Exploration Company Limited and ors ((2006) 1 GLR 658), a Gujarat High Court Decision.

The Supreme Court referred to the following observation of the Hon'ble Supreme Court in Bhatia International: "To conclude, we hold that the provisions of Part I would apply to all arbitrations and to all proceedings relating thereto. Where such arbitration is held in India the provisions of

Part I would compulsorily apply and parties are free to deviate only to the extent permitted by the derogable provisions of Part I. In cases of international commercial arbitrations held out of India provisions of Part I would apply unless the parties by agreement, express or implied, exclude all or any of its provisions. In that case the laws or rules chosen by the parties would prevail. Any provision, in Part I, which is contrary to or excluded by that law or rules will not apply."

Similarly, the Supreme Court relied upon the observation in the case of Venture Global, "...By omitting to provide that Part I will not apply to international commercial arbitrations which take place outside India the effect would be that Part I would also apply to international commercial arbitrations held out of India. But by not specifically providing that the provisions of Part I apply to international commercial arbitrations held out of India, the intention of the legislature appears to be to ally [sic allow] parties to provide by agreement that Part I or any provision therein will not apply. Thus in respect of arbitrations which take place outside India even the non-derogable provisions of Part I can be excluded. Such an agreement may be express or implied."

Lastly, the Supreme Court relied upon the judgment of the Gujarat High Court in Hardy Oil and Gas Limited v. Hindustan Oil Exploration Company Limited and Ors, which also relied upon the judgment of Bhatia International and held that provisions of Part I of the Indian Act would apply unless the parties by agreement express or implied, exclude all or any of its provisions.

While answering the above question, the Supreme Court of India held that since the law of England is the governing law of the Arbitration Agreement, there is an implied exclusion of Part I of the Indian Act and therefore the Indian Court had no jurisdiction to entertain the petitions of Respondent No.1 and further held that Part I of the Indian Act is applicable to all arbitration including international arbitration unless the parties to the arbitration agreement have expressly or impliedly excluded its applicability.

This judgment augers well for international commercial arbitration and is a positive step towards making India a friendly jurisdiction, especially when India has received a lot of flak for intervention of the courts in arbitration proceedings.

Sidhartha Srivastava is a partner at D. H. Law Associates.

JULY 2011

Ashley Bell

HAS THERE EVER BEEN A BETTER TIME TO ARBITRATE DISPUTES IN ASIA?

The advantages of arbitration over other dispute resolution methods are well known. In Asia, those advantages, together with the perceived need to avoid local courts, have led to arbitration being a preferred method of dispute resolution for some time. However, governments and arbitral institutions in the region are not resting on their laurels. A number of recent developments in Asia, driven by competition between governments and arbitral institutions attempting to gain a foothold or increase their presence in the market, have resulted in the region becoming an even more attractive destination for the resolution of international disputes. The upshot is that the international business community can now be more confident than ever that disputes in the region will be resolved efficiently and in accordance with best international practices.

Modern arbitration regimes

There have been a number of recent legislative developments across Asia, as governments either fine-tune their already arbitration-friendly regimes or overhaul their regime in a bid to enter the arbitration marketplace.

Perhaps the most eagerly awaited development was the introduction of the new Arbitration Ordinance ('New AO') in Hong Kong on 1 June 2011. In accordance with the current trend in Asia, the New AO largely mirrors the framework of the UNCITRAL Model Law, unifying the previously existing dual 'domestic' and 'international' regimes, whilst at the same time allowing parties to 'opt-in' to a number of provisions which previously applied only to domestic arbitrations and provide for a higher degree of court supervision. The New AO also clarifies the nature of interim

measures which arbitral tribunals may order, clarifies the procedure for the enforcement of New York Convention awards, Mainland awards and Non-Convention Non-Mainland awards (such as awards made in Taiwan) and expressly empowers Hong Kong courts to grant interim measures in respect of foreign arbitration proceedings (in certain circumstances).

One of the more interesting features of the New AO is that it contains an express provision preserving the confidentiality of arbitration proceedings. Under the new law, parties are prohibited from disclosing any information relating to arbitration proceedings or the arbitral award (unless they agree otherwise) and court proceedings ancillary to arbitration proceedings are now to be conducted in closed court, unless the court directs otherwise. This is a welcome development given that, whilst confidentiality is often promoted as an advantage of arbitration over other dispute resolution procedures, such obligations often need to be 'implied' into arbitration agreements in other jurisdictions.

Another interesting feature of the New AO is the preservation of the 'arb-med' procedure which existed under the previous regime, allowing arbitrators to act as mediators in the same proceedings after the arbitral proceedings have commenced, provided that the parties consent. If the mediation fails, the arbitrator must disclose all material confidential information obtained during the mediation to the parties and, as recent case law suggests, arbitrators must ensure that no impression of bias is created during the mediation phase (Gao Haiyan v Keeneye Holdings Ltd [2011] HKEC 514).

Hong Kong is not the only jurisdiction in Asia seeking to improve its arbitration regime. On 1 January 2011, Vietnam introduced a new Law on Commercial Arbitration aimed at correcting a number of flaws which plagued the previous system. The new law introduces a number of concepts which will be familiar to international parties, including the ability of courts to stay litigation proceedings if there is a valid arbitration agreement in existence and the ability of arbitral tribunals to grant interim relief. The new law also provides that foreign nationals may be appointed as arbitrators in Vietnam and foreign arbitration bodies may establish themselves in Vietnam.

Singapore and Australia have also recently amended their legislation. In Singapore, amendments in early 2010 empowered local courts to make interim orders in respect of foreign arbitrations and made it clear that Singaporean courts will not interfere in the arbitration process to make an interim order unless a tribunal cannot do so efficiently. In Australia, recent amendments sought to remove any lingering confusion caused by the interaction of State and Territory legislation to international

arbitration and, amongst other reforms, addressed the issue of confidentiality by providing parties with an option to make any arbitration proceedings confidential. Long overdue reforms are also proposed in India.

Progressive arbitration rules

Increased competition in the arbitration marketplace has also led a number of arbitral institutions to amend their existing arbitration rules in a bid to attract a larger share of disputes in the region. The SIAC, for example, revised its arbitration rules with effect from 1 July 2010 in an effort to provide a speedier and more cost efficient service.

Two aspects of the new SIAC Rules are particularly noteworthy. The first is the new expedited procedure, which will be available in cases where the total value of claims in dispute is below SGD$5m (approximately US$3.6m) or where there is exceptional urgency. If SIAC determines that the expedited procedure should apply, time-limits may be shortened, a sole arbitrator will be appointed unless the chairman determines otherwise and the arbitral tribunal need only state its reasons for the award in summary form. Further, unless there are exceptional circumstances, any award must be made no later than six months after the constitution of the tribunal.

The second noteworthy amendment is the introduction of the new emergency arbitrator procedure. The procedure aims to provide parties with an alternative to making an application to court where urgent interim relief is required prior to the constitution of the tribunal. Under the new procedure, the SIAC shall appoint an emergency arbitrator within one business day of receiving the application.

Thereafter, the emergency arbitrator has two business days in which to establish a schedule for the consideration of the application. Upon hearing the application, the emergency arbitrator may order or award any interim relief he deems necessary, with any such award being revisited by the arbitral tribunal ultimately appointed. The SIAC has to date received three applications for the appointment of an emergency arbitrator and in each case, an arbitrator was appointed within one day of the application and a decision on the application for interim relief was made within a week of appointment.

Upgraded facilities and increasingly international panels

The race to secure a larger piece of the arbitration pie has also led to the establishment of first class arbitration facilities in a number of jurisdictions and the establishment of increasingly international

panels of arbitrators. In Singapore, the Maxwell Chambers opened to much acclaim in early 2010 with 14 custom designed, state-of-the-art hearing rooms, whilst in Sydney, the new Australian International Disputes Centre opened in mid 2010. According to recent newspaper reports, the AIDC has already handled around 70 cases, 80 percent of which have involved foreign parties. Hong Kong is also doing its best to ensure that it retains its crown as the preferred venue for Chinese-foreign disputes, with the HKIAC recently announcing that it will double the size of its premises, whilst the Korean Commercial Arbitration Board is also refurbishing its facilities. At the same time, CIETAC has sought to actively promote its services to international parties by appointing another 37 non-Chinese practitioners to its panel, bringing the total number of foreign arbitrators to 218 from 30 countries.

Best practices

In light of the above developments, there can be little doubt that competition in the arbitration marketplace in Asia has led to improved arbitration regimes, rules and facilities across the region and, in turn, a more attractive environment for international disputes to be resolved. Given the strength of Asian economies and the active investment in arbitration by governments in the region, this 'friendly' competition is likely to continue. Now is the time for the international business community to take advantage of these developments.

Ashley Bell is counsel at O'Melveny & Myers.

AUGUST 2011

John Choong, David Bateson and Eric A. Szweda

TALKINGPOINT: ARBITRATION IN HONG KONG

FW moderates a discussion on arbitration in Hong Kong between John Choong at Freshfields Bruckhaus Deringer, David Bateson at Mallesons Stephen Jaques, and Eric A. Szweda at Troutman Sanders.

FW: What were the main reasons behind the implementation of Hong Kong's new Arbitration Ordinance? In your opinion, will they achieve their intended objectives?

Choong: The new Arbitration Ordinance is intended to bring into place a unitary system for international and domestic arbitrations, based on the UNCITRAL Model Law (Model Law). This will minimise the extent of judicial supervision and intervention in both types of arbitrations. I think this aim has been largely met. Under the new Ordinance, the Model Law applies to both types of arbitrations. However, certain legacy provisions which used to apply under the old Ordinance will continue to apply to domestic arbitrations, for a further six years. These legacy provisions allow for greater court intervention, and were included at the request of domestic users – in effect, this allows for a very lengthy transition period to adjust to the new unified regime.

Szweda: The motivation was to implement the latest thinking in the global arbitration community as to best practices in order to better achieve objectives such as cost reduction, speedier resolution of disputes, enhanced confidentiality, and in turn advance Hong Kong's position globally as a key centre for arbitrations. The new Ordinance has streamlined the arbitration process and reduced

areas of uncertainty, which will help meet the intended objectives. Furthermore, the new Hong Kong Ordinance includes an innovative section of options enabling parties to tailor the process to meet the specific needs of the case. This section of the law was driven more by domestic concerns, largely arising out of local construction disputes, but has produced a law that presents a measure of flexibility that others may gravitate towards over time. We can see on one hand the drive to harmonise, and on the other, to create flexibility.

Bateson: The new Arbitration Ordinance was implemented to set up a unitary system of arbitration based on the Model Law, which is an internationally recognised model. Non-Hong Kong parties and their lawyers are more familiar with the Model Law, rather than the previous domestic regime. The aim is to enhance Hong Kong as a premier arbitration venue in the region.

FW: Broadly speaking, could you outline the primary changes that have been introduced? How influential was the UNCITRAL Model Law in their development?

Szweda: Overall, the primary change has been to significantly streamline the Ordinance. The Ordinance is built on the UNCITRAL model provisions, and where deviations have been made, they are spelled out. Specific provisions enhancing the powers of tribunals to order an array of interim measures are a welcome addition. Provisions ensuring greater confidentiality than exist in most other jurisdictions are included. While certain provisions enhance the powers of the tribunals and limit the role of the courts, the 'opt in' provisions include a greater role for judicial oversight, including judicial review of awards based on grounds of serious irregularity, if the parties agree to such provisions. In an attempt to deal with the criticism that the costs of arbitrations are now nearing the cost of court litigation, the Ordinance gives tribunals the power to use procedures "appropriate to the particular case" and that parties shall be given a "reasonable" opportunity to present their cases.

Bateson: It is based in part on additions to the Model Law in 2006 and the notable changes are a compulsory stay of court proceedings in breach of the arbitration agreement; no right of appeal against awards, setting aside awards under limited grounds based on the New York Convention; new interim measures and preliminary orders; that tribunal will assess costs unless court taxation is agreed by the parties; and opt in provisions to previous domestic regime, for the appointment of sole arbitrator, determination of preliminary questions of law, challenging awards on grounds of serious irregularity and appeals on question of law.

