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**To: ISDA Financial Law Reform Committee**

**Date: 19 January 2011**

**From: Peter Werner ([pwerner@isda.org](mailto:pwerner@isda.org))**

MEMORANDUM FOR MEMBERS OF THE INTERNATIONAL SWAPS AND  
DERIVATIVES ASSOCIATION, INC.

**The use of arbitration under an ISDA Master Agreement**

**1. INTRODUCTION**

- 1.1 Recent years have seen a marked increase in the use of arbitration in the financial sector, including in relation to privately negotiated or over-the-counter (OTC) derivative transactions entered into under master netting agreements such as 1992 and 2002 versions of the ISDA Master Agreement. This is particularly the case in relation to ISDA Master Agreements involving parties established in or operating from emerging market jurisdictions.
- 1.2 This development has led to a desire among some ISDA members for further information on the use of arbitration under an ISDA Master Agreement. To that end, we have prepared this memorandum with the assistance of arbitration specialists in the London and Hong Kong offices of Allen & Overy LLP.
- 1.3 **This memorandum is intended for general guidance to facilitate further discussion of these issues among members. It does not constitute legal advice. Members should seek specific advice from their own internal and/or external legal advisers in relation to the circumstances of individual matters or cases where they may wish to consider arbitration as an alternative form of dispute resolution under an ISDA Master Agreement.**
- 1.4 In this memorandum we describe market trends and suggest reasons for them. We suggest that the main attraction of arbitration is that it benefits from a much more comprehensive regime for the cross-border enforcement of arbitral awards than exists for court judgments, and we outline possible advantages and disadvantages of arbitrating rather than litigating derivative disputes.

- 1.5 We also describe current issues and problem areas and make two observations that ISDA members may wish to bear in mind when considering arbitration. The first of these is that parties to derivative transactions appear often to have limited knowledge of arbitration and are consequently using poorly drafted clauses and/or failing to use arbitration as effectively as they might do. The second is that the level of expertise amongst arbitrators in relation to derivatives lags behind their knowledge of other areas, such as construction, joint ventures or shipping.
- 1.6 Having considered this memorandum, interested ISDA members are invited to contact Peter Werner ([pwerner@isda.org](mailto:pwerner@isda.org)) with any comments or questions. If there is sufficient interest, we may organise an appropriate forum for members to consider the issues raised by the use of arbitration and the development of good practice in this area.

## **2. OVERVIEW OF ARBITRATION**

- 2.1 Arbitration is a method of dispute resolution by a privately constituted tribunal, typically made up of one or three arbitrators, to be decided in an arbitral award which binds the parties. The binding nature of an arbitral award means that arbitration is a true alternative to the resolution of disputes by litigation in a court. This feature distinguishes arbitration from some forms of alternative dispute resolution, such as mediation, which may be used before or in addition to court litigation.
- 2.2 Arbitration is based on consent. A choice of court agreement (a jurisdiction clause) is not always necessary for a court to have jurisdiction over a party or dispute: the court may have jurisdiction by virtue of its rules of civil procedure. In contrast, an arbitral tribunal's jurisdiction over the parties and the dispute is always based on an arbitration agreement. Typically, the agreement to arbitrate is found in a clause in the substantive contract providing that all disputes arising out of or in connection with the contract shall be arbitrated rather than litigated in a national court.
- 2.3 Whilst arbitrators are obliged to act fairly and impartially in deciding the dispute and to give each party an opportunity to present its case, proceedings before an arbitral tribunal do not have to (and typically do not) follow the procedures of a national court. Instead, parties may make provision in their arbitration agreement as to how the arbitration should be conducted and may agree to arbitrate under rules published by arbitral institutions. The arbitral proceedings will also be subject to the arbitration law of the jurisdiction chosen as the "seat" of arbitration (sometimes called simply the "place" of arbitration). The courts of the seat will also have a range of powers (which vary from country to country) in relation to the arbitration. In practice, the approach of the courts to their exercise of such powers also varies from country to country: in some jurisdictions, particularly the leading arbitral centres, they will support the arbitral process; in others they may interfere with or undermine it. The significance of the rules and seat are discussed in more detail, together with some of the additional provisions that parties may add to their arbitration agreement, in the Appendix to this memorandum.
- 2.4 The arbitral award can be enforced against a party or its assets by invoking the coercive power of a court. As explained further below, the cross-border enforcement of arbitral awards is underpinned by an international treaty, the 1958 New York Convention,<sup>1</sup> which makes arbitration particularly attractive for resolving disputes arising out of international transactions.

