

May 2009

Editors:

Ian Meredith

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

Peter R. Morton

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

In this issue:

- News from around the World
- Enforceability in the United States of Class Action Waivers in Arbitration Agreements: The Third Circuit Court of Appeals Signs On To Majority Trend
- Legal Privilege - A Recurrent Problem in International Arbitration
- Challenges Ahead: Arbitrating with Russian and Eastern European Parties
- More U.S. Courts Permit Discovery in Aid of Foreign Arbitrations, But Texas Dissents: U.S.C. § 1782
- The Right to be Heard: CAS Award Annulled by Swiss Federal Supreme Court
- Recent ICSID Decisions on the Meaning of "Investment"
- U.S. Supreme Court Permits Non-signatories to Arbitration Agreements to Seek Stays of Litigation and Interlocutory Appeals Under FAA

From the Editors

Welcome to the 9th edition of Arbitration World, a publication from K&L Gates' Arbitration Group that highlights significant developments and issues in international and domestic arbitration for executives and in-house counsel with responsibility for dispute resolution.

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

News from around the World

Africa

Algeria

A new international arbitration law has entered into force in Algeria. The new law replaces legislation from 1966 and is based on the French law of 1981 with various updates. The new law empowers arbitrators to order interim measures, and sets out restrictive grounds for national courts to deny enforcement of awards.

Americas

United States

The draft ABA Best Practices for Arbitrator Disclosure Standards (discussed in detail in the March 2009 edition of Arbitration World) were rejected by the ABA Dispute Resolution Section on April 15, 2009 and will now not be presented to the ABA House of Delegates for adoption as ABA policy. The draft Best Practices, first published in January 2008 and since revised on several occasions, have been criticized for containing overbroad disclosure requirements, particularly in relation to international arbitrations.

Asia Pacific

India

The London Court of International Arbitration (LCIA) has opened an arbitration centre in Delhi, India. The centre was formally opened at a ceremony in April 2009. The centre, which is intended to provide a forum for the increasing numbers of commercial disputes involving Indian parties, will be financed by the LCIA but managed locally.

Singapore

The Singapore International Arbitration Centre has appointed Michael Pryles as its Chair. Professor Pryles, an Australian, is the first non-Singaporean to occupy the post and will serve until 2011.

Europe

England and Wales

The English High Court has held that the English courts do not have jurisdiction to grant pre-action disclosure in support of an arbitration. In *EDO Corporation v Ultra Electronics*, it was held that neither the Supreme Court Act 1981, nor the Arbitration Act 1996, nor the court rules empower the court to grant pre-action disclosure in respect of disputes which were to be referred to arbitration.

The London Maritime Arbitrators Association (LMAA) has introduced an [Intermediate Claims Procedure](#) to deal with medium-sized claims (between US\$100,000 and \$400,000) that require a more comprehensive procedure than that provided by the LMAA Small Claims Procedure while not justifying the full procedure offered by the LMAA Terms. The new procedure's noteworthy features include caps on the costs of the parties and tribunal, and provision that rights of appeal will depend on certification by the tribunal.

Sweden

The Arbitration Institute of the Stockholm Chamber of Commerce (SCC) has announced its intention to revise its arbitration rules by adding provision for the appointment of an emergency arbitrator to order interim measures. An emergency arbitrator would have the power to decide on requests for interim measures before a case is referred to the arbitral tribunal. It is proposed that the emergency arbitrator would be appointed within 24 hours of an application being made, and an emergency decision given within five days from the date that application was referred to the arbitrator. The new provisions will be incorporated into the SCC Rules and will apply in all SCC arbitrations, unless the parties agree otherwise. The new rules will replace the current SCC Rules on 1 October 2009.

Switzerland

The Swiss Supreme Court has partially annulled an ICC award which prevented the participation in a Swiss-seated arbitration of non-signatories to the arbitration agreement. In a claim by a UAE company against an Italian company, the respondent sought to join three other parties who were not parties to the arbitration agreement but had certain rights under the underlying contract, including the

right to terminate the contract. The respondent's application for joinder was rejected both by the ICC Court and the sole arbitrator. The Swiss Supreme Court's annulment of the arbitrator's award on this point illustrates a contrast between the restrictive approach of the ICC and the more flexible approach in the Swiss courts.

Middle East

Saudi Arabia

A Saudi court has been reported as overturning and reversing the result of an arbitration award. A Saudi company, Jadawel, brought a Saudi Arabia-seated arbitration claim against the UAE company Emaar in relation to a property development in Saudi Arabia. The three-member tribunal, including a member of the royal family, dismissed Jadawel's claim and ordered that it pay legal costs. On Emaar's application to enforce the costs award, the Second Commercial Court of the Board of Grievances in Saudi Arabia overturned the tribunal's award and ordered that Emaar pay legal costs to Jadawel. Reasons for the judgment have not yet been released.

