

THE METROPOLITAN CORPORATE COUNSEL

International Arbitration: A Tool to Manage Risk When Dealing in High Growth/High Risk Markets¹

As many businesses experience declining growth in their domestic and traditional markets, they are looking increasingly towards the "BRIC" countries (Brazil, Russia, India and China) and other high growth economies outside their traditional trading areas. The report of the International Monetary Fund entitled the "*World Economic Outlook*" which was released on 9 April 9, 2008 downgraded projections for growth in 2008 and 2009 across the major Advanced Economies including those of the US, Canada and Western Europe whilst continuing to project relatively higher rates of growth across certain Emerging and Developing Economies including China and India. It seems likely that the move by many US businesses to target Emerging and Developing Economies will gather pace.

This article will assess the extent to which international arbitration can play a role in assisting US businesses in managing commercial risk when seeking to invest and/or trade in higher risk overseas markets and it will provide a number of suggestions on ways to limit risk².

"Home Courts" Are Not an Option

When dealing in many high growth overseas markets, court based dispute resolution is simply not a viable option. Seen from the perspective of the US business, the "home court" of the other party may appear to have a poor reputation for neutrality and impartiality. This may be all the more the case in circumstances where the other party is a state controlled or politically connected entity and there is perceived to be a risk of state interference in the operation of the local judiciary.

It is also increasingly the case that many non-US parties are unwilling to agree to subject prospective disputes to determination by US courts. The rationale behind this may differ in individual cases but may include: an adverse perception of the jury trial concept, an aversion to penal damages or simply an unwillingness to agree to the US businesses, home court as a result of a less coherently reasoned reciprocal reaction to the rejection of its own home court.

Factors Favoring Prescribing International Arbitration as the Dispute Resolution Mechanism in Cross-Border Contracts

¹ For a version of this article that includes a complete set of footnotes, as well as a checklist of "Do's and Don'ts" for international arbitration, please see:

² See further my chapter on drafting effective arbitration clauses in the PLC Cross-Border Handbook on Arbitration, publication expected May 2008, also available on-line at www.practicallaw.com

A cynic might suggest that in many cross border transactions the primary reason why International Arbitration is selected by parties is that it is "*the least worst option*". This may be true but the relative attractiveness of International Arbitration can in fact be assessed more analytically by reference to the following 6 factors.

Neutral and Independent Decision Makers

One of the key reasons for prescribing International Arbitration is the ability to select a neutral and independent Tribunal that will determine any disputes that may arise under the relevant contract. This addresses precisely the kind of "home court" deficiencies noted above in connection with traditional Litigation.

It is a basic tenet of Arbitration that the Tribunal is neutral and most domestic arbitration laws³ and most sets of Arbitral Rules⁴ promoted by the leading arbitral institutions expressly provide for neutrality and/or independence, though the precise definition of what constitutes a conflict of interest which impairs neutrality differs across the world⁵.

The Availability of a Range of Viable "seats" across the World

The clause in the contract prescribing the parties' agreement to arbitrate (or a subsequent submission agreement executed after a dispute has crystallised) should expressly prescribe the "seat" or legal place of the arbitration.

The key criteria to consider when selecting a seat is to ensure that the country in which the city is situated has both a supportive arbitration law and a supportive but non-interventionist judiciary and that the country has ratified the UN Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958 (the "New York Convention")⁶.

³ See Articles 12 and 18 of the UNCITRAL Model Law and section 1 of the UK Arbitration Act 1996

⁴ See Article 7 of the ICC Rules, Article 7 of the ICDR Rules, Articles 9 and 10 of the UNCITRAL Rules and Article 5.2 of the LCIA Rules

⁵ The International Bar Association Guidelines (pub. 2004) have come to represent a standard. See too *Aimcor v Ovalor* (05 CV 10540 [RPP]).

⁶ The New York Convention has now been adopted by over 140 countries around the world and establishes a framework for the recognition of agreements to arbitrate by domestic courts preventing parallel court proceedings and a limited number of bases under which an aggrieved party can challenge an arbitral awards before domestic courts at the point of enforcement.

The Arbitration Law

Key requirements are that the law:

- establishes the requirement that all arbitrators are neutral⁷;
- provides a court-administered mechanism for appointment of arbitrators in the absence of agreement between the parties⁸; and
- provides a court-administered mechanism for challenge to and removal of arbitrators in circumstances in which there are justifiable doubts as to their impartiality or their capability to perform their role⁹.