Choong: One of the most significant changes is the abolition of the dual regime for 'international' and 'domestic' arbitrations, with the Model Law applying throughout. Another significant change is the adoption of new provisions dealing with interim measures. With the increasing pace of business, the availability of interim measures has grown in importance, and the new Ordinance gives the tribunal broad powers to order such measures. The new Ordinance also imposes a broad-ranging duty of confidentiality, with a list of circumstances in which disclosure will be allowed. The influence of the Model Law on the development of the new Ordinance has been considerable. For example, many of the new provisions on interim measures are drawn from the Model Law. In addition, the influence of the Model Law is clear from the layout of the new Ordinance, where entire Model Law provisions have been reproduced in the Ordinance proper, to emphasise its role under Hong Kong's arbitration regime.

FW: Drilling down slightly, could you explain the significance of the 'dual regime' which abolishes the distinction between 'international' and 'domestic' arbitration? Do you believe this will lead to more multi-jurisdictional disputes being resolved in Hong Kong?

Bateson: The previous regime was bifurcated into domestic and international arbitration, based on the Model Law. International arbitration was where the parties had places of business in different states, or the place of arbitration or place substantial part of obligations is to be performed was outside Hong Kong. This caused confusion with foreign parties, or those who were governed by the domestic regime but who were more familiar with the Model Law. The new regime is unitary – subject to opt in. It is hoped more international parties will find the regime more user-friendly and either insert Hong Kong as the venue in the contracts, or hold the arbitration in Hong Kong.

Choong: Under the old regime, the Ordinance distinguished between 'international' and 'domestic' arbitrations, with greater court intervention in the case of the latter. Under the new Ordinance, this distinction has, at least notionally, been withdrawn. However, in reality, parties who provide that their arbitration is a 'domestic arbitration' will continue to be subject to legacy provisions contained in Schedule 2 of the Ordinance. These legacy provisions reproduce key features of 'domestic arbitrations' under the old regime, including the submission of arbitrations to a sole arbitrator, and the right to appeal to the courts on a question of law. Nonetheless, the effect of this should not be overstated. The key change under the new regime is that the Model Law provisions will apply to both types of arbitrations. This will increase the overall volume of Hong Kong arbitrations conducted under the Model Law regime, and will lead to greater familiarity of the unified regime

by all users. Ultimately, this will contribute positively to the overall development of international arbitration in Hong Kong.

Szweda: The key considerations for multi-jurisdictional disputes always include neutrality, whether the forum's process and procedures ensure a more cost effective and speedier resolution of disputes, and location or convenience. The unitary system is a simplifying feature, but the real promise of the new Ordinance is that it is built on the well known and understood UNCITRAL model provisions, coupled with provisions enlarging and specifying the powers of the tribunals, all decreasing uncertainty. For a lawyer having to advise a deal team on whether to accept Hong Kong as the site of arbitration, he or she, without much knowledge of the Ordinance, can have a reasonable degree of comfort there are not rules peculiar to the forum that will come as a surprise later in time and, overall, that the streamlined Ordinance presents one of the better options for realising savings.

FW: How will the new powers issued to arbitral tribunals re-shape arbitration processes in Hong Kong?

Choong: Let me touch on two new powers. First, the tribunal has been granted more extensive powers in relation to interim measures. In particular, a party may now apply for preliminary orders from the tribunal without notice to the other party. This is important, where there is a risk that the counterparty will take steps to frustrate the purpose of an interim measure before the application can be heard. It may also obviate the need to apply to the Hong Kong courts in such situations. Secondly, the tribunal now has the express power to make peremptory orders, for a party to comply with its orders and directions. A peremptory order grants a party a certain time limit for compliance following which certain consequences will follow, such as the drawing of an adverse inference. This power will likely grow in importance, as the arbitral process becomes more adversarial.

Szweda: By enlarging and better specifying or clarifying powers of arbitration tribunals, there is less room for dispute and delay. I think this is most evident in the provisions relating to interim measures. Also, it may be that the provisions of Part 7, Conduct of Arbitral Proceedings, are used by tribunals to more aggressively control the procedures used, subject to the overarching goal of party authority. Apart from the tribunals, the parties have the opportunity to tailor the process in certain ways through the use of the opt in provisions.

Bateson: The new powers mirror Article 17 of the Model Law, which grants tribunal a wide discretion to grant interim measures, including injunctions. The problem of non-compliance with a tribunal's order remains, however. Absent the tribunal disallowing a claim or counterclaim due to non-compliance, action in the courts may still be required for effective enforcement, or more appropriate for urgent relief. The court can in fact order interim measures for proceedings outside Hong Kong, if certain conditions are met.

FW: As a venue for arbitration, how would you compare Hong Kong to other regional centres such as Singapore?

Szweda: As the two leading common law jurisdictions in Asia, with abundant legal talent, and possessing independent judiciaries, which also seek to facilitate and not interfere with arbitration, Hong Kong and Singapore often make sense for global companies as neutral and effective forums for dispute resolution. As such, more often than not, I have seen the selection of one over the other of these two jurisdictions as coming down to location, which is driven by consideration of convenience and in turn costs, unless greater distance is regarded as better ensuring neutrality. The ICC favoured Hong Kong by establishing its Asia-Pacific branch of the ICC Secretariat in Hong Kong in 2008, but also set up a secondary 'liaison office' in Singapore, in effect, choosing both.

Bateson: The two main arbitration centres in the region are Hong Kong and Singapore. Both have excellent arbitration centres – HKIAC in Hong Kong, and Maxwell Chambers in Singapore – pro-arbitration regimes, and the necessary back up of experienced professionals. Hong Kong attracts more PRC and North Asia cases, and Singapore, more from Southeast Asia and India. Frankly, there is little to choose between the centres, and enough work to sustain both. Hong Kong has a longer established track record as a neutral place of arbitration, and was the first jurisdiction in Asia to adopt the Model Law, and allow open legal services. Perceptions that the 1997 handover adversely affected Hong Kong's legal independence are misconceived. Other regional centres such as Kuala Lumpur, Seoul, and CIETAC – plus numerous other PRC arbitral institutions – are all growing and enhancing their attractiveness for consumers.

Choong: Although it is common to compare the two, I think the reality is that Hong Kong and Singapore cover somewhat different regions. Singapore has increasingly become the leading choice for South Asian arbitrations, including India-related arbitrations, whereas Hong Kong remains very much the pre-eminent choice for China-related arbitrations. Both venues are excellent choices, with

very good infrastructure. Singapore has excellent facilities in the form of Maxwell Chambers, and the HKIAC will also be doubling the size of its premises soon. Both jurisdictions also have specialist arbitration judges and are pro-arbitration. They have 'state-of-the-art' arbitration legislation and Hong Kong's new Ordinance, in particular, is clearly one of the most progressive arbitration laws in the region. As for the selection of arbitrators, both venues also have an excellent range to choose from and I know that many leading arbitrators are happy to hold hearings in both locations. Beyond Hong Kong and Singapore, there has also been a considerable growth of arbitration throughout the region. However, when it comes to complex, high-value disputes, it is fair to say that both Hong Kong and Singapore are undoubtedly the two leading international seats, and no other venue comes close.

FW: How difficult is it to enforce awards against Chinese companies through the local court system? What methods tend to yield the most success?

Bateson: There is no problem enforcing in Hong Kong. In the PRC, there have been historical problems over enforcement that are well documented. However, there has been an improvement since the requirement was put in place in 2000 that the Supreme People's Court must vet a copy of a local court judgement not allowing enforcement. Enforcement of arbitral awards is generally more favourable than resorting to litigation in the PRC, with its attendant problems of under-qualified judges, protectionism and discrimination against foreign companies. Also, enforcement of foreign court judgements faced a hurdle if there was no treaty in place between the two countries facilitating mutual enforcement. Based upon the Arrangement on Reciprocal Recognition and Enforcement of Judgments in Civil and Commercial Matters (REJV) signed between PRC and Hong Kong in 2006, court judgments are reciprocally enforceable. Tips to achieve the earliest enforcement in China are avoid mediation (which generally wastes time) and seek any interim relief in the local courts that is available, including asset seizure orders.

Choong: In 2010, there were a total of 25 cases where enforcement of arbitration awards was sought in Hong Kong; two of these orders for leave to enforce were later set aside. This track record speaks for itself: provided that there are assets in Hong Kong, it is generally relatively easy to enforce awards in Hong Kong against Chinese companies. That said, a recent case has highlighted the risk that in extreme cases, the Hong Kong courts will still refuse to enforce an award. In the Gao Haiyan case, the judge refused to enforce an award made by the Xian Arbitration Commission, on the ground of public policy. This arose from the apparent bias of one of the arbitrators and

a Commission member during a mediation which took place in the course of the arbitration. The difficulties in that case arose from the mediation-arbitration model that is popular in China. Nonetheless, it must be emphasised that this case is an outlier and in most cases, awards are recognised and enforced in Hong Kong.

Szweda: We have had success by starting enforcement of arbitration awards in jurisdictions like Cayman Islands or British Virgin Islands, two offshore jurisdictions often used for holding companies by Chinese companies. An enforcement action in these jurisdictions can lead to a chain of events, including the appointment of receivers, which creates leverage and in turn, settlements.

FW: How does the recent decision of the Court of Final Appeal in FG Hemisphere affect the law on state immunity, and arbitration generally, in Hong Kong?

Choong: In FG Hemisphere, the Hong Kong Court of Final Appeal held by a majority of three to two that the Hong Kong position on state immunity now follows the Chinese position of absolute immunity, rather than the restrictive immunity doctrine, which previously applied prior to the handover. This means that state immunity extends to a state's public, as well as commercial, activities. This decision is subject to confirmation by the Standing Committee of the National People's Congress. An interesting aspect of the CFA decision is that it makes it clear that under Hong Kong law, a state party cannot by contract waive its immunity to court jurisdiction. Instead, any such waiver can be made only when the state appears before the Hong Kong courts. This restriction does not affect arbitration agreements, and it remains the case that by agreeing to arbitration, a state party is consenting to the jurisdiction of the tribunal over the dispute. As a result, Hong Kong arbitration has actually become a much more attractive alternative to Hong Kong litigation, when it comes to contracts involving state parties.

Szweda: Any court opinion that opens as follows is surely significant: "It has always been known that the day would come when the court has to give a decision on judicial independence. That day has come." It may be that for some transactions, Hong Kong will not be selected as the seat of arbitration due to this opinion, but with respect to the majority of matters to be arbitrated in Hong Kong, the opinion will have no effect. In FG Hemisphere, a party owning an arbitration award against the Congo was precluded from using the courts of Hong Kong to in effect intercept payments being made by a Chinese state-owned enterprise to the government of the Congo, for which payments were moving through Hong Kong.

Essentially, the opinion provides that foreign states are absolutely immune from suits in the courts in Hong Kong, that the courts of Hong Kong cannot be used to aid arbitrations involving states, or to enforce judgments against foreign states rendered in arbitration proceedings or other courts, unless a waiver exists. Issues over whether a state instrumentality is involved, the scope of immunity for instrumentalities, such as state-owned commercial enterprises, and the existence of an effective waiver may be subjects of future cases. On the issue of waiver, in FG Hemisphere a pre-dispute consent to the ICC Rules was held not to be a sufficient indication of waiver of sovereign immunity. Heightened consideration will have to be given to the effectiveness of waivers.

Bateson: The FG Hemisphere case affects the law on state immunity, but is unlikely to affect arbitrations in Hong Kong generally or its competitive edge as a pre-eminent venue. The case rules that HK must follow the PRC's doctrine on absolute state immunity, and the Hong Kong Court can refuse execution of an arbitration award. This decision was referred by the Court of Final Appeal to the National People's Congress Supreme Court, pursuant to the Basic Law. Bearing in mind Hong Kong is a Special Administrative Region of the PRC, the decision was anticipated, as restricted immunity and absolute immunity are in conflict. Most commentators agree that there is no question of the judicial autonomy of the Hong Kong Courts being compromised or harmed. Bearing in mind state arbitrations are very few, the decision will not affect the vast majority of commercial cases in Hong Kong.

FW: Looking ahead, what trends do you expect to see in Hong Kong arbitration over the coming months and years?

Szweda: We all have witnessed massive inflows of investment into mainland China, and across the region. Hong Kong arbitration is specified in many deals involving investments into China and into other countries. We expect to see more disputes arise out of these investments.