International

UNCITRAL Rules

The report on the last meeting of the UNCITRAL Working Group considering amendments to the UNCITRAL Rules of Arbitration 1976 has been published. At its latest meeting in February 2009, the Working Group reviewed Articles 18 to 26 of the Rules. Various reforms are proposed, notably the possibility for an arbitral tribunal to grant interim measures on a without notice basis.

CEDR - Settlement in International Arbitration

The CEDR Commission on Settlement in International Arbitration has published the final part of its [consultation document](#) containing a draft report and rules. Two key areas of focus in the report are safeguards for arbitrators who use private meetings with parties as a means of facilitating settlement, and 'med-arb'. The Commission has invited comments by August 2009.

Enforceability in the United States of Class Action Waivers in Arbitration Agreements: The Third Circuit Court of Appeals Signs On To Majority Trend

Irene C. Freidel and Robert W. Sparkes, III
(Boston)

As reported in past editions of *Arbitration World*, a “hot topic” among federal and state courts and legal commentators (and a significant practical issue for consumer finance and credit entities) is the enforceability of class action waiver clauses contained in contractual arbitration agreements.

The majority of state and federal courts considering the issue have followed a two-pronged, fact-intensive test, striking down a class action waiver where: 1) the party to be bound did not have a meaningful opportunity to negotiate or reject the arbitration agreement (*i.e.*, the agreement is one of adhesion); and 2) if enforced, the waiver would effectively eliminate a party’s right to seek redress because the expected recovery is not large enough to justify the risks and costs of individual proceedings. In practice, most courts applying this test have found class action waivers in consumer finance related agreements to be unconscionable, and thus unenforceable.

As reported in the [July 2008 edition of *Arbitration World*](#), the Third Circuit Court of Appeals’ decision in *Gay v. CreditInform* stood as a strong judicial statement that class action waiver provisions are not inherently unconscionable and may be enforceable. In *Gay*, the Third Circuit panel upheld a mandatory arbitration clause in an agreement between a consumer and a credit repair organization, which clause required individual arbitration of all disputes arising out of the agreement. Applying the contract law of Virginia, the Third Circuit panel held that the right to proceed on a class-wide basis was merely a procedural right and was therefore waivable. Although the amount in controversy appeared to be relatively small, the court refused to consider whether the consumer would have a meaningful opportunity to recover if she were barred from pursuing the claim as a class action. Instead, the court ruled that the arbitration provision was not, on its face, so unreasonable that it could be considered unconscionable under Virginia state law. Any

further inquiry into the *effect* of the provision, according to the Third Circuit panel (albeit in dicta), would violate the Federal Arbitration Act’s (“FAA”) prohibition of state laws which restrict the enforcement of agreements to arbitrate. Similarly, the court held that two Pennsylvania state law cases finding class action waivers unconscionable would, if applicable, be preempted by the FAA. In short, the *Gay* opinion suggested that the Third Circuit would not follow the majority trend of refusing to enforce class action waivers in mandatory arbitration provisions.

Recently – February 24, 2009 – a different three-judge panel of the Third Circuit, in *Homa v. American Express Company*, appeared to change course from the implications of the *Gay* decision. The *Homa* court, applying the contract law of New Jersey, found that a class action waiver included in a mandatory arbitration provision in a consumer credit card agreement was unconscionable. The crux of the court’s analysis turned on the choice of law between Utah (expressly selected as applicable law under the parties’ agreement) and New Jersey law – the importance of such analysis highlighted by the fact that Utah statutory law expressly allows class action waivers in consumer credit agreements. Applying the choice of law rules for New Jersey (the forum in which the district court sat), the Third Circuit found that New Jersey had a fundamental public policy against enforcing class action waivers in the context of “a low-value consumer credit suit.” As such, the court applied New Jersey state law to the class action waiver at issue and found that “if the claims at issue are of such a low value as effectively to preclude relief if decided individually, then . . . the application of Utah law to the class-arbitration waiver is invalid and the class-arbitration waiver is unconscionable.”

Addressing the *Gay* opinion, the *Homa* court found that New Jersey state law clearly applied to class action waivers in *all* contracts and was not limited solely to arbitration agreements. Thus, the court found that the unconscionability principles espoused in New Jersey law were not directed solely at arbitration agreements and thus not preempted by the FAA. In fact, the *Homa* court made clear that *Gay* cannot stand for the proposition that the FAA preempts all state laws directed at class action waivers unless such law “is read as a blanket prohibition on unconscionability challenges to

class-arbitration provisions.” In so ruling, the *Homa* court did not overrule *Gay* and expressly refused to address the *Gay* court’s analysis of Virginia or Pennsylvania state law – focusing, instead, on the public policy expressed in New Jersey state law.