The Judiciary

It is also essential to ensure that the courts of the country in which the seat is located are supportive yet non-interventionist. An important element of this (especially in countries that are new adopters of the concept of International Arbitration) is that the judiciary is experienced in interpreting arbitration law and so can be relied upon to facilitate (without undue court interference) an efficient arbitral process¹⁰.

In recent years the number of Arbitral Centres has grown rapidly as the popularity of International Arbitration has grown. There are now Arbitration Centres in many cities in the US (with New York chief amongst them) together with London, Paris, Stockholm, Geneva, Zurich, Vienna, Singapore and Hong Kong¹¹.

It should also be borne in mind that the choice of seat can influence the style and approach to the practice and procedure applied in the arbitration. Whilst there could be said to be a developing set of "procedural

⁷ Articles 12 and 18 of the UNCITRAL Model Law

⁸ Article 11 of the UNCITRAL Model Law

⁹ Article 13 of the UNCITRAL Model Law

¹⁰ This can be an issue in certain countries in the Middle East which have now adopted UNCITRAL Model Law based arbitration law and ratified the New York Convention.

¹¹ The further growth of International Arbitration has led in recent years to the emergence of Dubai, Qatar and Cairo in the Middle East, Santiago in South America and most recently Barbados in the Caribbean.

norms"¹² an arbitration conducted in a civil law seat such as Berlin before a civil law schooled Tribunal may differ somewhat from one conducted in a common law city such as London or New York¹³.

The Opportunity to Select the Applicable Law of the Contract

Whilst it is possible to prescribe that the law of country A will regulate a contract and yet prescribe that disputes under that contract will be resolved by the courts of country B that is often felt to be a more dangerous course to adopt. This is because domestic courts whilst adept at applying the domestic law of the relevant country are less used to applying "foreign" laws. In the area of International Arbitration it is commonplace to prescribe that the substantive law of the contract is that of country C with the parties selecting a seat in country D and being themselves based in or primarily headquartered in countries E and F¹⁴.

The interaction between the choice of seat and the choice of substantive law does however bring with it various hazards especially when the parties additionally prescribe that the arbitration will be governed by specific institutional rules. Many such rules mandate that any Sole Arbitrator or Chair of a 3 person Tribunal must be of a neutral nationality to the parties¹⁵. It can create significant difficulties in arbitrator selection if the chosen law of the contract is also the law of the country of nationality of one of the parties especially when that law is one that is practiced by a smaller pool of experienced International Arbitrators¹⁶.

Flexibility of Procedure

As originally developed arbitration was intended to offer a straight forward means by which business people could secure the resolution of commercial disputes more speedily and cost effectively than by

¹² Based in particular on the IBA Rules of Evidence in International Commercial Arbitration and a growing consensus on certain procedural matters.

¹³ This will manifest itself particularly in relation to the approach to the level of detail expected of initial filings, the breadth of document production obligations, the role of the Tribunal in settlement and the style and approach to witness examination and advocacy at any hearing.

¹⁴ Perhaps even with the hearing taking place in country G as UNCITRAL Model law countries and the arbitration law of many other countries allow hearings to be conducted outside the country of the seat without thereby changing the choice of seat.

¹⁵ See Article 9(5) of the ICC Rules and Article 6.1 of the LCIA Rules. For a different, more flexible approach, see Article 6.4 of the UNCITRAL Rules and Article 6.4 of the ICDR Rules

¹⁶ Clearly a choice of New York, English, French or Swiss law opens up a larger pool of possible Arbitrators than a selection of Norwegian or Chilean law.

reference to domestic courts. It first gained popularity in business sectors in which disputes tended to develop over highly technical issues or ones for which there was perceived to be a requirement for the decision maker to possess a high level of industry knowledge.

Today, whilst it is often said that many high stakes international commercial arbitrations increasingly resemble court disputes, scope continues to exist to finesse the actual procedure to fit the dynamics of the particular dispute¹⁷.

Limits on the scope to Appeal

One of the greatest criticisms of traditional Litigation (in both the Developed and Emerging countries of the world) is that the availability of rights of appeal means disputes can last for many years. In arbitration the right to appeal on the merits is precluded¹⁸ and even when the seat of the arbitration is in a country that allows for appeals on a point of law¹⁹ to the courts at the seat, that can be expressly excluded by the parties in their agreement to arbitrate.

Enforceability

Perhaps the greatest advantage of International Arbitration over traditional litigation is the far greater scope that exists to enforce an arbitral award than any court judgement.