Choong: We expect Hong Kong to continue to be an important international centre for China-related arbitrations, as well as other cross-border arbitrations. In addition, we are seeing an increasing number of contracts which provide for arbitration under the HKIAC Administered Arbitration Rules. Those rules were first introduced in 2008 and the number of cases administered by the HKIAC under those rules will continue to grow. This will also contribute to the growth of the HKIAC itself, as a leading arbitral institution. With the coming into force of the new Ordinance, we will increasingly see the Model Law influence arbitral practice in Hong Kong, especially on the

domestic front. This in turn will mean that the Hong Kong arbitration regime will become even more aligned with best international practice elsewhere, given that the Model Law has now been adopted by over 60 jurisdictions worldwide.

Bateson: I expect an increase in cross-border and investor-state arbitrations, and increasing use of Hong Kong as a venue, particularly for PRC companies. Further, there will also be an increase in financial institutions using arbitration for confidentiality and easier enforcement – instead of traditional litigation usually according to UK law. A Financial Dispute Resolution Centre is to be established to allow mediation or arbitration of consumer banking disputes. All regional centres should thrive, with healthy competition.

John Choong is a senior associate with the International Arbitration Group at Freshfields Bruckhaus Deringer, David Bateson is a partner at Mallesons Stephen Jaquesand and Eric A. Szweda is the managing partner of Troutman Sanders' Hong Kong office.

SEPTEMBER 2011

Stephen P. Younger

NEW YORK LAW AS AN INTERNATIONAL STANDARD FOR BUSINESS

As an international commercial and financial capital, New York law has traditionally been selected to govern commercial contracts and has served as a venue of choice for the resolution of cross-border disputes. The historic prominence of the state's judiciary and bar, along with its well-developed, fair and predictable body of law have drawn parties from around the world to select New York law to govern their agreements and to choose New York as the venue for resolving their disputes.

Today's era of global commerce has spurred the importance of international law as a key aspect of economic development. Consider that in 2008, dollar receipts from the export of legal services by US law firms was over $7.25bn (according to an ABA study). At the epicentre of the legal services industry, New Yorkers benefit from hundreds of millions of dollars generated in direct, indirect and tax revenues from legal matters each year.

Consider also that lawyers are typically among the first to be contacted when an international company is deciding where to site a business, where to site a transaction or where to form a corporate entity. The lawyer's role as part of the engine of economic development is thus often underappreciated.

In today's economic climate, it is imperative that New York maintain its reputation as a standard for choice of law and as a stage for international dispute resolution. This need is especially critical

in light of recent competition from other legal systems and from international seats of arbitration. Australia, India and Ireland recently established specialised international arbitration courts. France, the United Kingdom, Switzerland, Sweden and China – all jurisdictions well-known for international arbitration – have designated specialised courts or judges to hear cases to challenge or enforce arbitration awards. Several commercial centres such as Hong Kong and Singapore have state-of-the-art international arbitration centres.

Economic experts estimate that if the business of dispute resolution in New York were to increase by only 10 to 20 percent, it could produce approximately $200m to $400m in incremental revenues annually, and would no doubt promote New York commerce.

The New York State Bar Association's Task Force on New York Law in International Matters was formed last year to synthesise the advantages of New York Law as an international standard and the use of New York as a neutral forum for resolving international disputes. Comprised of experts in the fields of commercial law, litigation, arbitration and mediation, the Task Force recently published a report of its findings.

Key advantages of New York and New York law

Chief among the advantages to resolving disputes in New York is the state's highly qualified, diverse and prominent bar, a large segment of which is routinely exposed to the world's most complex and sophisticated international commercial transactions.

Likewise, New York's judiciary has vast experience in presiding over international disputes. Complex commercial litigation in the State's Supreme Court system is likely to be handled by justices in the Court's specialised Commercial Division, a forum of choice for business litigations. Similarly the US Bankruptcy Court for the Southern District of New York, with its proximity to Wall Street, is highly specialised and a natural venue for major Chapter 11 and 15 cases, and litigation within those cases which have an effect on world markets.

New York is also home to a deep roster of international arbitrators and arbitration providers.

International corporations' selection of a particular legal structure is a key factor in the outcome of their disputes. The task force's report points to New York's position as a global financial centre as a major influence on the development of its laws, which are framed around the goal of ensuring

stable, just and predictable outcomes. For example, New York courts have articulated a strong interest in "protecting the justifiable expectation" (J. Zeevi & Sons v. Grindlays Bank [Uganda] , 37 N.Y.2d 115, 120 (N.Y. 2002)) of foreign parties choosing New York law.

Several key institutional aspects of New York law also make it well-suited for the resolution of international disputes. Because New York is a common law jurisdiction, businesses can rely on the law being clearly articulated in judicial decisions. Litigation results in New York are final upon exhaustion of a defined appeal process. Parties cannot, as is possible in some civil law jurisdictions, introduce new evidence at the appellate level. Cross-examination, too, distinguishes New York from other civil law systems, and ensures the veracity and completeness of witness testimony.

Furthermore, New York courts are uniquely accessible to foreign parties, with minimal restrictions on the ability of a foreign corporation to sue in State Courts and statutes that honour the choice of New York law and venue. The State has a tradition of conforming its statutory law to international trade practice, and, as a part of the United States, complies with relevant treaties and free trade agreements. New York law permits the consideration of international customs, so parties can vary certain procedural aspects of New York law. For example, parties can waive the right to a jury trial. Parties can provide for attorney-fee shifting if they so desire. And, parties who are wary of American-style litigation discovery may choose to limit discovery through arbitration or through agreed limits in a contract clause.

The potential for economic growth related to international arbitration in particular cannot be understated. In addition to being home to leading arbitrators, lawyers and arbitral institutions, New York offers the highest respect for parties' choice of arbitration and provides an established framework for supporting international arbitration. Importantly, arbitration awards are subject to very limited review by the courts.

Sound case management skills are typically a key ingredient to selecting New York arbitrators. New York arbitrations are characterised by their efficiency in streamlining pre-hearing disclosure, focusing claims and defences early in proceedings, and generally structuring proceedings in a way that is convenient and cost-efficient to the extent possible.

Mediation, too, has become an integral and beneficial component of New York litigation and arbitration, and many courts now regularly provide for court appointed mediation. The resulting

efficiency can often be very beneficial. For example, settlement is achieved in the mediation program offered by the United States District Court for the Southern District 88 percent of the time and in the Commercial Division of Supreme Court, New York County over 50 percent of the time. Even these figures do not capture the resolutions reached after mediation that are facilitated by the process.

Recommendations of the Task Force

First, the task force recommends the creation of a permanent centre for international dispute resolution in New York. While suitable facilities are available through the provider organisations in New York City and in various New York law firms, in order to compete with arbitration centres in London, Zurich and Singapore, New York should have a facility dedicated to international arbitration.

As previously stated, the judges in New York's Commercial Division are seasoned in commercial matters. However, the designation of one or more judges in the existing Commercial Division to hear all matters that come before the court involving international and other commercial arbitration issues could serve to enhance New York's attractiveness to international parties.

Finally, the task force proposes creating a 'rocket docket' in the court system's Commercial Division to expedite the handling of international matters. This option might be attractive to international parties who do not wish to use the full array of procedures available under New York civil procedure law. Such parties might elect streamlined procedures modelled on those available generally in international arbitration, such as use of written witness statements in place of affirmative testimony at trial, limitation of pre-trial discovery procedures, waiver of jury trial and possibly limitations on grounds for appeal.

Given the potential for economic growth, it is important for the business community to understand the advantages of invoking New York law and how it can be a flexible legal structure for business people and lawyers around the world.

Stephen P. Younger is a partner at Patterson Belknap Web & Tyler LLP and the Immediate Past President of the New York State Bar Association.

OCTOBER 2011

Tim Portwood, Jérôme Richardot and Patricia Peterson

TALKINGPOINT: ARBITRATION IN FRANCE

FW moderates a discussion on France as a seat of arbitration between Tim Portwood at Bredin Prat, Jérôme Richardot at Fasken Martineau, and Patricia Peterson at Linklaters LLP.

FW: In your opinion, what overall advantages does Paris offer as a venue for arbitration proceedings as compared to other locations?

Portwood: France ticks all of the boxes as a jurisdiction favourable to arbitration proceedings. Its substantive and procedural laws are pro-arbitration; the judiciary is accustomed to dealing with issues arising out of arbitrations at all stages of the proceedings from requests for provisional measures before an arbitration has started, through assistance in the constitution of an arbitral tribunal, to enforcement of arbitral awards. There is a significant body of culturally diverse counsel experienced in handling international arbitrations and practitioners who sit as arbitrators all resident in Paris and who are capable of working in English, French and other languages. Likewise there is a corpus of other specialists whose expertise is often called on in the course of international arbitration proceedings. On a more materialistic front, there is a wide range of facilities for the holding of hearings available and if care is taken these facilities need not be expensive. In addition, the ICC Court of International Arbitration has its headquarters in Paris which inevitably means that local counsel experienced in international arbitration have ready access to the ICC.

Peterson: Three principal advantages of Paris as an arbitration seat merit emphasis. First, France

has a legal framework that is highly supportive of arbitration as a method of dispute resolution, which has recently undergone a thorough review process, with publication of a new arbitration Decree in January 2011. Second, there exists considerable expertise in the arbitration field at all levels in France, including among counsel, arbitrators and in the courts. With regard to arbitrations seated in Paris, a specialised chamber of the Paris Court of Appeal decides all applications to set aside arbitral awards and appeals from enforcement decisions. The new legislation reinforces the supporting role of the courts, through the juge d'appui, and, in the case of international arbitrations, gives those powers to the Presiding Judge of the Paris Court of First Instance, unless the parties agree otherwise. Finally, Paris offers a central location in Europe with infrastructure that is well-adapted to conducting international arbitration proceedings, including hearing facilities, competent translators, interpreters and court reporters.

Richardot: When a city applies for the Olympics, it promises a future. Paris has already proven its devotion to arbitration when hosting the ICC some decades ago. Moreover, French law since 1981 is at the forefront of international arbitration law and sets an example for other countries. Indeed, our French code of civil procedure provides a specific and friendly legal framework for arbitration and French case law is considered to be clear and efficient. Moreover, the recent French decree dated 13 January 2011 will contribute to making Paris even more attractive. Lastly, as well as having a long-standing reputation as a well-recognised arbitral seat, Paris has all the logistics of a big city. It is also a good venue for parties and arbitrators who wish to spend some time in a friendly and beautiful city.

FW: In your view, does the location of an arbitration affect the speed and efficiency of proceedings? If so, how does France compare to other locations in this regard?

Peterson: Speed and efficiency can be influenced by the extent to which a party can use the courts at the seat to interfere with the arbitration process, thereby causing delay. Another factor is the availability of assistance from the courts in aid of arbitration proceedings. The French legal framework for arbitration seeks to limit court interference; for example the compétence-compétence principle requires courts to decline jurisdiction to determine the validity of an arbitration agreement, except in limited circumstances, giving priority to the arbitral tribunal. At the same time, the system provides the necessary support for arbitration through the juge d'appui, including assistance in constituting the arbitral tribunal or in obtaining evidence from third parties. The new arbitration Decree introduced significant changes designed to promote speed and efficiency in international

arbitration proceedings once an award has been rendered. Parties can now waive the right to bring an application to set aside an award rendered in France, which would leave challenges to the enforcement stage. Where the right has not been waived, the filing of an application to set aside an award will no longer automatically stay its execution. The time limit for filing an application to set aside an award has also effectively been shortened because the point of departure for the general one-month time limit is now the date of notification of the award by the applicable method, rather than service of the award bearing an enforcement order.

Richardot: The seat of arbitration undoubtedly influences the speed and efficiency of arbitration. The law of the seat, and domestic courts, should favour arbitration and not interfere with the arbitral process. On the other hand, it should authorise reasonable recourses against awards if needed. Our purpose is not to enter into a comparative study between legal systems but France, undoubtedly offers the predictability and the security of a legal system that will ensure the enforceability of the arbitral award at a reasonable cost. Meanwhile, exequatur of awards is refused only for very limited reasons, which gives the parties the security of the arbitration system.

Portwood: The factors that most readily affect the speed and efficiency of an arbitration are found in the choice of the members of the Tribunal and of counsel. The actual location of an arbitration proceeding is not in and of itself significant to speed and efficiency unless the assistance of the courts is called upon. Otherwise, the ease of communication even of large masses of material today means that location is not, in my view, an important factor.