Notwithstanding the *Homa* court’s distinguishing of *Gay*, the Third Circuit’s opinion in *Homa* suggests that the Third Circuit has, for now, fallen in line with the majority of state and federal courts that have addressed class action waivers in arbitration agreements. This development supports the increasing trend of consumer finance and consumer credit entities to include voluntary opt-out and other similar provisions in class action waivers in their various consumer agreements. For instance, in *Guadagno v. E*Trade Bank* the U.S. District Court for the Central District of California found a class action waiver enforceable relying, in part, on an opt-out provision contained therein. On the other hand, the *Homa* court’s reliance on New Jersey state law – law not at issue in the *Gay* case – may not signify any change in the Third Circuit’s approach to class action waivers, but may merely stand as evidence of one court (via different panels) interpreting and applying two different states’ laws to similar contract provisions.

The fluidity and importance of this area of the law does suggest that this issue may be ripe for U.S. Supreme Court consideration.

Legal Privilege - A Recurrent Problem in International Arbitration

Max Bartram (London)

The problem posed

Imagine an arbitration seated in London, regarding a contract governed by French law, involving one U.S. party advised by Louisiana and New York lawyers and one German party advised by English and French lawyers. When it comes to lawyer-client privilege, which rules should apply? Each side will have strong views, and a careless decision by the tribunal could lead to allegations of lack of due process, unequal treatment, or procedural irregularity.

The common and civil law approaches

A comparison of the different approaches to privilege taken in common and civil law jurisdictions illustrates the sort of problems that can occur in international arbitration.

Under common law systems, privilege is an exception to the principle in the adversarial process that all documents relevant to a dispute should be disclosed to the other side, whether they help or hinder the disclosing party. Privilege belongs to the client and only the client may waive it. Civil law systems, on the other hand, follow an inquisitorial rather than adversarial approach in which there are no "automatic" disclosure obligations. Parties disclose documents in support of their cases and a court may require disclosure of other documents to assist it in resolving the dispute. Privilege belongs to the legal adviser.

Problems can arise from this dichotomy of approach. For example, in the U.S., legal privilege is a substantive right which covers documents produced by both independent and in-house lawyers. In Switzerland, however, legal privilege or "attorney secrecy" is a matter of procedural law. Under Swiss law, in-house lawyers cannot be members of the professional bar and as such are not covered by the laws of attorney secrecy. Any obligations of secrecy they owe will typically arise out of either their contracts of employment or the Swiss law governing business secrets.

This creates obvious tensions. If a tribunal presiding over a dispute between a U.S. party and a Swiss party adopts the Swiss approach to privilege, the U.S. party may be obliged to disclose documents produced by its in-house legal team, since they do not fall within Swiss legal privilege. The U.S. party would more than likely have taken a different approach when dealing with its in-house team had it known that those documents might be disclosable in the arbitration. In that sense, the Swiss party would be at an advantage, being accustomed to the approach to privilege and having in place practices and procedures to prevent certain information being disclosed. This could lead to allegations by the U.S. party of unfairness and inequality in the procedure.

In-house lawyers

As illustrated by the scenario described above, the problem is particularly acute in relation to in-house lawyers. Some jurisdictions attach legal privilege to advice from in-house lawyers; others do not. Where international arbitration is a possibility, in-house lawyers should be aware of the risk that their correspondence with their internal client may not attract legal privilege in such an arbitration process, and tailor those communications accordingly.

Even in those jurisdictions where privilege does attach to advice from in-house lawyers, that is generally only where the lawyers are acting in a legal capacity and not where the lawyers are acting in a business advisory role. It is common practice, and good practice, for communications between in-house lawyers and their internal clients to be marked "Legally Privileged and Confidential" and to state that the communications are for the purpose of legal advice. Such formal markings may not, however, suffice, as many tribunals will perform an analysis of substance rather than form.

How do tribunals approach the problem in practice?

The rules of the major arbitral institutions barely assist, as they are generally silent on the issue of evidential privilege. Even in the few rules which do mention privilege, such as Rule 20.6 of the ICDR Rules (the tribunal "*shall take into account applicable principles of legal privilege, such as those involving the confidentiality of communications between lawyer and client*"), there is no guidance as to which rules or principles should apply.

It has been reported that the IBA is planning the inclusion of a new rule in its Rules of Evidence to fill this gap.

In the absence of any formal guidance, tribunals have developed a variety of approaches. A tribunal's starting point is likely to be any prior agreements between the parties. Parties in search of certainty would be well advised to outline the position as to which rules of legal privilege will apply in the arbitration clause itself.

Where (as is generally the case) there is no agreement as to which legal system's principles shall apply, the tribunal has discretion. The tribunal can

choose between the legal system where the documents are held; that in which the communications took place; that with the closest connection to the events or the documents; that where the lawyer is registered; or the law which is closest to the lawyer-client relationship.

An alternative, known as the "most favoured nation" approach, is to apply whichever law provides the greatest level of protection from disclosure. This has the advantage that both parties are treated equally, with neither party having to disclose anything they would not have to in their own jurisdiction. The converse, the "least favoured nation" approach, applies the law that offers the least protection. This is likely to give rise to complaints from a party that feels it has to disclose evidence that it expected would be covered by legal privilege.