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<sup>1</sup> United Nations Convention on Recognition and Enforcement of Foreign Arbitral Awards, done at New York 10 June 1958.

### **3. MARKET TRENDS**

- 3.1 Arbitration has long been popular as a method of dispute resolution in a number of business sectors,<sup>2</sup> and recent decades have seen its growth in connection with commercial transactions of all natures. This growth has largely been driven by globalisation and the increase in international trade. The same period has also seen the modernisation by many countries of their arbitration laws,<sup>3</sup> which has further facilitated the growth of arbitration.
- 3.2 Although arbitration has long been used to some extent in relation to financial services and transactions (for example, in the insurance sector; or for the resolution of disputes between members of stock and other exchanges), its use in financial transactions has lagged behind the growth in other sectors. Recent years, however, have seen a surge in the frequency with which arbitration clauses are included in a range of financial contracts, including derivatives transactions documented under ISDA Master Agreements, and in the number of financial disputes referred to arbitration.
- 3.3 This surge has been driven by similar factors to the growth of arbitration generally: globalisation and the increased involvement of parties from emerging markets in international finance. The use of arbitration for derivatives is likely to continue to increase. Regulatory pressure for the development of clearing mechanisms for OTC derivatives may also encourage the use of arbitration. The clearing rules of most, if not all, of the world's clearing houses, both those long-established for securities and commodities trading, as well as exchange-traded futures and options, and also those established more recently specifically to clear OTC derivatives provide for disputes to be resolved by arbitration.

### **4. MAIN REASONS FOR USING ARBITRATION FOR DERIVATIVES**

- 4.1 A number of attributes are typically cited as advantages of arbitration.<sup>4</sup> However, in our experience, the increase in the use of arbitration in derivatives contracts (and in international financial transactions more generally) is driven primarily by a combination of the unattractiveness of litigating such disputes in the courts of many jurisdictions, particularly in emerging markets, and the enforcement advantages of the New York Convention.
- 4.2 Historically, international financial transactions have tended to be documented under agreements governed by English or New York law and which contain jurisdiction clauses conferring jurisdiction on the English or New York courts. These are, of course, the options provided for in the 1992 and 2002 ISDA Master Agreements. The courts of both these jurisdictions have a reputation for probity and experience of resolving disputes arising out of derivative transactions, and they can generally be relied upon to do so with reasonable despatch. Today, however, many parties to such transactions are based in emerging jurisdictions in which it is difficult to enforce a foreign judgment. Succeeding on the merits of a dispute may prove to be a pyrrhic victory if it is not possible to enforce the resulting judgment. Many counterparties in emerging jurisdictions are also increasingly reluctant to accept that any dispute will be resolved in the English or New York courts; arbitration is often a more acceptable alternative.

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<sup>2</sup> For example, for disputes in connection with insurance, shipping or construction.

<sup>3</sup> Many countries have adopted the Model Law on International Commercial Arbitration published by the United Nations Commission on International Trade Law (**UNCITRAL**) or arbitration statutes influenced by it.

<sup>4</sup> See the Appendix to this memorandum.