FW: How would you characterise the commercial and legal expertise of arbitrators based in France?

Richardot: Paris is home to many international arbitrators from different origins, mainly leading academics as well as specialised lawyers from major international law firms. Many of them are internationally recognised as leaders in arbitration, and have a specific knowledge of different legal systems and languages. Moreover, one may find in France specialists in almost every field. French case law also looks seriously at the impartiality of the arbitrators which again offers the parties the predictability of an arbitration which will be respectful of due process.

Portwood: Because of the history of France as being at the forefront of international arbitration law and the presence of the headquarters of the Court of International Arbitration of the ICC

in Paris, a significant body of skilled and experienced arbitrators exists in Paris. The experience of the majority of these persons is wide covering all industry sectors and all types of arbitration, whether institutional, ad hoc, or treaty based. The individuals work either out of the Paris offices of international law firms, in specialised boutique firms, or as sole practitioners – which is the case in particular for law professors who practise as arbitrators. In my experience, the commercial and legal expertise of the large majority of these practitioners is of a high standard.

Peterson: France offers a large choice of arbitrators with varied backgrounds and extensive arbitration experience. Whilst arbitrators with civil law training are obviously abundant in France, there are a number of experienced arbitrators with common law backgrounds who practise within the Paris international legal community. There are perhaps two main profiles of arbitrators in France with a legal background: practitioners and law professors, some of whom practise with law firms or consult for them. The choice of an arbitrator will depend on the type of case. One might not chose the same arbitrator for a treaty arbitration, as for a commercial case raising intricate questions of contract law, or a technical construction case which will turn on the facts and expert evidence. There exists a good range of options in France for each type of case.

FW: Is there sufficient precedent and predictability in French arbitration proceedings from a procedural point of view to give some comfort to disputing parties?

Portwood: The difficulty with talking about precedent and predictability of the procedural aspects of arbitration is the lack of any publicly available records. Whilst the Secretariat of the ICC in Paris may be able to give some guidance at the commencement of arbitration once the tribunal has been constituted, the guiding rule in all arbitration is that of due process. France is no different here from any other jurisdiction. What can be said, however, is that the wealth of experience among the arbitration professionals in Paris is such that counsel can predict with a reasonably satisfactory degree of certitude what due process should mean and how it will be applied by a tribunal in any given circumstance. The likelihood of an experienced tribunal diverging wildly from such standard is small.

Peterson: In France, there is a wealth of case law on arbitration issues from the specialised chamber of the Paris Court of Appeal and the Cour de cassation, the highest court in France. This provides a significant degree of predictability of results in the context of court applications, since most of the fundamental issues have already been addressed. The principles derived from the case law

have now been rendered more accessible, notably to parties outside France, with the reform of French arbitration law this year. Many of the new provisions constitute a codification of solutions to problems that were established by the French courts in case law. The previous arbitration Decrees of 1980-1981 were particularly laconic with regard to international arbitration. The new Decree, which maintains the distinction between domestic and international arbitration, now sets out the basic principles and procedural framework for an international arbitration seated in France, while preserving the ability of the parties to agree upon the arbitration procedure, if they so desire.

Richardot: The important case law developed by French Courts since 1930 in international arbitration, as well as our French code of civil procedure, provide for a solid predictability. French courts have a long-standing reputation as excellent courts dealing with arbitration proceedings. They have been supportive of arbitration for years and judges are specialists in arbitration. French courts commonly deal with all aspects of arbitral proceedings. Since 1981, hundreds of decisions have been rendered by the specialised Court of Appeal together with the Supreme Court in Paris. Many countries have decided to take advantage of French case law on arbitration.

FW: What advice would you give to parties on how to control their arbitration costs in France and generally?

Peterson: Controlling arbitration costs begins with a well-drafted dispute resolution clause. This can help to avoid expensive arguments over jurisdiction and, in some cases, parallel proceedings. The composition of the arbitral tribunal can also have an impact on costs. An arbitrator's approach to procedure and case management should be taken into consideration when selecting arbitrators. The costs associated with an arbitration can be controlled, to some extent, through the adoption by the arbitral tribunal of streamlined procedures that are adapted to the needs of the particular case. The ICC publication on Techniques for Controlling Time and Costs in Arbitration contains a number of sensible suggestions.

Richardot: There is a need for strong case management at the early beginning of the process. First of all, this involves the careful drafting of the arbitration clause. We have recently been involved in a never-ending proceeding due to the fact that the arbitration clause was referring to two arbitration institutions thus blocking the entire proceedings for years. Therefore, the early identification of issues, the preparation of detailed statements of claims, the full disclosure of evidence, the choice of arbitrators and the type of arbitration – ad hoc or institutional – are as many elements that should

be carefully considered. Moreover, having suffered from criticisms, institutions such as the ICC have issued guidelines for controlling time and costs worth referring to.

Portwood: The first step for a party to take when considering its own arbitration costs is to work out with counsel a careful and detailed flow diagram of the different steps that need foreseeably to be taken throughout the arbitration and to set estimates of the costs of each of these steps. This flow diagram should be updated from time to time as the proceedings progress. Any significant divergence from the estimates should be addressed immediately by and between the party and counsel. As for the costs of the proceedings themselves, in institutional arbitration, control of such costs is usually out of the hands of a party. In ad hoc arbitration, however, it is important to agree on the arbitrators' fees and any other arbitration costs that are to be borne by the parties at the outset immediately upon constitution of the tribunal. That agreement must be recorded in writing and signed by the tribunal and the parties.

FW: How does Paris measure up as an arbitration centre for resolving international disputes, compared to other major centres around the world?

Richardot: Paris has long been the pre-eminent place of arbitration as France has supportive and innovative law towards arbitration – whether domestic or international. Paris undoubtedly competes with other cities, such as London, in attracting international arbitrations, especially regarding business operations in Europe but France has confirmed, with its new legislation, its leadership as a friendly forum. Moreover, France, and Paris in particular, can be seen as competitive in terms of costs for both arbitrators and lawyers compared to Anglo-Saxon cities. For all these reasons Paris should help to ensure the success of the proceedings.

Portwood: In my experience, Paris measures up extremely well as an arbitration centre as it has done in the past. The decision of the ICC Court to maintain its headquarters in Paris is an important one for the city and for its arbitration professionals. Likewise, the reformed law on arbitration has sent an important signal to the rest of the arbitration world that not only the French judiciary but also the French legislature and governments are keen to promote Paris as an arbitration centre. It would perhaps be going too far to say that Paris is at the top of the ladder, but it is certainly ex aequo with a number of other centres.

Peterson: The Queen Mary, University of London, 2010 International Arbitration Survey reported

that London, Paris, New York and Geneva were the seats most frequently used by respondents to the survey over the preceding five years. Paris compares well with the other prominent arbitration centres for a number of reasons. These include the fact that it is a neutral, arbitration-supportive jurisdiction, with a good track record on enforcement of agreements to arbitrate and awards. Rivalry between arbitration seats is particularly intense in the case of Paris and London. London is often said to be preferred by companies for disputes involving contracts governed by English law or the law of other common law jurisdictions. Given the number of international firms that are represented in Paris, and the range of expertise available, I would not view governing law as a reason not to choose Paris.

FW: Have there been any significant legal developments in France affecting arbitration? What impact, for example, will the French Decree of 13 January 2011 have on the process going forward?

Portwood: Apart from the decision of the ICC to maintain the headquarters of the Court in Paris, the main recent development has been the passing on 13 January 2011 and the coming into force on 1 May 2011 of a reform of the French law on arbitration. The purpose of the legislature was openly to render the law more user friendly and to codify much of the previous 30 years' judicial development of arbitration law. The result has received much praise from the academic and professional circles in France and elsewhere. France, although not a Model Law country, continues to have perhaps the most modern of all arbitration laws and certainly one of the most forward looking judiciaries in the world.

Peterson: Another element that deserves mention is the treatment of confidentiality, since it is frequently cited by commercial parties as a reason for choosing arbitration and is often assumed to exist. The new Decree specifically provides that, subject to legal obligations and unless the parties provide otherwise, domestic arbitration proceedings are to be confidential. By contrast, the Decree is silent with respect to international arbitration. This was a deliberate choice on the part of the drafters of the Decree, which appears to have been influenced by the trend towards greater transparency, particularly in investor-state arbitration. It remains to be seen how the French courts will interpret this silence in the text. A party that wishes to ensure the confidentiality of any aspect of arbitration proceedings would be well advised to provide for it contractually.

Richardot: France was one of the first countries to adopt favourable legislation on arbitration and

there has been abundant innovative case law from the French Supreme Court and the Paris Court of Appeal since then. The new arbitration law which came into force on 1 May 2011, aims to speed up the arbitration process. Not only does it clarify French law, notably the role of French courts, it also reinforces the well-established principle of recognition enforcement of awards by facilitating exequatur proceedings, making the whole process all the more accessible to all both foreign and domestic practitioners.

Tim Portwood is a partner at Bredin Prat, Jérôme Richardot is a partner at Fasken Martineau and Patricia Peterson is counsel at Linklaters LLP in Paris.

OCTOBER 2011

Brenda Horrigan

ARBITRATION OF DISPUTES IN OR INVOLVING CHINA

Recent years have seen a rapid increase in the number of international arbitration proceedings involving Chinese parties, both within and outside of mainland China. By far the most active arbitration institution within the mainland – and indeed worldwide by published number of cases – is the China International Economic and Trade Arbitration Commission (CIETAC). A total of 1352 arbitration cases were filed with CIETAC in 2010, with a total value in dispute of some RMB 13.75bn, and the number of Chinese-related disputes heard before other institutions is also on the rise.

Set forth below is an overview of some of the basic features of arbitration involving Chinese parties.

Domestic vs foreign-related disputes

Chinese arbitration law draws an important distinction between domestic disputes and foreign-related disputes (i.e., disputes with a 'foreign element'). A contract has a 'foreign element' where: (i) at least one party to the contract is foreign; (ii) the subject matter of the contract is located in a foreign country; or (iii) the act creating, modifying or extinguishing rights and obligations under the contract occurs in a foreign country. With respect to the first criteria, the domicile of the party is controlling – an entity registered within mainland China is always a domestic entity, even if 100 percent owned by non-Chinese interests. Conversely, Hong Kong is treated as foreign for these purposes, so participation of a Hong Kong-based company would give a transaction the 'foreign element' necessary to allow the seat of arbitration to be outside of the mainland.

If the transaction qualifies as 'domestic' (even if between wholly-owned Chinese subsidiaries of foreign companies), the arbitration agreement may only provide for arbitration: (i) conducted within mainland China; and (ii) under the auspices of an arbitral institution registered in China. Chinese law specifically requires that there be "certainty in the designation of the institution" for administration of the arbitration, and ad hoc arbitration is not permitted for such disputes. If the parties to a domestic dispute agree on the applicable arbitration rules but do not specifically designate an arbitration institution to administer the arbitration, the arbitration agreement will generally be invalid unless the designated arbitration rules clearly provide for the selection of the relevant arbitration institution. In this connection, although there has been some uncertainty in court interpretations on the topic, the prevailing view it is that foreign institutions such as the ICC are not a valid choice for a domestic dispute. In addition, the types of 'one-sided' arbitration agreements that one might encounter in other jurisdictions – such as where one party is given the right to choose between arbitration and litigation, or between two different arbitration institutions, at the time the dispute arises – are considered invalid in China.

If the transaction entails a 'foreign element', the agreement may call for arbitration either within or outside of mainland China, and if outside mainland China then either under the rules of an arbitral institution or ad hoc. Foreign investors in such transactions generally prefer – and negotiate strenuously for – arbitration provisions calling for disputes to be heard outside of the mainland. The Arbitration Institute of the Stockholm Chamber of Commerce (SCC) traditionally handled a number of such cases, but the Hong Kong International Arbitration Centre (HKIAC), the Singapore International Arbitration Centre (SIAC), and the ICC are rapidly increasing their market share in this respect.