Conclusion

The application of legal privilege is a notoriously problematic area. In order to limit the difficulties that may arise, issues of legal privilege should be considered at an early stage. Consider making provision in the arbitration agreement itself, and once arbitration is contemplated, each party should look at the position from its opponent's point of view. What regime might the opposing party and their lawyers expect to apply, and what would it mean if such rules were to govern document disclosure on both sides? What approach would you like your Tribunal to adopt? What approach is most likely? This analysis will inform the approach to be taken, for example, on the creation of new documents relating to the arbitration.

Challenges Ahead: Arbitrating with Russian and Eastern European Parties

Marcus M. Birch (London)

International arbitration is on the rise in Russia and Eastern Europe. The ICC's latest case statistics reveal that in 2008 around 20% of the parties involved in ICC arbitrations were from the region, an increase of 10% from 2007. In the same year, the Arbitration Institute of the Stockholm Chamber of Commerce (SCC) handled 25 cases involving parties from Russia and the Ukraine.

Yet the widespread adoption in the region of the standard procedures of international arbitration would not appear to be accompanied by a concomitant adaptation to the standard methods and practices of parties to such procedures. Parties entering into an arbitration involving a Russian or Eastern European opponent should be prepared for a challenging process. Four matters reported by the ICC are grounds for concern:

- A disregard for procedural deadlines;
- A high incidence of unfounded or abusive procedural applications. It is far from unknown for a party to submit a request for "interpretation" or "correction" of an award (i.e. under Article 29 of the ICC Rules) that amounts in substance to an appeal on findings of fact or law;
- A trend towards open criticism of a Tribunal's procedural decisions backed with threats to challenge awards for procedural irregularity; and
- Intervention by state authorities, including obtaining judgments in domestic courts dealing with the same subject matter as the arbitration that may conflict with an award.

Even where the arbitration process is concluded and an award is obtained against a party from the region, substantial risks remain. The courts of Russia and the Ukraine are notorious for taking an approach to enforcement of arbitral awards that is interventionist to the point of obstruction. Outcomes can be unexpected. By way of example:

- The Supreme Court of Ukraine has held that arbitration clauses in company by-laws or shareholders' agreements are void as a matter of Ukrainian law; and

- In Russia, it has been held that an application for the enforcement of an arbitral award by the assignee of such award may be refused on grounds that the Arbitrazh Procedural Code provides that an application can only be made by the party in whose favour the award was made.

Reported cases are marked by what many see as an excess of formalism: for example, in *Italtel v Administration of Purovsky Rayon* the Federal Arbitrazh Court of the West Siberian Circuit refused to enforce an ICC award because although the arbitration agreement referred disputes to the ICC Rules, evidence of the existence of those Rules was not provided to the Court and the parties' agreement to refer the dispute to arbitration was held not to be specific. In *IManagement Services Ltd v Cukorova Holding* the Moscow City Arbitrazh Court set aside an ICAC award on grounds that no originals of the arbitration agreement had been presented to the court, and faxed copies were inadmissible.

The picture is not all negative. In some Russian cases, the Supreme Arbitrazh Court has reversed decisions of lower courts and permitted enforcement. The Ukrainian courts' wide interpretation of the public policy exception to enforcement is the subject of an investment treaty claim (*Western NIS Fund*) which might prompt a reappraisal. At a more general level, the ICC, ICAC and other institutions continue efforts to train a corps of local arbitrators and to integrate them into the global arbitration community.

But until the overall position improves, how might a party seek to protect itself against a potentially obstructive opponent from this region? First, consider instructing not just experienced international arbitration counsel, but also local counsel who may be well-placed to advise on tactics and hurdles in obtaining and enforcing an award. Second, take extreme care on formalistic procedural matters: for example, ensure you have the original signed contract and arbitration agreement, and hard evidence of physical service of the request for arbitration and any other proceedings. Third, consider whether it may be advisable to allow your opponent considerable latitude in procedural and timing matters to reduce the chances of a claim of procedural unfairness.

More U.S. Courts Permit Discovery in Aid of Foreign Arbitrations, But Texas Dissents: U.S.C. § 1782

Abram I. Moore (Chicago)

Under 28 U.S.C. § 1782, parties to proceedings before foreign tribunals can apply directly to U.S. federal district courts for orders granting discovery from persons or entities located in the U.S. Prior to 2004, U.S. courts had generally refused to find that foreign arbitral bodies constituted “tribunals” under Section 1782. In 2004, however, the United States Supreme Court found that the Directorate-General for Competition of the Commission of the European Communities was a “tribunal” under Section 1782. *Intel Corp. v. Advanced Micro Devices, Inc.* In *Intel*, the Supreme Court also suggested, in dicta, that foreign arbitral tribunals may constitute Section 1782 “tribunals”. In the [Summer 2007 edition of Arbitration World](#), we noted that, after *Intel*, federal courts in New Jersey (*In re Oxus Gold*) and Georgia (*In re Roz Trading*) had interpreted Section 1782 to apply to international arbitrations. Recently, courts in Minnesota, Massachusetts and Delaware have followed suit, while a court in Texas has disagreed.