- 4.3 One way for a party to mitigate the enforcement risk is to agree to litigate disputes in the courts of the place where its counterparty has its assets (often, but not always and not only, its place of incorporation). In many jurisdictions, however, this may give rise to other risks in relation to the proceedings to decide the merits of the dispute:
- (a) perception of bias or corruption on the part of a judicial authority;
  - (b) delay;
  - (c) lack of experience/expertise by local lawyers and judges in dealing with derivatives contracts;
  - (d) failure by the court to respect a foreign governing law;
  - (e) lack of familiarity with a foreign governing law;
  - (f) lack of consistency in decision-making;
  - (g) having to litigate in an unfamiliar and/or inconvenient language (giving rise to a need to translate documents and evidence).
- 4.4 Agreeing to arbitration allows a party to avoid having to litigate in a jurisdiction in whose courts it does not have confidence, whilst producing an award which has a clear advantage over a foreign court judgment at the enforcement stage. This enforcement advantage arises because arbitration benefits from a global regime for the cross-border enforcement of arbitral awards under the New York Convention, whereas there is no comparable regime for court judgments.<sup>5</sup>
- 4.5 The starting point for assessing enforcement risk is to consider whether there is any arrangement for reciprocal enforcement between (i) the country of the chosen court or of the seat of arbitration and (ii) the likely place of enforcement. Within the European Union, judgments in civil and commercial matters can be enforced relatively easily under EU Regulation 44/2001 (the **Brussels I Regulation**).<sup>6</sup> This regime is extended to Norway, Switzerland and Iceland by the Lugano Conventions.<sup>7</sup> Beyond this area, however, reciprocal arrangements are patchy, typically depending upon bilateral treaties.<sup>8</sup> In the absence of any reciprocal arrangement, a judgment creditor is reliant entirely on local law at the place of enforcement. This does not necessarily mean that a foreign judgment will be unenforceable, but the procedure will often be more complex and, in the worst cases, the court may effectively rehear the merits of the case.
- 4.6 In contrast, 144 states are party to the New York Convention. The New York Convention imposes an obligation on the courts of signatory states to recognise and enforce an arbitral award subject only to specific and limited grounds for refusal, which do not include a review of the merits of the dispute. Some states undoubtedly have a better record than others in complying

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<sup>5</sup> The Hague Convention of 30 June 2005 on Choice of Court Agreements may at some time in the future provide an effective regime for enforcing judgments made pursuant to exclusive jurisdiction clauses. However, at present only one state (Mexico) has ratified it and it is not yet in force.

<sup>6</sup> Council Regulation (EC) No 44/2001 of 22 December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters. One member state, Denmark, initially opted out of the Brussels Regulation but it was subsequently extended to Denmark pursuant to the Agreement between the European Community and the Kingdom of Denmark on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters.

<sup>7</sup> The Lugano Conventions of 1988 and 2007 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters.

<sup>8</sup> Such treaties may contain restrictions, e.g. the UK's bilateral treaties only cover the enforcement of judgments for a sum of money.

with their obligations under the New York Convention. However, it will typically be easier to enforce an award under the New York Convention than to enforce a foreign court judgment where no reciprocal arrangement exists.<sup>9</sup>

## 5. CURRENT ISSUES AND PROBLEM AREAS

### Defective or poorly thought out clauses

5.1 Defective arbitration clauses are encountered surprisingly often in practice. Poorly drafted arbitration agreements often give rise to delay and the additional costs of resolving disputes as to their meaning and validity. In the worst cases, they may be held to be invalid, frustrating the arbitral process entirely. Errors include:

- (a) adding an arbitration clause but failing to delete the jurisdiction clause from the document (in an ISDA Master Agreement, Section 13(b) should be deleted in its entirety and replaced with the arbitration clause; Sections 13(c) and (d) should be amended take account of the change of dispute resolution process to arbitration);
- (b) failing to make clear which arbitral rules are to apply or choosing non-existent rules (for example, we have been told of a clause that provided for "arbitration before ISDA");
- (c) failing to make a clear choice of seat (for example, we have been told of a clause providing that the seat should be in Hong Kong but that any challenge to an award should be heard by the English courts);
- (d) unclear provisions for exercising an option in an optional arbitration agreement, or for the consolidation of disputes.