Selection of arbitrators

For arbitrations seated within the PRC, arbitrators must meet certain qualifications established by law, including a requirement of having eight years of arbitration or legal experience, or having equivalent professional knowledge. CIETAC and other major Chinese institutions maintain panels of names from which arbitrator appointments are to be made. The CIETAC panel lists some 1000 names, of which 45 are from Hong Kong/Macau and another 218 from elsewhere in the world; appointments from outside of the panel are only permitted upon agreement of all parties and confirmation by the chairman of CIETAC.

Both Chinese and foreign institutions generally permit the parties to include in the arbitration agreement requirements concerning nationality and other qualifications of the chair of the tribunal,

and it is increasingly common to see clauses requiring that the chair not be of the same nationality as either party.

Language of the arbitration

The rules of CIETAC and all relevant major international arbitration institutions permit the parties to specify in their arbitration agreement the language of the arbitration. Absent such specification, the default language for arbitrations seated in mainland China will be Chinese.

The choice of language affects the ability of each party to participate effectively in the proceedings, and also affects the choice of arbitrators, since the arbitrators should ideally be able to speak the language – or at least one language – of the arbitration. Bilingual arbitration requirements, where, e.g., the arbitration agreement requires conduct of the arbitration in "both English and Chinese", significantly increase the cost, timing and complexity of the arbitration, and are best avoided in most situations.

Enforcement

An award rendered in a 'domestic' arbitration seated in mainland China may be reviewed and refused enforcement by a Chinese court on substantive grounds as well as on grounds of procedural irregularities. In particular, courts have the right to overturn an award upon a finding of: (i) error in the application of law by the arbitral tribunal; (ii) lack of evidence to ascertain the facts; (iii) a showing that the evidence on which the award was based was forged; or (iv) a showing that a party withheld evidence sufficient to affect the impartiality of the arbitration.

These grounds provide considerable latitude for de novo court review of, and interference in, the decisions of the arbitral tribunal.

The scope of review for awards rendered in arbitral proceedings seated in mainland China that concern disputes with a 'foreign element', and for review of foreign awards rendered outside of mainland China, is much more narrow. For foreign awards the grounds for review are those established under the UN Convention on the Recognition and Enforcement of Foreign Arbitral Award (the NY Convention); the standards established for review of foreign-related awards rendered within mainland China are similar.

Foreign awards rendered outside of the PRC may be enforced in the PRC under the NY Convention,

and awards rendered in the PRC may be enforced in any other NY Convention country. In addition, pursuant to the "Arrangement between the Mainland and the Hong Kong SAR on the Mutual Enforcement of Arbitral Awards", a mainland Chinese award can be enforced in Hong Kong, and a Hong Kong award can be enforced in mainland China, on terms essentially the same as those applicable under the NY Convention. The PRC has also ratified the NY Convention on behalf of Hong Kong, making Hong Kong awards internationally enforceable.

For foreign-related awards, foreign awards, and Hong Kong awards, the Supreme People's Court (SPC) has instituted a pre-reporting system which requires a court that wishes to set aside or refuse to enforce the award to report that intention to its superior court, which must in turn report to the SPC. Only if the SPC approves may the award be set aside or refused enforcement.

Conclusion

Careful attention to construction of dispute resolution clauses at the beginning of transaction with Chinese parties is vital to ensure that in the unfortunate event that a dispute does arise, the parties have a valid and viable mechanism for resolving that dispute and then, hopefully, getting on with business as usual.

Brenda Horrigan is partner and co-head of the International Arbitration Practice Group at Salans LLP.

CHAPTER 8

LITIGATION TRENDS

in association with:

Von Wobeser y Sierra

FEBRUARY 2011

William Fahey

THE CHANGING LITIGATION LANDSCAPE FOR DIRECTORS AND OFFICERS IN THE UNITED STATES

The market for directors and officers liability insurance in the US continues to trend softer, fuelled by an abundance of capacity never seen before in our market. There were at least 15 new entrants to the D&O marketplace in 2009-10, bringing the overall number of carriers to somewhere north of 50. Evidently, the fact that carriers are jumping in to the market during the eighth year of a softening market cycle would seem to indicate that there are those who believe they can still make money at premiums that are a fraction of where they were a mere few years ago. Why are so many people making this unprecedented bet, and will they be successful?

Any recent analysis of D&O claim trends has to start with the trio of US Supreme Court decisions issued from 2004-06: Dura, Tellabs and Stoneridge. Those decisions raised the bar that plaintiff's needed to show establishing causation and scienter in a securities claim, limited the ability to bring deep pocketed third parties into a lawsuit on the grounds that they were aiding and abetting the wrongdoer, and furthermore firmly established that the Supreme Court meant business in eliminating frivolous lawsuits. Securities Class Actions filed following those cases have trended down to a low of 111 in 2006, and more recently 168 filed in 2009 and 177 filed in 2010. In fact, every year since 2005 has been below the 1997-2008 average of 197 claims filed. Furthermore, the claims that have been filed experienced higher dismissal rates than ever before. This all occurred during a period coinciding with the greatest financial crisis the US has faced in decades. Small wonder that new entrants have decided that the litigation landscape in the US has entered a

paradigm shift and become a more benign place, permanently.

But have things really changed so much? D&O profitability has always been evaluated in terms of exposure to securities class actions (SCAs), but SCAs are only one type of claim covered under a D&O policy. A closer look at all securities claim trends reveals that, while class actions may be down, other types of securities claims are generally up.

A number of statistics illustrate the point. First, while final results have yet to be announced, recent Advisen securities claims data projected that 2010 would end with a total of 1136 securities claims filed, beating the record of 1105 set in 2009. Prior to that, no year had experienced 1000 securities claims.

Second, deal related breach of fiduciary duty lawsuits arising from M&A have exploded from 36 in 2008 to a stunning 216 through October in 2010, a sixfold increase, according to Securities Class Action Services as quoted in the Wall Street Journal.

Third, FCPA enforcement is up so much that there were 74 actions brought by the DOJ and SEC in 2010; in 2009 there were 40. Five years ago there were 12. Eight of the top 10 monetary settlements happened in 2010 (the other two happened in 2008 and 2009). Many of those actions resulted in follow on civil litigation, usually in the form of a derivative claim, according to Gibson Dunn.

Fourth, derivative claims rose again in 2010 to over 100 cases filed, and also included mega-settlements of older claims against firms such as Pfizer and AIG.

Finally, EEOC charges increased 7.2 percent in 2010, from 93,277 to 99,922, affecting both D&O and EPL policies.

When one looks at that data, suddenly class actions no longer appear to be the bellwether metric for measuring profitability that it has historically been. Rather, it becomes clear that 2010 was a transition year for securities claims, and that the plaintiff's bar has pivoted as opposed to disappeared.

So who is paying these claims?

Primary carriers. A common thread of the many areas experiencing an uptick of claims activity – M&A, FCPA, regulatory actions, derivative claims, and employment suits – is that those are all typically types of claims that disproportionately affect the primary carrier, and quite often the primary carrier only. What makes that fact so interesting is that it highlights the schizophrenia in the D&O marketplace today: the established carriers, who have the biggest primary books, are already feeling the pain of paying losses arising from all those non-class action claims. The defence costs alone are costing them many millions of dollars. Accordingly, these carriers are increasingly inclined to not give away rate, because they have the loss experience to prove that if they do so, they will be unprofitable or at least less profitable.

Excess carriers, on the other hand, continue to enjoy a less worrisome existence. Whereas the primary carrier may be up to its eyeballs paying defence costs for different defendants in a breach of fiduciary duty M&A claim, it is likely that the excess will pay nothing. Thus, the newer market entrants, whose book is comprised almost entirely of excess accounts, have yet to materially feel the pain of paying multiple and substantial claims. As long as that scenario continues, we will likely continue to see aggressive competition for market share from newer carriers.

However, how long that scenario lasts is anyone's guess. 2011 will see the first examples of how meaningful as a new source of claim activity the Dodd-Frank Act and its whistleblower provision will be; many are speculating that as opportunities go for the plaintiff's bar, this one is a gusher. 2010 was also a rare year in that it did not feature a one time seismic event that drove up claims, such as IPO laddering or stock options backdating did in the past. In contrast, about the closest thing to a systemic risk that 2010 offered was the mini-subprime implosion of the for-profit education industry. If history serves as a guide, some new crisis will rear its enterprising head before much longer, resulting in increased claims activity.

It is also worth noting that the present is not the first time in recent memory that the industry made a collective bet on lower claims trends for the foreseeable future.

The passage of the 1995 Private Litigation Securities Reform Act elicited many of the same predictions that are commonplace today. The plaintiff's bar had been reined in. New, permanent changes in the law would make it more difficult to bring suits. Claims activity would never go back to its previous terrifying heights. In the years following the passage of the 1995 PLSRA, amidst a bull run in the stock market, those predictions appeared to have come true. Carriers took comfort

that they would continue to be profitable, even as they charged substantially lower rates for their product.

Then came Enron, and Worldcom, and corporate kleptocracies and other scandals. Every major market participant lost money in the ensuing years of 2000-02. The lower claims environment and its coefficient, lower premiums, didn't last. If anything, the current claims landscape seems even less of a change than that era, because this time claims are up overall, just not in the class action arena. It will be interesting to see when the newer mix of securities claims rises to a level where both established and new market entrants can no longer ignore them.

William Fahey is a senior vice president at Zurich North America.

MAY 2011

Dr Steven Schwartz

THE CHANGING ROLE OF EXPERTS IN THE CURRENT LITIGATION ENVIRONMENT

It's a brave new world, this world of litigation, 2011 style. And, it seems, we have the recession and financial crisis to blame for all the changes. Gone are the days of loose litigation budgets and client deference to counsel in defining the scope of work and budgets for litigation, expert work included. Gone, too, are the days of experts defining the scope of the analysis they wish to undertake with little push back or question from lawyers and the ultimate (paying) client.

While some of these changes are undoubtedly for the better, on balance, there is a danger in clients – and, by extension, their lawyers – becoming enamoured of false economies, of letting control of the litigation budget actually get in the way of the best work getting done and the best results obtained. In fact, there are several clear steps that inside counsel and company executives can do to maintain that control and, at the same time, realise true economies from the proper use of experts.

In our experience working with lawyers in litigated matters, there are at least three steps counsel can take to make the most effective use of their experts. The first is early retention. Second, provide your expert with the information she says she needs, not what you – the lawyer – think is necessary. And, third, listen to what your expert tells you about the soft spots in his analysis. For many years, these arguments typically have been well-received by inside and outside counsel alike, though, in truth, they were not always followed. What was clear is that lawyers at least understood why these suggestions made sense.

As litigation budgets became tighter and subject to greater scrutiny and, certainly since the financial crisis began in 2008, however, things changed. As the search for savings has intensified, there are increasing delays in hiring experts. Often experts are contacted by counsel, told they will be retained, but that the retention is not yet authorised because 'it is too early for experts'. And, despite best efforts to persuade counsel – inside and outside – differently, retentions are often delayed. Why? There is a myth that hiring experts early unambiguously raises the cost of litigation. Not true.

Hiring an expert early is likely, in fact, to save you money. Hiring an expert early allows him to weigh in on discovery issues, to help frame a theory of the case or damages that comports with, say, good economics, and to offer advice on the realistic order of magnitude of damages in a case. It is not unusual for an expert to be allowed to begin work on a case at the very end of discovery only to find that the proper discovery was not taken, that positions have been advocated that do not comport with the relevant economic facts or principles—and cannot be supported—or to find that the client thought their claim was worth $100m when, in fact, it was only a fraction of that amount. Hiring an expert early does not mean that the expert will have to be working non-stop, running up bills. To the contrary, hiring an expert early, to undertake a defined set of tasks, will yield real economies in terms of the efficiency and effectiveness of the conduct of the remainder of the litigation and will yield more useful results from the expert analysis.

A second myth says that if you limit the information that the expert has available for her analysis, she cannot spend as much time on the expert work and the costs will necessarily be lower. This view could not be more wrong. When you limit the information you give to your expert, you actually drive them to spend more time trying to make a fine meal from the incomplete set of ingredients you provide. Trying to discern an economic pattern from arbitrarily limited data is expensive, more expensive (and risky) than if all the relevant data are provided. Giving the expert the data that you know tell the right story will backfire if there are other data that don't support that story. It may be inexpensive for your expert to discern the story you know is in the data you provide, but the costs of having that expert's work undermined when confronted with other data – available, but not provided – are incalculable. It is reasonable and, indeed, completely appropriate to ask your expert for a work plan. You should not let your expert take a romp through thousands and thousands of pages of data and documents without having them provide you with a route map that shows where they are headed... and why. That is the right way to control costs, not by making arbitrary judgments about what information they may and may not see.