The three decisions permitting the use of Section 1782 in aid of foreign arbitrations each focused on whether an arbitral body can be considered a tribunal. In September 2007, the District of Minnesota court found that a private Israeli arbitral body qualified as a “tribunal” under Section 1782, and permitted the service of nine document requests and nine interrogatories upon a U.S. witness via the statute (*In re Hallmark Capital Corp.*). In October 2008, a Delaware federal court found that Section 1782 applied to a private arbitration pending in Geneva, Switzerland and ordered the issuance of subpoenas for depositions and the production of documents (*Comision Ejecutiva, Hidroelectrica Del Rio Lempa v. Nejapa Power Co.*). That same month in Massachusetts, a district court held that the ICC International Court of Arbitration was a “tribunal” for the purposes of Section 1782, but the court refused to exercise its discretion to order the requested discovery based upon the particular facts in that case (*in re Babcock Borsig AG*).

A 2008 decision by a federal court in Texas is the sole outlier among the opinions considering this

issue after *Intel*, holding that Section 1782 does not apply to foreign arbitrations (*Comision Ejecutiva, Hidroelectrica Del Rio Lempa v. El Paso Corp.*). The Texas case involved the same Swiss arbitration as the Delaware action described above, and was filed by the same applicant. However, the Texas court disagreed with the expansive interpretation of *Intel* advanced by the other district courts and relied instead upon a pre-*Intel* decision holding that private international arbitral bodies are not “tribunals” under Section 1782.

As illustrated in *Babcock Borsig*, a finding by a district court that a foreign arbitral body constitutes a tribunal for purposes of Section 1782 does not guarantee that the requested discovery will be ordered. Discovery orders under Section 1782 are discretionary, and courts consider such factors as (1) whether the U.S. witness is a party to the foreign arbitration, (2) whether the particular foreign arbitral body is receptive to U.S. judicial assistance in gathering evidence, (3) whether the request is an attempt to circumvent foreign evidence-gathering restrictions, and (4) the burden of the requests at issue.

Although the weight of post-*Intel* legal authority suggests that participants in foreign arbitrations can now successfully apply for discovery in the U.S. under Section 1782, there remains a conflict in the federal district courts. Until the scope of Section 1782 is clarified by Circuit Courts of Appeals or the United States Supreme Court, a party to foreign arbitration who hopes to discover evidence in the U.S. cannot predict with certainty whether it will meet the first requirement: a recognition of the arbitral body as a “tribunal”. However, based upon the recent trend, it is likely that this hurdle will be cleared -- unless the evidence lies in Texas.

The Right to be Heard: CAS Award Annulled by Swiss Federal Supreme Court

Martin J. King (London)

The Court of Arbitration for Sport ("CAS") is headquartered in Lausanne, Switzerland. Appeals from CAS decisions may be made to the Swiss Federal Supreme Court on limited grounds, for example: lack of jurisdiction; violation of procedural rules; and public policy. In the *Jose Goitia* case in February 2009, the Swiss Federal Supreme Court allowed such an appeal and annulled a CAS award. The case is interesting both because it is only the second time a CAS award has been annulled (the first being in the *Guillermo Canas* case) and because the circumstances of the annulment raise questions about arbitrators' powers generally.

The dispute before FIFA

A Brazilian footballer engaged a Spanish football agent to find him a professional European football club to play for. The player subsequently signed for Portuguese football club Sporting SAD, although his agent is said to have had no involvement. The agent sought a commission, the player refused to pay, and so the agent took the matter to FIFA. The FIFA Players' Status Committee rejected the agent's claim for commission; the agent could not establish that he had participated in negotiations which led to the conclusion of the player's contract with Sporting SAD.

CAS Award

The agent appealed to CAS citing an exclusivity clause in his agency contract and asserting, *inter alia*, that he was entitled to a commission without showing a causal link between his actions and the conclusion of the player's playing contract.

The CAS tribunal agreed with FIFA: the agent could not show he had played any role in negotiating the player's contract; nor had the player breached his agency contract by signing for Sporting SAD without going through his agent. Further (and crucially in the context of the agent's subsequent appeal to the Swiss Federal Supreme Court), the CAS tribunal held that the exclusivity provision in the agency contract was void under a Swiss Federal employment law which declares void any

arrangement which purports to prohibit a jobseeker from approaching another employment agent. Neither party had cited or sought to rely upon that law during the proceedings before FIFA or CAS.

Award Annulled

The agent appealed to the Swiss Federal Supreme Court on the ground that the CAS tribunal had based its award on a legal principle which neither party could reasonably have expected to apply and thus, having not had a chance to address the point on Swiss employment law, the agent's right to be heard had been violated.