5.2 Defective drafting is not unique to arbitration clauses in derivatives contracts and typically arises from a lack of technical knowledge and/or dispute resolution clauses often being treated as boilerplate and therefore insufficient attention being paid to them. Even where the arbitration clause is valid and enforceable, these factors may lead to the arbitral process being less effective than it might otherwise have been, for example through a poor choice of seat, or a failure to confer additional powers on the tribunal which would have enabled it to deal with the dispute more efficiently.

### Optional arbitration agreements

5.3 An optional arbitration agreement allows one or more of the parties to a contract to choose the forum (arbitration or courts) for a dispute *after* the dispute has arisen. Typically, only the bank or finance parties may exercise the option. Such clauses are common in emerging markets deals (particularly loans) involving the London branches of multinational banks, although we understand that these are encountered less often in agreements relating to derivatives transactions and also less often in Asia.

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<sup>9</sup> The Hague Choice of Courts Convention, which is not yet in force, is intended to address some of the difficulties experienced internationally in getting foreign judgments enforced, but it may be some considerable time before that Convention has been sufficiently broadly adopted to redress significantly the current imbalance in relation to the relative ease of enforcement of foreign arbitral awards versus foreign court judgments.

- 5.4 The advantage of optional clauses (for the party entitled to exercise the option) is flexibility to consider whether arbitration or litigation best suits its purposes for the specific dispute that has arisen. The disadvantage is that optional clauses are of doubtful validity in a number of jurisdictions. Courts in a number of major arbitral centres such as England, France, Hong Kong and Singapore have upheld optional arbitration clauses. There are doubts, however, about the validity of optional clauses in China, Russia,<sup>10</sup> Spain, Poland and the UAE, and in many countries there is simply no clear authority on the issue. Parties which are considering using arbitration because of its advantages at the enforcement stage may therefore find that advantage undermined if they enter into an optional arbitration agreement. Parties should consider carefully whether the added flexibility is worth this risk, or whether they would be better served by a "pure" arbitration agreement. Our view is that parties do not always give sufficient consideration to the circumstances of the particular transaction before using optional clauses.

#### **Arbitrators' experience**

- 5.5 Although it is always dangerous to generalise, on average, international arbitrators' experience of derivative contracts is in general limited. This is, perhaps, an inevitable consequence of the fact that it is only relatively recently that a significant number of derivative disputes have been arbitrated.
- 5.6 This issue should be kept in proportion: leading international arbitrators are familiar with complex transactions and able to get to grips with issues outside their core expertise; they are likely to be much better able to deal with derivatives disputes than the courts of many jurisdictions. Moreover, where the arbitration agreement provides for the parties to nominate members of the tribunal, they may choose to nominate as arbitrators individuals whose main expertise is in derivatives rather than as arbitrators.
- 5.7 As more derivative disputes are arbitrated, it is likely that a greater number of international arbitrators will gain experience in this field (and/or derivatives experts may develop practices as arbitrators) and some may develop it as a speciality.

#### **Awards are private and carry no precedent value**

- 5.8 Arbitral awards are not public documents. They bind only the parties to the arbitration and, unlike court judgments in common law countries, do not create precedents. This feature of arbitration may be a particular disadvantage in the context of derivatives disputes, in which a ruling on a point of construction of one ISDA Master Agreement may provide guidance for all other ISDA Master Agreements signed by a party and, indeed, for the wider market. To illustrate this point, we have been told of a case where the tribunal considered the application of the Bretton Woods agreement to a derivatives transaction documented under an ISDA Master Agreement. There is no other public authority on this issue but because the decision of the tribunal is private it cannot be circulated more widely to inform and guide the market.
- 5.9 This disadvantage could be mitigated to a certain extent by using an optional arbitration clause. In deciding whether to arbitrate or litigate a dispute, the party with the benefit of the option may take into account whether it gives rise to an important point of principle on which it wishes to obtain a clear ruling on which to rely in other disputes.