Court judgements can only be enforced against assets located in countries in which the domestic courts will recognise the judgement of the "foreign court". The international network of reciprocal enforcement treaties is far from universal and there are very many countries across the world that are unlikely to enforce a US, English or French court judgement.

By contrast the New York Convention establishes a network of over 140 countries across the world that have by ratifying the Convention agreed to enforce arbitral awards made by a Tribunal seated at a country that is also a party to the Convention. Whilst there are number of examples of countries that have ratified the Convention, but whose judiciary remain prone to misapply the Convention and so refuse to enforce

¹⁷ Techniques include "Hot Tubbing", which involves the evidence of groups of experts being heard together, and "last offer arbitration", in which the parties are required to provide a single option at the close of the hearing with the Tribunal only able to award the successful party what is requested by party A or party B.

¹⁸ Save in the case of serious irregularity of procedure or on the basis of an absence of substantive jurisdiction.

¹⁹ Like England under section 69 of the Arbitration Act 1996.

arbitral awards made in favour of nationals of the country in which enforcement is sought,²⁰ the picture is far better than in respect of the enforcement of court judgements.

Playing the "Nationality Game"

The primary route to manage risks when dealing cross border is of course through a combination of the terms of the contract with the counterparty and overarching commercial structures (including payment protection mechanisms), but when dealing cross border in dynamic markets US businesses should be aware of the scope which may exist to bring Treaty claims as a last line of protection.

Whilst this is a complex area, Treaty claims are claims that a party can make against a host state in which a qualifying investment has been made, if the investor's rights have been infringed in a manner that constitutes a breach of the terms of either a Bilateral Investment Treaty (a "BIT") or a Multilateral Investment Treaty like NAFTA. There are now over 2,500 BIT's world-wide (46 involving the US, of which 39 are in force²¹).

The most common form of infringement of rights giving rise to a Treaty claim is "expropriation" and current examples include the alleged expropriation by Ecuador of the oil exploration and extraction rights of the US oil major Occidental²² and the recent actions of Venezuela in relation to the cement industry²³.

At the contracting stage US businesses should consider whether their transaction has the potential to qualify as an investment²⁴ and if so to consider how the transaction is structured so as to trigger an ability to claim nationality²⁵ in a country that has a BIT with the host state.

²⁰ See the recent Indian case of *Venture Global Engineering v Satyam Computer Services Ltd & Anor* (Civil Appeal. No. 309 of 2008), in which the Indian Supreme Court used the "public policy" exception to excuse a refusal to enforce an arbitral award made by an LCIA Tribunal seated in England.

²¹ See www.unctad.org under "Country Lists of BITs"

²² See <http://icsid.worldbank.org> under "Pending Cases"

²³ See, e.g., articles on the nationalisation of the cement industry on, *inter alia*, www.bbc.co.uk and www.nytimes.com

²⁴ A term which is widely interpreted in many Treaties.

²⁵ The concept of "structuring" is complex and those considering doing so should seek expert advice.

Checklist of do's and don'ts

Do:

- Keep arbitration clauses simple - ambitious drafting can more easily lead to pathological clauses.
- Select the seat or legal place of the arbitration with care to ensure a non-interventionist but supportive judicial system to underpin the arbitral process.
- Select an arbitral institution able to administer the arbitration and deal with challenges to arbitrators and appointment in default agreement.
- Scrutinise any institutional rules with care - they are not all the same.
- Select an odd number of arbitrators - provide for three unless you know for certain that the sums in the dispute will not justify it - you can always agree later to opt for a sole arbitrator.
- Think about adopting the IBA Rules of Evidence, particularly if your counterparty is from a different legal culture and so may have very different expectations about the approach to evidence and arbitral procedure.
- Ensure that your contract provides for the governing law of the contract (preferably separate from the arbitration clause itself).
- If the "seat" and governing law of the contract differ, expressly provide for the law of the agreement to arbitrate.
- Take care with multi-level dispute resolution clauses so as not to create preconditions to arbitration which may be incapable of being satisfied.
- Consider the "deal" or "project" structure in the light of available BIT's and MIT's so as to ensure that you have the option to bring a Treaty claim the host state if you suffer expropriation or other extreme violation of rights.

Do not:

- Name a specific arbitrator in the clause, as they may be unavailable or no longer alive by the time a dispute arises.

- Select a seat or legal place of the arbitration and applicable law without reviewing the implications - it is unwise simply to trade with one party specifying the law and the other the seat.
- Be overly prescriptive about the qualifications or experience required by an arbitrator - this can unduly reduce the pool of candidates qualified to be appointed.