The Swiss Federal Supreme Court held that:

- according to the maxim *jura novit curia* ("the court knows the law"), arbitral tribunals have the discretion to rule on the basis of legal principles other than those relied on by the parties;
- as an exception to the maxim, a tribunal should consult the parties if it contemplates applying a legal principle which has not been raised during proceedings and which the parties did not appreciate was relevant: the parties should not be "*surprised*";
- a Spanish agent domiciled in Spain claiming commission from a Brazilian footballer domiciled in Portugal in connection with a playing contract with a Portuguese football club cannot have reasonably expected the tribunal to apply provisions of Swiss employment law (indeed the Swiss Federal Supreme Court considered the specific employment law applied by the CAS tribunal to be manifestly inapplicable in these circumstances) - even less so in circumstances where neither party had mentioned the particular law during proceedings;
- the CAS tribunal should have first consulted the parties and invited them to make submissions on the particular law;
- by omitting to consult the parties, the CAS tribunal breached the agent's right to be heard; and
- accordingly, the appeal would be allowed and the CAS award annulled.

Wider relevance to arbitrator powers

The Court did not object in principle to the tribunal using its initiative to consider laws that may be applicable to the dispute before it. Yet the tribunal should have raised the issue with the parties first and given them a chance to argue its relevance and applicability before relying on the law in deciding the dispute.

The ability of tribunals to identify legal principles themselves is not limited to Switzerland. The position is similar in England under s34(2)(g) Arbitration Act 1996; subject to the parties agreeing otherwise, it shall be for the tribunal to decide all procedural and evidential matters including whether and to what extent the tribunal should itself take the initiative in ascertaining the facts and the law. Of course such discretion is always subject to the tribunal's overriding duty under s33(1) Arbitration Act 1996 to allow both sides a reasonable opportunity to put their case. This would likely include raising with the parties any legal principles that the parties had not raised in proceedings but which the tribunal considers might be applicable.

This in itself raises an interesting question as to fairness: when and how should a tribunal intervene and to what extent will an intervention give rise to an appearance of bias? A tribunal in this situation has a balancing act between acting judicially and meting out justice in accordance with the applicable laws, whilst at the same time remaining and being seen to be fair and impartial. A classic example is where one party to the arbitration is unrepresented by legal counsel and a tribunal may feel duty bound to raise applicable principles which may assist that party.

Experienced arbitrators have developed means of eliciting key issues and contributing to the legality, equality and fairness of the process by asking pertinent questions rather than unilaterally imposing the law without consultation. The *Jose Goitia* case highlights the importance of inviting submissions upon the law before imposing it on the parties.

Recent ICSID Decisions on the Meaning of “Investment”

Sean Kelsey (London)

As part of its efforts to promote international investment, since 1966 the World Bank has operated the International Centre for the Settlement of Investment Disputes (“ICSID”, or “the Centre”) pursuant to the ICSID Convention (the “Convention”). The Centre provides facilities for the resolution of international investment disputes, in particular disputes between an investor and a host state pursuant to a bilateral investment treaty (“BIT”).

Article 25.1 of the Convention states that

“The jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment, between a Contracting State...and a national of another Contracting State, which the parties to the dispute consent in writing to submit to the Centre.”

In a deliberate effort to keep its remit as broad as possible, the Convention does not define “investment”. It is therefore left open to Convention states to agree between themselves the type of investment to which the Convention applies. Parties to a BIT generally adopt some sort of definition of investment, and these definitions also tend to be very broad.

A body of ICSID arbitration caselaw has arisen on the interpretation of the term “investment”. Key criteria were established in the *Salini* arbitration. These “*Salini* criteria” – all of which must be satisfied – can be characterised as follows:

- a contribution of money or other assets of economic value;
- a certain duration over which the project is implemented;
- a sharing of operational risks; and
- a contribution to the host state’s development.

The jurisdiction of the Centre, by reference to interpretation of the term “investment”, has recently come under consideration in two ICSID arbitration decisions.

In 2002, two Czech companies involved in the trading of ferroalloys, Benet Group, a.s. and Benet Praha, spol. s.r.o. (respectively “Benet Group” and “Benet Praha”, collectively the “Czech companies”) were acquired by an Israeli company, Phoenix Action Ltd (“Phoenix”). Phoenix was, in turn, owned by a Czech national, Vladimir Beno, who had acted as executive officer of Benet Praha. In 2001, Mr Beno was arrested by Czech police in connection with a criminal investigation into alleged tax and customs duty evasion, in connection with which Benet Praha came under investigation, and had assets frozen and papers seized. Mr Beno escaped and fled to Israel, where he incorporated Phoenix, which then acquired the Czech companies from Mr Beno’s wife.