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<sup>10</sup> Although recent case law has provided some comfort in relation to Russia.

- 5.10 The disadvantage could also be tackled by the parties agreeing to the publication of awards, with names of the parties and other confidential information redacted. Although such awards would still not carry formal precedent value, a subsequent tribunal is likely to be influenced by the approach taken by a previous tribunal to the same issue.
- 5.11 A further alternative arises where the contract is governed by English law and the parties have chosen England as the seat of arbitration because, unusually, the Arbitration Act 1996 permits an appeal from an arbitral award to the High Court on a point of English law.<sup>11</sup> However, parties may need to make express provision in their arbitration clause to ensure that this right of appeal is available to them.<sup>12</sup>

### **Attacks on the validity of the contract and/or the arbitration agreement**

- 5.12 Recent cases highlight a marked tendency for parties seeking to avoid claims for payments under ISDA Master Agreements and other financial transactions to attack the validity of the agreement. This is often combined with an attempt to avoid the chosen forum.
- 5.13 The English courts, for example, have seen examples of parties bringing claims in tort outside the contractually-agreed forum against their counterparties and counterparties' affiliates for alleged mis-selling of financial products. In a case in which the ISDA Master Agreement provided for the English courts to have exclusive jurisdiction, the English court refused to grant an anti-suit injunction restraining proceedings in China against a non-party affiliate.<sup>13</sup> An affiliate would likewise be unable to enforce an arbitration agreement to which it was not a party.<sup>14</sup> Companies and public authorities have also argued that they had no capacity to enter into transactions or that the transactions have not been properly authorised or were entered into unlawfully, and that the transactions are, therefore, void.<sup>15</sup>
- 5.14 We understand that similar tactics have been used in arbitrations relating to derivatives transactions, particularly by Indian counterparties. In response to claims for payment, they have alleged that the transactions that they have entered into are void under Indian exchange control laws, and that this also affects the validity of the arbitration agreement, or that Indian public bodies have exclusive jurisdiction to determine the disputes, despite the arbitration agreement.
- 5.15 These sorts of tactics highlight the need to not treat dispute resolution provisions as boilerplate. Parties can improve their position if they consider the issues that might arise. For example:
- (a) if an affiliate has been involved in marketing the product, ensure it is made a party to and signs the arbitration agreement;
  - (b) ensure that the arbitration agreement is drafted broadly, so as to cover non-contractual as well as contractual claims;

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<sup>11</sup> Section 69.

<sup>12</sup> The court's permission is required for an appeal, unless all parties to the arbitration agree, but such agreement could be set out in their arbitration agreement. The right of appeal may also be excluded entirely by agreement, and the rules of several leading arbitral institutions contain such exclusions (e.g. Article 28(3) of the ICC Rules; Article 26.9 of the LCIA Rules). If parties wish to use those rules but preserve the right of appeal, they can do so expressly in their arbitration agreement.

<sup>13</sup> *Morgan Stanley & Co International plc v China Haisheng Juice Holdings Co Ltd* [2009] EWHC 2409 (Comm).

<sup>14</sup> See paragraph 21 of the judgment in the *Morgan Stanley* case.

<sup>15</sup> See, for example, the English court cases of *Berliner Verkehrsbetriebe (BVG) Anstalt des Öffentlichen Rechts v JP Morgan Chase Bank NA* [2010] EWCA Civ 390; *Depfa Bank PLC v Provincia di Pisa* [2010] EWHC 1148 (Comm); and *Deutsche Bank AG v Asia Pacific Broadband Wireless Communications Inc* [2008] EWCA Civ 1091.

