TRAVERS SMITH

Off-exchange and out of court: Arbitration clauses in ISDA master agreements

On 9 September 2013, the International Swaps and Derivatives Association, Inc. ("ISDA") published its 2013 Arbitration Guide (the "Guide"), providing guidance on the use of arbitration clauses in the 2002 ISDA Master Agreement and the 1992 ISDA Master Agreement (Multicurrency – Cross Border). The publication of the Guide was in response to market interest, in the context of a general increase in the number and value of cross-border derivatives disputes.

In this note we revisit the Guide one year on and outline key considerations for market participants.

Making the swap to arbitration in derivatives contracts

The 1992 and 2002 ISDA Master Agreements only contemplate the selection of dispute resolution clauses conferring jurisdiction on the English or New York courts to resolve disputes. The Guide has made it simpler for parties to choose to submit disputes to arbitration instead. It includes a range of model arbitration clauses for inclusion in an ISDA Master Agreement, reflecting various combinations of governing law, arbitral seats (i.e. the jurisdictions in which arbitrations are legally based) and arbitral institutional rules.

Given that both the English and New York courts have extensive experience of effectively and efficiently resolving derivatives disputes, it is worth asking why parties might agree instead to submit their disputes to arbitration.

Arbitration

Arbitration is a private form of binding dispute resolution, conducted before an impartial tribunal, emanating from the agreement of the parties but regulated and enforced by state courts. Arbitral tribunals are generally composed of either one or three arbitrators.

Arbitration has a number of features. Those which are often described as key advantages as compared to litigation include the following (although clearly one party's advantage may be another's disadvantage):

- **Enforceability:** An arbitral award is enforceable in more countries than a court judgment. This is because many countries are party to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958 governing the enforcement of arbitral awards, whereas there are few multilateral conventions for the enforcement of court judgments. As the number of derivatives transactions connected with emerging jurisdictions grows, so too does the attraction of arbitration as a means of reducing enforcement risk in those jurisdictions.
- **Neutrality:** Parties are attracted to arbitration because it gives them a neutral forum that does not involve submitting to the courts of the other party's home state, which may be a particularly useful tool when dealing with state entities.
- **Procedural flexibility:** Arbitration is procedurally more flexible than litigation and this can make it cheaper and quicker than court proceedings.
- **Finality:** Arbitral awards are generally more final than court judgments and this may be desirable for one or both of the parties. In most jurisdictions arbitral awards are

"Their lawyers are all user-friendly and pragmatic. Very good, very easy to deal with and very client-focused."

Chambers UK 2014

generally not subject to appeals on the merits, or such rights can be excluded by agreement between the parties. Generally awards can only be challenged for reasons pertaining to the jurisdiction of the tribunal or serious irregularities in the process of the arbitration.

- **Confidentiality:** Parties are often attracted by the greater privacy and confidentiality which arbitrations tend to afford, in contrast to the generally public nature of court proceedings. Arbitration hearings are conducted in private, and there is much that parties can do to ensure that both the proceedings and the award remain confidential. (Confidentiality can never be guaranteed, however, particularly where it becomes necessary to draw on the assistance of state courts to support the arbitral process or enforce an award.)
- **Expertise:** While the English and New York courts are very experienced in dealing with derivatives disputes, this may not be true of courts in another given jurisdiction and, in any event, parties are not generally able to choose their court judges. In arbitration parties can choose arbitrators with particular legal or technical expertise. The establishment in 2012 of the Panel of Recognised International Market Experts in Finance ("P.R.I.M.E Finance"), an institution based in The Hague and specialising in the resolution of complex financial disputes, demonstrates the apparent market appetite for specialist expertise in the resolution of financial disputes.

However, there are potential disadvantages to arbitration, for example:

- **Lack of summary or default procedures:** Before the English and New York courts, parties can deploy various techniques to bring claims to an early conclusion. For example, in England a party can apply for summary judgment if a claim or defence has no real prospect of success, or default judgment if a defendant fails to take part in proceedings. Comparable techniques do not exist in arbitrations and this may mean, for example, that parties with very strong claims are less able to dispose of such claims swiftly.
- **Multiple parties and contracts:** It is generally not possible to force third parties to be joined into arbitrations. This can be a disadvantage where a transaction involves multiple parties and/or multiple contracts. Contracts can be structured, however, to address these concerns to the extent possible.
- **Potentially reduced predictability:** international arbitration lacks a doctrine of precedent and this potentially reduces the predictability of the outcome of an arbitral award as compared to that of a court judgment in many legal systems.