Within weeks of its acquisition of the Czech companies, Phoenix commenced arbitration under the provisions of the 1997 BIT between the Czech Republic and Israel. Phoenix claimed that the continued freezing of Benet Praha’s funds and seizure of its documents was a breach of the fair and equitable treatment obligation under the 1997 BIT. The Czech Republic challenged the jurisdiction of the tribunal (the “Phoenix tribunal”) on the grounds that the purported investment by Phoenix was made – by a fugitive from Czech justice – solely in order to bring before an international judicial body the purely domestic disputes to which Mr Beno and the Czech companies were party. This was characterised by the Czech Republic as “one of the most egregious cases of ‘treaty-shopping’ the international arbitration community has seen in recent history”, and an abuse of the ICSID process.

The Phoenix tribunal accepted the Czech Republic’s case, and in so doing restated and developed the *Salini* criteria to set out the characteristics of an “investment” for purposes of ICSID arbitration as follows:

- a contribution in money or other assets;
- a certain duration;
- an element of risk;
- an operation made in order to develop an economic activity in the host state;
- assets invested in accordance with the laws of the host state; and
- assets invested *bona fide*.

The Phoenix tribunal was prepared to accept that the acquisition of the Czech companies satisfied the first five of these criteria but found that the transaction was not *bona fide*, and declined jurisdiction accordingly.

The day after the decision in the Phoenix case, two of the three members of an *ad hoc* ICSID committee (the “committee”) granted annulment (pursuant to Article 52 of the Convention) of an award given by a tribunal (the “Salvors tribunal”) declining jurisdiction in the case of *Malaysian Historical Salvors SDN BHD v Malaysia*. This decision is interesting because it down-plays the significance of the *Salini* criteria, hard on the heels of a decision which restated them.

An English company had contracted with the government of Malaysia for the salvage of a ship’s cargo on the basis of no-find-no-fee (the “Contract”). When a dispute arose, the Salvors tribunal, appointed pursuant to the UK-Malaysia BIT, declined jurisdiction on the basis that the contract which formed the subject matter of the dispute was not an investment because it did not involve a contribution to the economic development of Malaysia, an application of the *Salini* criteria.

The committee found that the Salvors tribunal had concentrated almost exclusively on Article 25.1 of the Convention, and had effectively ignored relevant provisions of the UK-Malaysia BIT, which defined investment as meaning “every kind of asset and in particular, though not exclusively...claims to money or to any performance under contract having financial value...[and] business concessions conferred...under contract...”. The Contract most certainly was an investment within the terms of the UK-Malaysia BIT, and on that basis the tribunal’s decision was impugned with gross error giving rise to manifest failure to exercise jurisdiction. The committee stated that the *Salini* criteria, on which the Salvors tribunal had relied, are not fixed or mandatory, and there is no requirement that they be strictly applied in every case.

Although they appear to have been reached in isolation from one another, the interaction between the decisions in the Phoenix and Salvors cases is interesting. The Phoenix tribunal’s adoption of the test of ‘development of an economic activity’ rather than ‘contribution to the host state’s development’ arguably lowers the bar sufficiently to have

accommodated the Contract in the *Salvors* case. Further substantial consideration of this restatement of the *Salini* criteria seems likely in future. But in the *Salvors* case the committee did not rely on any restatement of the *Salini* criteria in order to decide that the Contract did indeed qualify as an investment. The committee's decision reaffirms the principle that agreement between states party to the Convention is the primary basis for interpreting the term "investment" in international investment disputes.

In light of the decision of the committee in the *Salvors* case, the true significance of the *Phoenix* case may lie in its introduction of the notion of good faith as a characteristic of any investment giving rise to a dispute over which the Centre has jurisdiction.

U.S. Supreme Court Permits Non-signatories to Arbitration Agreements to Seek Stays of Litigation and Interlocutory Appeals Under FAA

Jeremy A. Mercer (Pittsburgh)

In a case that will have major ramifications for arbitration agreements throughout the United States, on May 4, 2009, the U.S. Supreme Court resolved a split in the federal courts of appeals regarding the rights of non-parties to arbitration agreements. The question before the Court was whether federal courts of appeals have jurisdiction to hear interlocutory appeals by non-signatories to arbitration agreements of the denial of stay motions under the Federal Arbitration Act ("FAA"). By a six to three majority, the Court answered that question in the affirmative.

Legal Framework

The question before the Court arose from the interplay of Sections 3 and 16 of the FAA. Section 3 entitles a litigant to a stay of any action that is "*referable to arbitration under an agreement in writing....*". Section 16 entitles a litigant to immediately appeal an order denying a Section 3 request to stay an action. In applying these sections, the federal courts of appeal were split in their interpretation as to whether a non-signatory to an arbitration agreement – claiming the benefit of

the agreement through a state law legal theory – could avail itself of either of these FAA entitlements.

Case Background

The case arose out of failed tax advice relating to the plaintiffs' sale of their business in 1999. Wanting to minimize their tax liability, the plaintiffs sought tax advice from Arthur Andersen, who introduced them to Bricolage Capital, LLC, a financial boutique. Bricolage then introduced the plaintiffs to a New York law firm that specialized in tax advice. All three defendants (Arthur Andersen, Bricolage and the law firm) recommended a tax shelter that the Internal Revenue Service ("IRS") later deemed to be an abusive tax shelter, resulting in the plaintiffs paying the IRS tens of millions of dollars.