- (c) take advice on whether the counterparty has gone through the proper steps under its local law to authorise entry into the transaction and also the arbitration agreement;
- (d) choose a seat in a jurisdiction in which the severability of the arbitration agreement is recognised (i.e. the arbitration clause is treated as a separate agreement from the contract in which it is contained, and may therefore be valid and enforceable even if the rest of the contract is not); and
- (e) avoid a seat in the counterparty's home jurisdiction: the local courts may be more likely to accept arguments that the tribunal has no jurisdiction because of some provision of local law.

## 6. POSSIBLE NEXT STEPS

- 6.1 If, after considering the issues in this memorandum and/or drawn from their own experiences of the use of arbitration in the context of an ISDA Master Agreement, members are of the view that there are further steps that could usefully be taken to improve information regarding arbitration in the derivatives market or to improve the drafting of arbitration clauses<sup>16</sup> or that would otherwise be helpful for members to address in an ISDA forum, then members are invited to contact Peter Werner, Senior Director, ISDA EMEA Office in London ([pwerner@isda.org](mailto:pwerner@isda.org)). Equally, as suggested in paragraph 1.6 above, if members have any comments or questions on this memorandum, they are also invited to address those to [pwerner@isda.org](mailto:pwerner@isda.org).

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In terms of existing precedents, the ISDA/IIFM Tahawwut Master Agreement, published jointly by ISDA and the International Islamic Financial Market in 2010, is structured to provide for disputes to be litigated in the English or New York courts unless the parties choose arbitration in the Schedule. If arbitration is chosen, the seat of arbitration will be London or New York (according to whether English or New York law is chosen as the governing law of the Master Agreement) and the ICC arbitration rules will apply, unless other rules are specified in the Schedule



## **APPENDIX: KEY FEATURES OF ARBITRATION**

1. In this Appendix some of the key features of arbitration are described. Two of the key choices to be made when drafting an arbitration clause are the rules and the seat of arbitration, which are mentioned in the memorandum and explained here in more detail. Some of the factors often cited as advantages or disadvantages of arbitration are then discussed. As explained further below, the disadvantages can arguably often be mitigated by the inclusion of additional provisions in the arbitration agreement.

### **Arbitral rules and institutions**

2. Arbitral rules provide a procedural framework for the arbitration, including conferring procedural powers on the tribunal. Arbitral rules are much briefer than court rules, and leave much to the tribunal's discretion unless the parties are able to agree a matter.
3. Arbitral rules are published by a range of arbitral institutions., and a choice of rules usually also constitutes a choice of that institution to administer the arbitration (the exception to this is the UNCITRAL Arbitration Rules, which have no administering institution). The institution will not decide the dispute; rather its role is to assist with the appointment of the tribunal (including selecting arbitrators where a party fails to exercise a right to do so, or where the parties are unable to agree), and the administration of the proceedings (for example, taking deposits on account of the arbitration costs and fixing the arbitrators' fees, or making arrangements for hearing facilities).

### **Seat of arbitration**

4. The seat of arbitration is a legal concept tying the arbitration into a legal jurisdiction. The seat is typically expressed as a city, but the key aspect is the jurisdiction in which the seat is located (e.g. a choice of London ties the arbitration to the legal jurisdiction of England and Wales). Whilst arbitral hearings are typically (but not always) held at the seat, far more important are the legal consequences of the choice, of which there are three.
  - (a) The arbitration law of the seat will govern the arbitral procedure (e.g. in England, the Arbitration Act 1996 will apply). Modern arbitration laws typically provide default rules which apply unless the parties have agreed otherwise (either in their arbitration agreement, or by choosing to arbitrate under arbitral rules which deal with the issue), but will also impose some mandatory provisions designed to underpin the fairness of the proceedings (such as an obligation for the tribunal to be impartial).
  - (b) The courts of the seat will have certain powers in relation to the arbitration, for example, jurisdiction to hear a challenge to an arbitrator alleged to be biased or an application to annul an award.
  - (c) The award will be treated as having been made at the seat. To ensure that the New York Convention applies to the award, it must be made in a state that is a party to the New York Convention.
5. A 2006 survey of arbitration users suggests that the tactical significance of the choice of seat is not fully appreciated: only 29% of respondents to the survey said that legal considerations were