And, finally, there is the myth that says the client obtains greater value from an expert when you know the expert is 'on your side'. This myth is among the more insidious of expert-related myths because it embraces the ultimate of false economies: if I use a compliant expert (translated... one who will say what I want), it will cost me less. Again, this is wrong. Using an expert who claims knowledge of the answer before analysing the data or who has proven to be sympathetic in the past: (i) won't save you money; and (ii) will come back to hurt you at trial, if their lack of real analysis is exposed. Ultimately, those so-called 'easy to work with' experts will be exposed and you never can know if it will be in your case... or the next one.

The real economy is in choosing an expert who will honestly advise you about the soft spots in your case, the limits of his comfort in offering opinions in a report or at trial and the strengths of your adversary's case. That information allows counsel – inside and out – to make informed judgments about litigation and trial strategy and about the correct approach to settlement.

There is no denying the change in the economic environment has created perhaps permanent changes in the pressures imposed on experts by clients. But, to let those pressures get in the way of the intelligent and efficient conduct of your litigation is a mistake. It will limit the information at your disposal for making informed judgments about how to handle the case; and it will expose your expert to unnecessary risk on the stand and put your case, your damage claim and your reputation at risk.

There is no economy in the illusion of saving a few dollars (in the overall scheme of things) when doing so can create such real risks. It simply isn't worth it: it is a false economy.

Dr Steven Schwartz is senior vice president at NERA.

JUNE 2011

Philip Robben

MANAGING THE EVOLVING RISKS OF LAWYER-DRIVEN LITIGATION

Obney v. Taco Bell Corp., the widely reported class action filed earlier this year, is, as is sometimes said, a teachable moment. Although much of the reporting focused on Taco Bell's media campaign in response to the suit, and that the claims were withdrawn a few months after being filed, the real take-away is more significant. Obney highlights the most recent iteration of the ever evolving threat posed by US plaintiff's lawyers. The case gives rise to an occasion to briefly review the state of play in lawyer-driven litigation.

The evolving threat

Every lawyer that represents US companies is likely familiar with certain well-established litigation threats, such as securities class actions, mass torts, and personal injury claims. However, particularly in the last 10-15 years, the threats faced by companies from lawyer-driven litigation have become more varied. This is the result of several factors that have come together to bring more corporate activity into question while at the same time giving plaintiff's lawyers greater power to pursue claims.

For example, many states have enacted consumer protection statutes that prohibit false advertising, deceptive business practices, and consumer fraud. These laws are written in broad terms and conduct can come within the scope of their prohibitions even if not 'fraudulent' in the classic sense. Typical consumer protection statutes allow for the recovery of actual damages, injunctive relief, and, sometimes, civil penalties, a type of fine. Often, the laws provide that a victorious plaintiff may

recover attorney's fees and court costs. This means that the plaintiff's lawyer can have a greater stake in the litigation than the plaintiff, as the plaintiff's recoverable damages may be dwarfed by the potential attorneys' fee award.

Many consumer protection laws empower the state attorney general to bring claims on behalf of consumers or the state or both. In addition, several states, following the lead of the federal government, have enacted false claims acts. These laws permit the attorney general – or private persons, called relators – to bring claims on behalf of the state for alleged false claims against the public fisc. Conduct alleged to be a false claim is growing ever more expansive over time. Relators (and their attorneys) stand to claim rich rewards in false claims cases as they are entitled to a significant portion of any money awarded to the state.

Increasingly, under consumer protection and false claims laws, litigation on behalf of states is being conducted not by the state itself but by private plaintiff's lawyers. As state budgets are squeezed, contingency arrangements with plaintiff's lawyers offer an attractive way for a state to bring litigation at low cost. Under such arrangements, private law firms are cloaked with the significant power and prestige of the state or even the state attorney general's office, a potent weapon.

The proliferation of consumer protection and false claims laws has led to the opening of new avenues for lawyer-driven litigation. Claims under such laws have been brought against numerous companies, including the pharmaceutical companies, consumer product manufacturers, insurers and banks. Indeed, two California consumer protection statutes were the vehicle for the claims in Obney. Litigation such as this, particularly when brought across a number of states or as a class action, can create the potential for large exposure. Lawyers for plaintiffs regularly collaborate behind the scenes, often with the help of government, to prosecute wide-ranging cases seeking billions of dollars in damages.

Dealing with the risk

While the current state of the law provides certain advantages to litigation plaintiffs and their lawyers, companies can take steps to limit the risks.

Compliance. Lawyer-driven litigation has been a feature of the US landscape for some time and many companies have built up compliance and other functions that attempt to minimise risks. However, as more litigation is characterised by reliance on consumer protection and false claims

statutes, compliance professionals need to be sure that their company's internal review mechanism is up to the task of ensuring compliance with these multiple and varied sources of law. All significant communications, particularly in dealings with the government and advertisements, should be reviewed with an eye toward how they might later be used as the basis for a claim under such laws.

Be prepared for scrutiny. Litigation in the US is characterised by extensive pretrial discovery, including the production of documents and emails. This reality means that companies need to do business with the understanding that everything memorialised could later be subject to discovery and could wind up being used by an adversary in court. This is a particularly important issue where a US company has a non-US parent as the consequences of broad discovery are not often well understood by non-US executives.

Employees should be counselled that intemperate, lewd, racist, sexist, or carelessly phrased emails and other documents could come back to haunt them later. For example, an email that seemed funny at the time it was sent may look quite damming when later viewed in the context of a lawsuit. As such, employees should understand that at all times they should abide by the law, maintain a professional demeanour appropriate for the work place, and carefully choose their words as they might later be analysed in court.

Vigorous defence. If, despite all best efforts, a lawsuit is brought, it is imperative that a vigorous defence of the lawsuit begin immediately to contain the potential damage. All employees with knowledge bearing on the subject of the suit should be interviewed at length to establish the facts and realistically gauge the company's exposure. All interviews should be documented so details are not forgotten over time. All documents, emails, and other evidence potentially relevant to the case should be immediately collected, reviewed, and preserved.

Although not every company will be well-served by a Taco Bell-style-defence that includes a heavy media presence, such an approach may be necessary in certain circumstances. Where employees critical to the case are likely to leave the company, explore the prospect of entering into consulting agreements to ensure access to these witnesses later on for purposes of the case.

Settlement strategy. Part of a vigorous defence includes a reality-based settlement strategy. Most cases against corporations settle because the certainty of a settlement is easier to manage than the

uncertainties inherent in a trial. This does not mean that settlement should be the goal at all costs. Some cases will be appropriate to press to trial. However, where a vigorous defence results in a positive record, the opportunity to settle the case relatively cheaply is greatly increased and should be taken advantage of where possible. Of course, where there is the potential for multiple lawsuits over the same conduct, the settlement strategy needs to take account of the risk that a settlement that appears large could spur further lawsuits by making the defendant seem like an easy mark.

Conclusion

The risk to companies presented by lawyer-driven litigation continues to evolve. At present, consumer protection laws, false claims acts, and alliances between plaintiff's lawyers and government represent a clear and present danger to companies. With proper planning as outlined above the danger can be lessened.

Philip Robben is a partner at Kelley Drye & Warren LLP.

JULY 2011

James H.M. Sprayregen, Bruce Leonard, Ian Ratner, Aristos Galatopoulos, David S. Cohen, Van Durrer and Adam Strochak

ROUNDTABLE: BANKRUPTCY LITIGATION

In the past few years the nature of business bankruptcies has changed radically. Previously, litigation arising from a bankruptcy was usually peripheral to the bankruptcy itself. Today, however, almost every bankruptcy matter brings complex litigation and investigatory issues. A turbulent economic climate and precedent-setting rulings have increased the potential for claim subordination, fraudulent transfer and litigation claims by disgruntled stakeholders. Legal expertise and efficiency is paramount to resolving disputes and allowing companies to successfully emerge from bankruptcy protection.

Sprayregen: What has been the biggest difference in litigation trends this year compared to last year?

Galatopoulos: In the Cayman Islands, this year has seen far more emphasis on the external funding of litigation claims. Bankruptcy litigation is seen as a fertile ground for external funding because it is one of the main exceptions to the ancient laws prohibiting trafficking in litigation. Feeder funds in an investment fund structure are an obvious example of a company in distress whose asset base may include litigation claims but no liquid assets. External funding may be a liquidator's option for recovering assets. Professional litigation funders are showing a great interest in Cayman Islands litigation and have established good contacts with the bankruptcy professionals here. The funding structures vary and create interesting challenges and opportunities for everybody involved, including the potential defendants to the litigation claims. Another major trend in Cayman and the British Virgin Islands (BVI) is the focus on the position of the investor, in particular the surge in claw-back claims.

Cohen: Although new corporate Chapter 11 filings have decreased somewhat from their peak in the past few years, new adversary proceedings within these bankruptcies continue to be commenced as statutes of limitations begin to run and tolling agreements expire. The ultimate resolution of claims, however, is increasingly becoming more creative and consensual. This is largely due to the growing expense and inherent uncertainty involved in litigation. I expect to see this trend continue in the near future.

Durrer: Last year saw an increase in bankruptcy litigation spurred by parties who were arguably 'out of the money' seeking to use the litigation as a means to leverage a recovery. More recently, we have seen this trend worsen. Such litigation can persist even where the amount in controversy does not justify the legal fees incurred. Insolvent estates are also increasingly negotiating contingent fee arrangements for the pursuit of avoidance litigation.

Strochak: There has not been any significant shift in bankruptcy litigation trends compared to last year. There are cases where major litigation is avoided through successful negotiation – General Growth Properties is a good example – and cases that become mired in litigation despite efforts to avoid it, such as Tribune Companies and Washington Mutual. We have seen more litigation over the treatment of specialised securities in bankruptcy: litigation tracking warrants, trust preferred securities, residential and commercial mortgage-backed securities, and others. There also seems to be an increase in aggressive use of involuntary bankruptcies and receivership proceedings by bank lenders.

Ratner: As the bankruptcy and restructuring area slows, the litigation asset is becoming more and more important to all stakeholders in the process. That said, attorneys are spending more time working through the litigation assets. This will result in more post bankruptcy litigation. This is not unique to this cycle; in every cycle the litigation cases tend to follow the bankruptcy cycle. The only difference this time is that the world is so much more leveraged than in the past, that there are lower and lower recoveries for unsecured creditors from the core case, and the litigation recovery is more important in this cycle.

Leonard: I do not think there has been any significant difference in litigation trends this year. Probably there is more litigation this year than last because of the state of the industry. The mega-cases that were filed a couple of years ago are now reaching stage where claims and distributions become important, and those issues always attract more litigation. We are seeing

more claims and allocation-of-asset litigation, but nothing dramatically different compared to last year.

Sprayregen: What types of bankruptcy disputes seem to be prevalent in the current market, and what are their underlying causes?

Cohen: Bankruptcy litigation tends to lag Chapter 11 filings, sometimes significantly. This is due to a variety of factors, including the need to prioritise a debtor's initial actions in a bankruptcy case and the time it takes to investigate and commence adversary proceedings. Because Section 108 of the Bankruptcy Code extends the time within which a debtor may bring claims, there is usually no urgency to commence adversary proceedings early in a Chapter 11 case. Given the economic realities many debtors and creditors have faced in the wake of the global recession, increasingly, creditors will leave no stone unturned in seeking viable causes of action to augment a debtors' estate and, ultimately, creditors' recoveries.

Durrer: So-called 'lender liability' claims have become more prevalent. This is where a borrower alleges that some bad faith mistreatment on the part of the lender has caused the borrower and its business harm. With so many lenders themselves in distress, a borrower sometimes perceives that a lender's refusal to negotiate may have more to do with the lender's own financial condition, and less to do with the enforcement of the lender's contractual rights. However, this litigation can also be nothing more than a borrower's last-gasp attempt to force the lender to restructure the underlying debt obligation. Depending on the nature of the allegations of bad faith, the litigation can take a long time to resolve and, as a consequence, be very expensive. When a credit becomes troubled, lenders are well advised to have the borrower sign a pre-negotiation agreement which can be a valuable tool in resolving such litigation.