The plaintiffs sued the three defendants in federal court in Kentucky. The three defendants filed motions, pursuant to the FAA, to stay the litigation based on an arbitration clause in an agreement the plaintiffs signed with Bricolage that provided for any dispute arising out of or relating to the agreement to be settled by AAA arbitration in New York. Importantly, only the plaintiffs and Bricolage were named parties to the agreement that contained the arbitration clause.

While the motions to stay were pending, Bricolage filed for bankruptcy and the case against it was automatically stayed under the bankruptcy code. The trial court then denied the FAA motions to stay by Arthur Andersen and the law firm defendant, who immediately appealed the denials.

The Court of Appeals for the Sixth Circuit found that Arthur Andersen and the law firm were not named parties to the arbitration agreement and therefore, as non-parties to the arbitration agreement, were not entitled to benefit from the law permitting immediate appeals of denial of stay motions. This decision was in accord with prior decisions by two other courts of appeals but in conflict with a decision of one other court of appeals.

The defendants then sought review in the Supreme Court.

Arguments before the Supreme Court

The defendants told the Court that whether the movant in a Section 3 motion was a signatory to the arbitration agreement was irrelevant; all that was needed was a written agreement to arbitrate that would cover the dispute at issue and a request by a litigant, under Section 3, to stay the litigation. Once that request is denied, said the defendants, the frustrated litigant has a right to an immediate appeal. It was the defendants' view that the words "referable to arbitration under an agreement in writing" did not apply only to signatories of the agreement but also to those claiming to have a right to enforce the agreement under state law principles, such as third-party beneficiary, estoppel, or assignment.

The plaintiffs read Section 3 in a more limited manner. On their theory, only those who had signed an arbitration agreement could request referral of the matter to arbitration "under" the written agreement. Those, like the defendants, who seek cover under the agreement in reliance on state law principles that permit them to enforce the agreement seek reference of the matter to arbitration "under" those principles and not "under" the agreement itself.

The Supreme Court's Decision

The majority sided with the defendants. Justice Scalia, writing for the majority, read Section 3 literally, finding that under "that provision's clear and unambiguous terms, any litigant who asks for a

stay under §3 is entitled to an immediate appeal from denial of that motion – regardless of whether the litigant is in fact eligible for a stay." To require more, as the plaintiffs advocated, would "conflat[e] the jurisdictional question with the merits of the appeal." For the majority, the language of the FAA could not be clearer. "The jurisdictional statute here unambiguously makes the underlying merits irrelevant, for even utter frivolousness of the underlying request for a §3 stay cannot turn a denial into something other than 'an order ... refusing a stay of any action under section 3.'"

The majority reiterated the primacy of state law when determining whether a non-signatory could rely on an arbitration agreement. State law determines whether arbitration agreements are binding and enforceable under the FAA, and some state law principles allow a non-signatory to be bound. Accordingly, the Court held that the Sixth Circuit's holding that non-parties to a contract are categorically barred from Section 3 relief was in error.

Thus, the Court reversed the decision of the Sixth Circuit and confirmed that courts of appeal have jurisdiction to hear interlocutory appeals and that a non-signatory to an arbitration agreement may invoke Section 3 of the FAA to enforce the agreement if state law allows that litigant to enforce the agreement at issue.

Anchorage Austin Beijing Berlin Boston Charlotte Chicago Dallas Fort Worth Frankfurt Harrisburg Hong Kong London
Los Angeles Miami Newark New York Orange County Palo Alto Paris Pittsburgh Portland Raleigh Research Triangle Park
San Diego San Francisco Seattle Shanghai Singapore Spokane/Coeur d'Alene Taipei Washington, D.C.

K&L Gates comprises multiple affiliated partnerships: a limited liability partnership with the full name K&L Gates LLP qualified in Delaware and maintaining offices throughout the U.S., in Berlin and Frankfurt, Germany, in Beijing (K&L Gates LLP Beijing Representative Office), in Singapore (K&L Gates LLP Singapore Representative Office), and in Shanghai (K&L Gates LLP Shanghai Representative Office); a limited liability partnership (also named K&L Gates LLP) incorporated in England and maintaining our London and Paris offices; a Taiwan general partnership (K&L Gates) which practices from our Taipei office; and a Hong Kong general partnership (K&L Gates, Solicitors) which practices from our Hong Kong office. K&L Gates maintains appropriate registrations in the jurisdictions in which its offices are located. A list of the partners in each entity is available for inspection at any K&L Gates office.

This publication is for informational purposes and does not contain or convey legal advice. The information herein should not be used or relied upon in regard to any particular facts or circumstances without first consulting a lawyer.

©2009 K&L Gates LLP. All Rights Reserved