the most important factor in their choice.<sup>17</sup> However, choosing a seat in a jurisdiction where the courts have little experience of or are sceptical of arbitration carries the risk that the local courts may interfere with, and possibly derail, the arbitration. Parties should choose a seat in a New York Convention state that has a modern arbitration law and courts that will be supportive of the arbitration but will not interfere in it. Parties are well advised to think twice and seek local law advice before agreeing to a seat outside one of the recognised arbitral centres such as London, Paris, Stockholm, Geneva, Hong Kong, Singapore or New York.

### **Neutrality**

6. When neither contracting party is prepared to submit to the jurisdiction of its counterparty's local courts, arbitration in a third country may be an acceptable, neutral forum. The neutrality of arbitration is often particularly attractive to state entities and international organisations. This is a factor which sometimes prompts the use of arbitration in derivative transactions.

### **Finality**

7. Unlike a court judgment, an arbitral award is generally not subject to appeal on the merits, and may only be annulled for reasons going to the jurisdiction of the tribunal or a failure of due process.<sup>18</sup> The greater finality of awards is attractive to parties in some fields, although this is not necessarily perceived to be a significant factor in the use of arbitration for derivatives.

### **Procedural flexibility**

8. Arbitral procedures can be tailored to the circumstances of the transaction or dispute much more readily than court procedures. For example, the parties can agree the number and qualifications of arbitrators, the location of the hearings or the language of the proceedings. In the absence of party agreement, the arbitral tribunal typically has a great deal of discretion in procedural matters. Whilst parties to derivative transactions may take advantage of this flexibility, again it is our perception that this is not a significant factor in their decision to use arbitration.

### **Privacy and confidentiality**

9. Arbitral proceedings are always private (in the sense that, unlike court proceedings in most jurisdictions, third parties have no right of access to them) and may also be confidential (in the sense that the parties themselves may be obliged to keep the contents of the proceedings and the award confidential). Whilst privacy and confidentiality are often important reasons for the use of arbitration, again our experience is that this is not the case in relation to derivatives contracts.<sup>19</sup>

### **No default or summary judgment procedures**

10. The civil procedure rules of some jurisdictions (such as England and New York) permit the courts to grant default judgment on a claim if a defendant does not take part in proceedings, or to grant

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<sup>17</sup> See "International arbitration: Corporate attitudes and practices" by PWC and the School of International Arbitration, Queen Mary, University of London, 2006.

<sup>18</sup> The English Arbitration Act permits a challenge on jurisdictional grounds (section 67) or on the basis of a serious procedural irregularity giving rise to substantial injustice (section 68). As discussed in the memorandum, the right in England to appeal to the court on a point of law (under section 69 of that Act) is a very unusual provision, which may be excluded by agreement.

<sup>19</sup> Indeed, in some contexts financial institutions have considered the publicity of court proceedings may provide a useful tool to put pressure on a counterparty to comply with a judgment where enforcement is likely to be difficult. It is always open to the parties expressly to provide that their arbitration will not be confidential and we have been told of examples of parties doing so in relation to loan agreements.

summary judgment if a claim or defence has no real prospect of success, without a full trial. Arbitration laws and rules do not provide for such procedures. This can mean that undefended claims or claims that face only hopeless defences take longer to resolve than they would do in the English or New York courts.