Parties should consider carefully and take appropriate advice as to whether the circumstances of the derivatives transaction and the counterparty in question make arbitration an appropriate dispute resolution mechanism, or whether it is better to stick with the default jurisdiction provisions set out in clause 13 of the ISDA Master Agreements.

The model clauses

If arbitration is an appropriate dispute resolution mechanism, the first port of call will be the model clauses contained in the Guide. Each model clause is intended to form part of the Schedule to the Master Agreement. Parties amending existing agreements will need to include additional wording to reflect that fact.

The clauses reflect the following combinations of arbitral institutional rules, seat and ISDA Master Agreement governing law:

Rules	Seat	Governing law
ICC (International Chamber of Commerce)	London New York Paris	English New York English/New York
LCIA (London Court of International Arbitration)	London	English
AAA - ICDR (American Arbitration Association - International Centre for Dispute Resolution)	New York	New York
Hong Kong International Arbitration Centre	Hong Kong	English/New York
Singapore International Arbitration Centre	Singapore	English/New York

"This ... team certainly punches above its weight, acting in a variety of high-profile and commercially sensitive international disputes."

Chambers UK 2013

Swiss Chambers' Arbitration Institution	Geneva or Zurich	English/New York
P.R.I.M.E Finance	London	English
	New York	New York
	The Hague	English/New York

These combinations were selected by ISDA following a detailed consultation process, although parties remain free to choose other seats and arbitral rules as well. The model clauses are designed to be as straightforward as possible, but parties should always check that they do not need to be amended to suit the particular transaction in question. Parties may wish to adjust a given model clause to deal with various issues, including, for example:

- requiring arbitrators to have particular qualifications or expertise;
- providing for the arbitration to be confidential; or,
- providing one party with the option to choose between arbitration and litigation after the dispute has arisen.

Any amendments will require careful drafting to ensure an effective dispute resolution clause.

As well as more established arbitral institutions such as the ICC and the LCIA, provision is made in the model clauses for arbitration under the rules of P.R.I.M.E Finance.

Wider dispute resolution focus

The Guide has come at a time of increased regulatory focus on derivatives, as highlighted for example by the obligations arising from the EU's European Market Infrastructure Regulation and similar regulatory regimes worldwide. These regulations are increasingly imposing a requirement on parties to reconcile data in respect of their portfolio of derivatives trades, agree a procedure to attempt to resolve disputes relating to transactions prior to commencing litigation or arbitration, and to report to relevant regulators high value disputes that remain unresolved for a significant period. It is to be hoped that these regulatory initiatives will allow many potential disputes to be identified and resolved before formal dispute resolution measures are engaged.

However, there is unlikely to be a shortage of derivatives disputes requiring ultimate resolution via litigation or arbitration. In this regard the Guide has resulted in welcome flexibility for market participants in allowing them more easily to adopt arbitration provisions where the circumstances of any given transaction warrant this.

Please contact us if you would like further information about the issues set out in this note.

"Highly commercial and pragmatic."

Chambers UK 2014

Travers Smith LLP
10 Snow Hill
London
EC1A 2AL

T: +44 20 7295 3000
F: +44 20 7295 3500

www.traverssmith.com

Jan-Jaap Baer
Partner, Dispute Resolution
T: +44 (0)20 7295 3449
jan-jaap.baer@traverssmith.com

Jonathan Gilmour
Partner, Derivatives & Structured Products
T: +44 (0)20 7295 3425
jonathan.gilmour@traverssmith.com

Huw Jenkin
Partner, Dispute Resolution
T: +44 (0)20 7925 3213
huw.jenkin@traverssmith.com

Caroline Edwards
Partner, Dispute Resolution
T: +44 (0)20 7295 3322
caroline.edwards@traverssmith.com

Peter Hughes
Partner, Derivatives & Structured Products
T: +44 (0)20 7295 3377
peter.hughes@traverssmith.com