Strochak: We have seen many disputes over the treatment of specialised securities, often at the bottom of the capital structure. Much of this litigation seems to be driven by aggressive distressed debt investors buying into these instruments at very low prices after a bankruptcy filing and then trying to use the litigation process to drive the value higher. There also appears to be more fraudulent transfer litigation, which is likely driven by the rapid collapse of values during the financial crisis and the many years of easy credit leading up to the crash that encouraged so many mergers and acquisitions.

Ratner: We have seen a large number of directors and officers (D&O) cases in this cycle. D&O recoveries or potential recoveries are turning into a great source of funds for bankruptcy estates. These cases are really forensic and investigative in nature and are a natural outcome of a failed business or failed deal. Did the directors or officers do something wrong? Did they take prudent steps to protect the creditors? Did they benefit from insider transactions? We have seen many cases in this area. The rash of failed financial institutions has left a trail of D&O litigation.

Leonard: In international cases, we are seeing a lot of friction which usually leads to litigation that spans several countries. Lehman is quintessentially fractious because there is no single central court or authority that can resolve disputes. Each dispute seems to be raised in each jurisdiction, which multiplies litigation in bankruptcy cases, particularly in the case of intercompany claims. We have not encountered bankruptcies on the scale of Lehman before, and financial intermediary entities are among the most complicated situations to resolve. There is no obvious solution: everybody has their own point of view, their own interests, and their own theories as to why they should be getting whatever money is available. That is a recipe for continuous full-time litigation.

Galatopoulos: In the Cayman Islands and the BVI we are still seeing lots of litigation involving investment funds. Many of these cases concern the question of whether a fund should be put into a formal bankruptcy process and placed under the control of an independent liquidator rather than wound down by its manager. That type of litigation is often caused by the investment manager losing the confidence of at least one significant investor and a perceived lack of transparency. We are also seeing a good diet of priority and avoidance disputes caused by basic instincts such as investors wanting to become creditors – such as the Westford case in the BVI – and not wanting their fellow investors to be paid before they are paid. Investors seem to have more appetite and resources to pursue this type of litigation compared with a couple of years ago.

Sprayregen: Are you seeing more disputes arising between creditors and debtors in the bankruptcy context? How difficult is it to resolve these issues for the benefit of all parties?

Durrer: The key to resolving disputes among parties in the bankruptcy context is first to understand a party's motivation and second to remain cognizant of the fact that, in an insolvency situation, all parties must be prepared to surrender something for a global resolution. It is when parties fail to understand the perspective of others and respect that fundamental truth in an insolvency situation that settlements are most challenging.

Strochak: There are always disputes between creditors, or creditor constituencies, and debtors, so there has not been much change there. What has changed is that it has gotten harder to settle some of these disputes. Case law limiting the ability of creditors to 'gift' part of their returns to other groups has made it a challenge to settle disputes where the settlement would have value moving across constituencies that are entitled to different bankruptcy priorities.

Ratner: We have certainly seen a lot of debtors threaten lender liability type claims against their secured lenders. This is often the reaction when a company ultimately has to file bankruptcy or liquidate, and management feels that their lender did not cooperate with them. Banks are very careful these days trying to give a consistent message to the borrower, but that does not always happen.

Leonard: Disputes often arise as a result of the intercompany nature of claims within multinational organisations. One entity may have a claim against another entity, and that entity may have a claim against the parent and so on. It can be an almost insoluble as there are separate sets of constituents, in separate countries, vying for a limited amount of assets. Litigation to decide what share of a global company's assets should go to each of the countries involved presents huge obstacles. Lehman is a prime example, but a Canadian example is Nortel, which sold its major operating divisions for around $4bn. Under the deal, the money was escrowed at a bank in New York and cannot be released without the consent of all of the estates involved. The sales were successful, the money came in, the sales closed, and there is around $4.3bn held at JPMorgan Chase in New York. However, because there are estates in Canada, the UK and the US, there is no single court in control of the situation, and the parties are unable to agree on anything – which means the funds remain 'locked' in the bank account.

Galatopoulos: I agree that resolving these disputes is often very difficult simply because of the number of parties with a financial interest and a voice. The 2006 SphinX/Refco collapse in Cayman continues to be a classic example of this. Also, there are not always clear lines between winning and losing. For example, who wins if the court decides to take a company away from its management and give control of it to an independent liquidator? Whether or not that was the 'right' decision economically may be impossible to tell – what matters is the creation of a transparent, accountable process, if what was previously in place was inappropriate or had come to the end of its useful life.

Cohen: Creditors continue to be very vigilant in their efforts to maximise recoveries from a debtor's estate. This includes attempting to exert more pressure and influence over reorganisation efforts at all stages of a Chapter 11 proceeding. For example, in the Lehman Brothers bankruptcy, we have seen two competing plans of reorganisation, in addition to the plan of the debtors, filed by creditor groups. The Tribune bankruptcy has also been particularly interesting, as there are four competing plans of reorganisation pending before the court. Which competing plan is ultimately adopted will impact the course of litigation in that case for years to come. How difficult it is to resolve disputes between debtors and creditors in the bankruptcy context varies dramatically from case-to-case based on the specific facts at issue, the interests of the parties, and the personality of counsel. Generally speaking, however, there appears to be an increased willingness to resolve disputes through mediation and multilateral negotiation.

Sprayregen: Can you outline some of the legacy issues stemming from Lehman's collapse and the subprime crash?

Strochak: The most closely-watched issue will be whether the reforms enacted under the Dodd-Frank law solve the 'too-big-to-fail' problem. Financial institutions are going to spend much time and money preparing living wills and fulfilling other regulatory requirements intended to prevent future collapses and provide an orderly resolution mechanism when they inevitably do occur. It remains to be seen if this advance planning will avoid protracted litigation in future failures.

Ratner: One of the legacies from the subprime era is that the amount of general litigation and government scrutiny that is being placed on financial institutions, and others that participated in that market, is extraordinary. Almost every major financial institution has been involved in some form of expensive litigation stemming from that era. One consequence of the backlash in this part of the economy is that there is a whole swath of the population that cannot get a mortgage or a line of credit. We are going through a period of tight consumer credit which will inevitably be followed again by loosening credit.

Leonard: When a financial intermediary collapses, it leads to the most complicated of administrations. All the bank loans and credit facilities have been split, and it is almost impossible to identify exactly who the creditors are because the original creditors may have taken on the initial loan then subdivided it out to another set of creditors, and so on. That is a key issue in Lehman but it's true of all of the major filings these days. Previously, if you had a major insolvency, there would be a number of

banks around a table and everybody would accept some of the pain. The banks would usually agree a workable solution rather than see the situation hang in limbo forever. But with the 'democratisation of claims', to coin a phrase, no one knows where all the creditors are, as each bank has packaged and sold its claims against the debtor. What may have begun as one bank with a $100m loan to the debtor becomes a $100m loan potentially broken into pieces held by thousands of claimants.

Galatopoulos: An important legacy issue affecting Cayman companies is the extent to which bankruptcy can be used to unwind a structured finance deal. Many deals in the CDO market are in default and the noteholders' recourse is limited to the amount of available assets. The notes will be held pursuant to the terms of a US law governed indenture in a structure deliberately designed to make the note issuer 'bankruptcy remote' and to allow the underlying pool of assets to be managed for many years. Some investors want to restructure or terminate those deals for their own commercial reasons; others want to sit back and wait for an upturn. There is no 'one size fits all' answer to this problem – everyone's rights and remedies are governed by the indenture. The Cayman Courts will respect and enforce the terms of the contract agreed to by the stakeholders, including any covenants not to file for the issuer's bankruptcy. The scope of those covenants, and whether the US Bankruptcy Court will override them, is one for the US lawyers.

Cohen: One of the significant collateral effects of Lehman's collapse is the uncertainty that arose in the derivatives and structured finance markets. Because the Lehman bankruptcy petition was hastily filed without the benefit of a planned unwind of the numerous derivatives positions, the Lehman estates and swap counterparties must now adjudicate novel issues in connection with the termination of swap transactions, which can be governed by US or foreign law. These issues are further complicated by the application of the US Bankruptcy Code, even in instances where the underlying transaction may be governed by foreign law.

Durrer: Lehman's collapse and the death of subprime continue to reverberate in the real estate and retail markets. Lehman was a huge force in commercial real estate, and many real estate investors across the US had projects stalled, abandoned or lost due to a failure or inability by Lehman and its partners to follow through with commitments in those projects. The demise of subprime contributed to decreased consumer confidence, hurting retailers' performance. Poor performance by retailers caused the closure of stores and even entire malls, contributing to a downtown in commercial real estate. We have not yet witnessed all of the fallout in the commercial real estate market from these two game-changing market events.

Sprayregen: To what extent are litigation issues linked to failed investment funds still playing out in the courts? What are the main challenges in these cases?

Ratner: One of the interesting challenges in these cases is access to the people that were present at the time, and collection of the records. In one current case related to a failed deal in 2001, there is a wealth of documents and financial information around but finding someone to walk you through the data and what exactly it all means is difficult. All the people associated with this deal have moved on – some permanently.

Leonard: Canada has escaped the worst of the investment funds kinds of failures. It did not suffer a subprime crisis, and its banks were not making loans in the same way as the US banks. One major conduit did collapse, but the major players rallied around and supported a reorganisation and that worked out successfully, although it was not what you would call a reorganisation or a liquidation. Since we have had only one large case of this kind, it is difficult to generalise about the Canadian experience.

Galatopoulos: Cayman and the BVI remain at the cutting edge in this area. Hot topics include the question of when the court will exercise its discretion to put a solvent fund into liquidation at the behest of an aggrieved investor. The BVI Court considers an orderly wind down by management to be part of the natural life of the fund and not in itself a reason for the appointment of an independent liquidator. The Cayman Court has taken a more interventionist approach, especially in circumstances where there has been a lack of proper disclosure to investors about the possibility of a management led wind down of indefinite length. The question of service provider risk remains topical. The challenge facing plaintiffs continues to be navigating around the broadly drafted exculpations and indemnities given to professional service providers. Under Cayman Islands and BVI law, those indemnities work unless they purport to exculpate or indemnify wilful default. They can create serious difficulty for plaintiffs trying to assess the economics of a claim, and personal risks for liquidators and external funders.

Durrer: We have all heard the expression, 'what goes around, comes around'. In the context of litigation, the notion is that if a party, like an investment fund, is overly aggressive or litigious, other market participants may be less willing to do business with such a party in the future. However, when an investment fund has failed, is winding down, and trying to achieve the best recoveries for its creditors, there is no longer any incentive to foster goodwill and forge relationships for the future,

for there is no future. In this regard, we have seen failed funds take more aggressive positions since they no longer have a reputation to preserve for the future.

Strochak: The Madoff case continues to generate litigation. We are awaiting a decision from the US Court of Appeals for the Second Circuit on the proper method for calculating the value of each investor's claim. The trustee there advocated for an approach that simply totalled the amount of cash invested and subtracted all distributions, and the bankruptcy court agreed. That decision, however, has riled many investors and they seek a ruling that the value of their claim should be the balance on their last statement before the Ponzi scheme was revealed. The trustee also has taken some aggressive positions in litigation against parties alleged to be complicit in the fraud; sustaining these theories will be a challenge for the trustee.

Sprayregen: What developments have you seen in the area of fraudulent conveyance and avoidance litigation in the last year?

Galatopoulos: As in the US, Cayman and BVI have seen a recent spike in clawback claims. The latest wave has of course been linked to the Madoff scandal. A key challenge is identification of the claim's governing law. If a redemption payment was made by a Cayman Islands company to the Irish bank account of a US incorporated investor, which law will govern the clawback claim? You may get a different answer depending on whether the claim arises from the payer's bankruptcy statute, or is based on common law principles such as mistake or 'knowing receipt'. Choice of law issues can really shape the strategy and ultimately the outcome of a case. A related hot topic is the extent to which the net asset value (NAV) of a fund can be restated if a payment was made based on that NAV. This is a question currently before the BVI Court in the Fairfield Sentry liquidation.