11. However, this disadvantage is often overstated by those who expect that the only likely dispute under their transaction is a straightforward debt claim in which they will be claimant. Defendants may raise complex defences which have little real merit but are sufficient to avoid summary judgment, so that, for example, English court proceedings would not be significantly quicker than an arbitration. Moreover, even without summary judgment procedures, an arbitration will often provide a quicker resolution of the claim than would be possible in what may be the only alternative forum for obtaining an enforceable decision – the counterparty's local courts. Finally, whilst an arbitral tribunal will always need to satisfy itself of the merits of the claim and provide a proper opportunity to both parties to present their cases, "fast-track" provisions can be included in the arbitration clause to speed up the arbitration. Such provisions may operate, for example, by shortening deadlines prescribed by the arbitral rules, and/or imposing a long-stop date for the rendering of the award.

#### **Lack of power over third parties; lack of power to consolidate proceedings**

12. In the absence of all parties' consent (which may be withheld for tactical or other reasons once a dispute has arisen), an arbitral tribunal has no power to join an additional party to an arbitration that has been commenced without it or to consolidate two separate arbitrations raising related issues into a single proceeding. In contrast, such powers in relation to court proceedings are typically conferred on courts by their civil procedure rules. Although some arbitral rules confer limited powers of joinder and/or consolidation on the arbitral tribunal and/or the administering arbitral institution,<sup>20</sup> none of the major rules deals with these issues in a comprehensive manner.
13. The lack of such powers can give rise to additional time and expense and the risk of inconsistent decisions if related disputes have to be resolved in separate proceedings. Transactions involving multiple parties and/or multiple contracts are more likely to give rise to the possibility of separate but related disputes. Where a derivative contract forms part of a larger transaction (for example, to hedge a risk under another transaction document), parties should consider whether a dispute may give rise to claims under a number of agreements that would be better heard together. If so, they should make specific provision in their arbitration agreements to confer additional powers on the arbitral tribunal. Such provisions require careful drafting to ensure that they will be effective.
14. On the other hand, the arbitral rules of most leading arbitral institutions permit a respondent to make counterclaims and give the tribunal a discretion to permit additional claims or counterclaims.<sup>21</sup> Where only two parties are involved, and an ISDA Master Agreement does not form part of a larger deal, such provisions are likely to be sufficient to deal with the prospect of multiple claims arising out of the relationship.

#### **Documents and evidence**

15. The extent to which a party to litigation is entitled to obtain the production of documents from its opponent differs markedly between jurisdictions (as is well known, common law jurisdictions

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<sup>20</sup> See, for example, Article 22.1(h) of the LCIA Rules and Article 4(6) of the ICC Rules.

<sup>21</sup> See for example, Articles 2.1(b), 15.3, and 22.1(a) of the LCIA Rules.

typically allow much greater "disclosure" or "discovery" of documents than continental European jurisdictions). Likewise, the evidence of factual and expert witnesses is handled in a variety of ways: experts may be instructed by the court or the parties, and factual witnesses may or may not be deposed in advance of trial, may give their evidence in chief (direct evidence) orally or in written witness statements, and may be cross-examined primarily by opposing counsel or by the judge.

16. Evidential matters fall within the arbitral tribunal's procedural discretion. The approach in any particular case varies according to the preferences of the parties and their lawyers (particularly if all parties are in broad agreement), and may be influenced by the legal background of the arbitrators and counsel concerned. Nevertheless, a degree of convergence has emerged in international arbitration. Evidence in chief tends to be given by way of written statements, and parties are typically permitted to cross-examine opposing witnesses and instruct their own experts. The International Bar Association's Rules for the Taking of Evidence in International Arbitration (the **IBA Rules**) are often used as guidance or expressly adopted by the parties or tribunal, particularly with regard to the production of documents, on which they seek to establish a compromise between common law and civil law practice. The IBA Rules allow a party to request the production of a specific document or a narrow and specific category of documents that are relevant and material to the outcome of the case. This approach may be a tactical advantage or disadvantage for a party in any given case, but is designed to avoid the costs associated with large discovery exercises.