Cohen: The biggest development in fraudulent conveyance law in the last year was the decision by the US District Court for the Southern District of Florida in the TOUSA bankruptcy that quashed a $480m fraudulent transfer judgment by the US Bankruptcy Court for the Southern District of Florida – 3V Capital Master Fund Ltd. v Official Committee of Unsecured Creditors of TOUSA, Inc. (In re TOUSA, Inc.), 444 B.R. 613 (S.D. Fla. 2011). There were three particularly significant aspects of the District Court ruling. First, entering into refinancing in order to avoid bankruptcy or default can provide a valuable, indirect benefit to parties who become obligated to repay the refinancing. Second, the District Court reaffirmed the narrow interpretation of who can be a party 'for whose benefit' a transfer was made under section 550 of the Bankruptcy Code. Third, the District Court

reversed the Bankruptcy Court's conclusion that lenders who get repaid in a refinancing transaction have an obligation to investigate how the borrower raised funds to repay them.

Durrer: Of course, the reversal of the TOUSA decision by the District Court was probably the most significant development in the law in the last year. The impact of the decision and the cost of the appeal will continue to be felt for some time. Lenders would be wise to be mindful of their borrowers' businesses and to understand the intended use of loan proceeds. Although not relevant in TOUSA, this latter point is particularly significant where loan proceeds are financing a dividend to equity, transactions of which continue to be the subject of ongoing litigation in bankruptcy courts.

Strochak: There have been several significant developments in fraudulent conveyance litigation. In the TOUSA case, decided in February 2011, the district court took the unusual step of 'quashing' the decision of the bankruptcy court below, which had sustained fraudulent transfer claims against lenders based on a finding that the financing in question did not provide 'reasonably equivalent value' to TOUSA subsidiaries. The case raises critical issues under fraudulent transfer law in situations where the proceeds of a financing are utilised by only one member of an integrated corporate family that jointly obligates itself to repay the loans. Decisions from the 7th and 11th Circuits provided guidance on who is an 'initial transferee' and explored the contours of the 'mere conduit' defence; applicable in situations where the actual recipient of a transfer does not itself benefit from the transaction. An important decision in the Chrysler bankruptcy rejected constructive fraudulent transfer allegations against Daimler AG, finding them implausible in light of the facts established in the main bankruptcy case.

Ratner: The solvency and valuation fight in these cases is getting more and more complex. In some cases business multiples were so high during the prior 10 years that, during the solvency investigation, the appraiser is challenged by comparable data from the time that may seem unreasonable based on today's environment, but was believable and consistent with the market at the time of the payment or transfer in question.

Sprayregen: With the amendment to Rule 2019 coming into effect in the US later this year, do you expect this to affect the formation of ad hoc committees and the ability to pursue litigation in bankruptcy cases?

Cohen: I do expect the changes to Rule 2019 to affect the formation of ad hoc committees,

because, as a result of the changes, typical 'ad hoc committees', 'steering groups' and 'informal groups', to use a few of the common appellations, will be subject to Rule 2019. The revised rule may cause creditors to more frequently operate through their contractual agents – for instance, administrative agents and indenture trustees – to take advantage of the specific exclusion granted to such agents. The revised rule may also spawn its share of litigation. For instance, the revised rule requires disclosure with respect to a group or committee that represents multiple creditors or equity holders when such entity "act[s] in concert to advance common interests". Because this concept is undefined, parties seeking to avoid disclosure may argue that they are not "acting in concert to advance common interests".

Durrer: I do not expect the changes to Rule 2019 to affect the formation of ad hoc committees. At this point, given the evolution in the case-law under the rule to date, I think the parties that typically band together in these groups are well aware of the risks associated with joining forces. One of the key reasons behind these combinations remains unchanged – pooling resources to have a more effective voice in a bankruptcy case. The new rule does not change that, it just makes disclosure of positions and timing more transparent. I do think that this transparency will assist distressed companies in their reorganisation efforts, because they will be better able to understand the motivation and goals of their constituencies.

Strochak: If the proposed changes to Bankruptcy Rule 2019 become final, groups of creditors working together will have to provide greater public disclosure in Chapter 11 cases. The additional disclosure requirements are not likely to deter many parties from acquiring claims or participating actively in Chapter 11 cases. Although the amended rule will require more disclosure than typically has been provided under current practice, proposals to require disclosure of date of acquisition and purchase price were watered down in the final version approved by the Advisory Committee on Bankruptcy Rules. The new requirements likely will not be a significant disincentive to the formation of ad hoc committees or other informal groups.

Sprayregen: What role have you seen mediators and arbitrators play in the bankruptcy process?

Durrer: In my experience, bankruptcy judges quite regularly take advantage of mediators for all sorts of disputes – from simple claim reconciliation matters, to more complex assumption and rejection of contract disputes, to the entirety of plan of reorganisation negotiation. The mediators themselves,

pulled from the ranks of sitting and retired bankruptcy judges or active restructuring professionals, tend to be expert in turnaround matters which adds to the likelihood of success of mediations.

Strochak: Mediation is very common in bankruptcy litigation matters. Courts like it because it reduces their workload and can expedite the resolution of complex matters. We have seen mediators in a variety of roles, sometimes mediating multi-party matters that are core to the reorganisation effort, such as negotiation of a plan of reorganisation, and sometimes mediating more traditional bilateral disputes on claims. Arbitration is much less common, and is rarely used to adjudicate disputes that are critical to the reorganisation.

Ratner: In many cases arbitration can be just as expensive as litigation and the process is not always as fluid as one would hope. On the other hand, mediation in bankruptcy can be wonderful. A good mediator can assess the issues quickly and get parties focused on 'what will happen' if they run their case to the logical conclusion. A good mediator can save parties significant amounts of money. Mediation is not successful when parties to a dispute 'love' their case too much. In other words when a party to a dispute cannot be even slightly objective and see the problems with their case, or 'hear' someone else's thoughts, mediation just does not work.

Leonard: The Nortel case has seen a huge mediation effort. One process involved representatives from 18 to 20 countries and more than 150 participants. It ended in an agreement to disagree, which can be endemic to mediation in bankruptcy. As the parties prepared for the second round of the mediation, they drilled down to concentrate on the points they thought would bring them more success than other claimants. As it turned out, everybody outlined their best case and, in the course of drilling down to improve the statements of their positions and their entitlement to the proceeds, they came up with new evidence. Consequently, the mediation ended up with the parties further apart than when it had started. That is not the way it is supposed to work, but it is a risk in mediation.

Galatopoulos: Cayman and the BVI have seen little emphasis on mediation and arbitration in bankruptcy proceedings, compared to general commercial litigation. The multi-party nature of the proceedings does not always lend itself to mediation. Also, it must be said that the emphasis of the BVI Commercial Court and Cayman Financial Services Division on proactive case management and speedy resolution of disputes means that the parties are less likely to consider mediation to be a quicker or cheaper alternative to litigation.

Cohen: Mediators have played a significant role in the bankruptcy process recently. For example, in the Lehman bankruptcy, the debtors have established multiple alternative dispute resolution procedures to resolve both claims against the estates and payables owed to the estates. These procedures have avoided burdening the bankruptcy court with an overwhelming number of matters. They have also created an environment that fosters settlements by capitalising on the desires of the debtors and their counterparties to avoid the time and expense of litigation.

Sprayregen: Have you seen judges in multiple jurisdictions in cross-border cases working more or less closely together this year?

Strochak: As courts, both in the US and in other jurisdictions, get more familiar with the requirements of Chapter 15, we anticipate the level of inter-court communications will increase. There do not appear to be any widely applicable trends in this area. In some cases, inter-court communications are frequent; in others, they rarely or never occur. The US courts are steadily developing a body of law interpreting Chapter 15 and the procedural aspects of cross-border cases will become more settled as time goes on.

Leonard: Judges are cooperating and coordinating more than ever before. At a recent conference the Canadian judge on the Nortel case mentioned that he had held about 20-25 joint court hearings with his US colleague. That is almost unprecedented. Five to 10 years ago it was unusual for one judge to even talk to another on the same case, let alone hold a joint hearing. But a number of organisations have promulgated the idea of a cross-border insolvency protocol, which have been adopted in around 35-40 cases. This offers a road map for the courts to speak to each other and coordinate their administrations, and this has been a very positive development in the last few years.

Galatopoulos: There seems to be more willingness to work closely together and to take a flexible and cooperative approach. In common law jurisdictions like Cayman and the BVI, this may be partly down to the recent landmark decisions – Cambridge Gas in the Privy Council and Rubin v Eurofinance in the English Court of Appeal – encouraging a universal approach to bankruptcy related problems. It is also good to see how the interpretation of Chapter 15 has evolved recently – the Condor decision was a welcome reminder of the cooperation afforded to 'foreigners' and their laws by Chapter 15's predecessor. It is noteworthy that judges are willing to participate in industry conferences and debate issues of general importance. In the last six months alone, bankruptcy conferences in the Caribbean have benefited from the participation of judges from the US, England

and the BVI. Practitioners really appreciate the efforts that the judges make to interact with each other and with the communities of bankruptcy professionals in other jurisdictions. This can only be a benefit to everybody involved in international bankruptcy cases.

Cohen: We have seen some examples of close collaboration in the last year between US bankruptcy courts and insolvency courts in Canada and England. For example, the Nortel bankruptcy has seen the US and Canadian bankruptcy courts generally evidencing a high degree of mutual respect. The courts have even held joint hearings via video link. In the Lehman bankruptcy, the US and English courts have exchanged multiple letters and are attempting not to usurp each other's authority.

Durrer: I would say collaboration continues to vary. All of the model laws encourage and foster communication and cooperation, but cultural divides can still raise barriers to that sort of interaction. The good news is that restructuring professionals – including judges – are becoming more and more aware of the critical need for coordination among multiple-jurisdiction insolvency proceedings. This has translated into a better environment for judges to work together across borders, but it still remains to be seen what will happen on a case by case basis.

Sprayregen: What general advice would you give to parties involved in bankruptcy litigation in today's climate? What basic considerations and preparations should they make before proceeding?

Leonard: It is tough to prepare for litigation in the general sense because you do not know where it's going to come from. That said, key areas to consider include claims processes, sales processes, jurisdiction, and stays. Most people are aware of these areas and remain vigilant, but that is about all you can do.

Ratner: I advocate 'case assessment'. Identify as many of the pros or cons and strengths or weaknesses of your case before proceeding. The case assessment team could include a lawyer, a forensic accountant, a financial adviser and a business person. Try to get as many of the issues on the table before diving into the deep water of litigation.

Galatopoulos: Generalising is very difficult. In rare cases, liquidator plaintiffs have needed reminding that they are expected to litigate like officers of the court and that un-particularised allegations will not be tolerated. Economically, a plaintiff litigating in Cayman and BVI will need to

ensure that he has the means to carry out his threats and to pay his opponent's costs if he does not succeed. The advice for defendants continues to be to check the small print carefully – if you have an indemnity, let the indemnifier know quickly. If the indemnifier is in liquidation, you will become a creditor and will acquire the leverage that goes with that creditor status.

Cohen: Bankruptcy litigation carries with it all of the costs and complexities of general commercial litigation, in addition to complexities inherent to the bankruptcy process. It also typically proceeds at a far quicker pace than non-bankruptcy commercial litigation. It behoves parties to put structures in place to streamline the litigation process for the benefit of the debtor's estate, creditors and potential defendants. All parties should give serious consideration to mandatory mediation protocols, streamlined discovery and aggressive coordination to control costs and the process.

Durrer: We continue to give the same advice to all of our clients – before you send an email or a text or post something on a social media platform, ask yourself the following question: 'Would I be embarrassed to have someone read this email, text or post back to me in a courtroom situation?' The proliferation of seemingly endless modes of real time communication with hundreds or even thousands of people has made many of us too casual in our approach to communicating in business. Often, it makes sense simply to pick up a telephone and have a live conversation with someone rather than firing off an email. Following this advice will not always avoid litigation, but it can make it less costly to resolve.

Strochak: The cost of litigation will continue to increase due in large part to changes in records management. Virtually all document production now is in electronic format and as records have migrated from file cabinets to hard drives to servers, and now to the 'cloud', and as storage costs have decreased, the volume of information retained and potentially subject to discovery, and the cost of retrieving and reviewing it, has grown exponentially. Document production is probably the most labour-intensive aspect of litigation. Any party contemplating a significant bankruptcy litigation is well served by collecting pertinent documents from its own files before commencing the litigation, both to expedite the matter and to gain an appreciation for what its own records will show.

www.financierworldwide.com