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SUPPLEMENTARY MATERIALS

to the ICC Commission Report

Financial Institutions and International Arbitration

ICC Dispute Resolution Services

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DERIVATIVES

INTRODUCTION

1 To understand the current state and potential development of arbitration related to derivatives, it is necessary to understand the size and significance of the derivatives market and the kinds of disputes that may arise in this context.

2 Today, derivatives are traded both on special derivatives exchanges (exchange-traded derivatives or ETD) and outside official exchanges (over the counter or OTC). OTC derivatives trade accounts for a significant majority of all derivatives trades. As of the end of 2014, the OTC market had approximately USD 630 trillion notional outstanding. This is an important area of financial activity, and dispute resolution options in the context of derivatives disputes are therefore worth examining and, if possible, improving for the benefit of all participants.

3 Derivatives transactions give rise to a multitude of disputes, including those over (i) misselling and wrongful investment advice (ii) calculation of payment streams and settlements (iii) the occurrence of specific events or the calculation of dates, (iv) the quantity and quality of commodities, and (v) various rights and obligations imposed by the ISDA Master Agreements which govern most OTC derivatives transactions.

4 The international framework for the arbitration of derivatives disputes has been steadily developing. The Master Agreements of the International Swaps and Derivatives Association (ISDA) traditionally provide for litigation of derivative disputes in English or New York courts, but arbitration has increasingly been presented as a viable alternative to litigation. In this context, the 2013 ISDA Arbitration Guide provides information and guidance on arbitrating derivatives disputes and offers parties a number of model arbitration clauses, which can be incorporated into their ISDA Master Agreements. Disputes can be resolved under a range of arbitral institutional rules, some of which offer special procedural rules for financial disputes.

5 Knowledge and recognition of arbitration as a dispute resolution method has also been growing. Interviews with representatives of banks and financial institutions conducted by the Task Force indicate that their familiarity with arbitration and willingness to utilise it has been on the rise, but it is important to emphasise that there is a great deal left to be done in terms of developing this trend. The interviewees also specified that while derivatives arbitration is a dispute resolution option less commonly used in Europe, it becomes more prominent where counterparties are from emerging markets. This is largely due to (a) the difficulties in enforcing court decisions in a number of emerging market jurisdictions and (b) general satisfaction, thus far, with domestic and intra-European enforcement of state court decisions.

6 Just as importantly, the respondents specified which aspects of the dispute-resolution process weigh in favour of (or against) arbitrating a dispute. They emphasised that, given the complexity of many derivative products, the financial expertise of the decision-makers is critical to the successful outcome of a dispute. In this regard, arbitration may offer an advantage over litigation, where parties cannot select or appoint their judges. Similarly, the enforceability of decisions may persuade parties to opt for arbitration in order to reduce the expense and uncertainty associated with enforcement proceedings. Whereas confidentiality is often an important factor leading parties to choose arbitration over litigation, market participants in the financial sector also value predictability and publicly-available, established legal precedent. The possibility of a speedy dispute resolution procedure and the interaction of arbitration with regulatory requirements may also constitute decisive factors in the decision to arbitrate.

7 A significant point that emerged from the interviews was as follows: while the respondents (understandably) had mixed views on the merits of arbitration, they were generally willing to arbitrate disputes when counterparties suggested doing so. A major reason why arbitration is less commonly used in Europe is that it is not yet viewed as a default dispute resolution mechanism, but rather one that banks and financial institutions would consider if it was presented to them in the context of particular transactions.

OVERVIEW OF DERIVATIVES MARKETS AND PRODUCTS

A Volume of derivatives transactions

8 Derivatives transactions are high-value and high-volume financial transactions. OTC derivatives make up a majority of all derivatives transactions and had approximately USD 542 trillion notional outstanding at the end of June 2017.[1]

9 The OTC market itself is dominated by interest rate derivatives. As of the end of June 2017:

- 77% of all OTC derivatives transactions (USD 416 trillion) consisted of interest rate contracts.[2]
- Interest rate swaps are the single largest segment in OTC derivatives markets. At end-December 2016, they accounted for 57% of the notional amount of all outstanding OTC derivatives.[3]
- Foreign exchange derivatives were the second largest category, with a market share of 14% (USD 77 trillion).[4]

10 The ETD market is also dominated by interest rate derivatives.[5]

11 Currently, there is a dearth of concrete numbers indicating precisely how the derivatives market is divided between private individuals, financial institutional investors, non-financial companies and government entities. There also appears to be little information illustrating what type of investors or financial institutions prefer specific derivatives. According to ISDA, the majority of derivatives users are institutional customers such as corporations, investment managers, governments, municipalities, insurers, energy and commodity firms, funds and international and regional banks, as well as financial institutions.[6]

B Legal framework for derivatives transactions

12 Different legal frameworks govern OTC and ETD derivatives transactions. OTC transactions do not benefit from institutional regulations and are conducted under standardised framework agreements. ETD transactions are governed by the regulations of the corresponding derivatives exchange. Nevertheless, disputes arising from both types of derivatives can potentially be resolved through arbitration.

13 Generally, parties intending to engage in OTC derivatives transactions enter into a framework agreement (also known as a master agreement) which sets out the standard terms and conditions that apply to all the transactions the parties enter into, but does not

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1 See statistical release, OTC derivatives statistics at end-June 2017 (Bank for International Settlements (BIS), November 2017), https://www.bis.org/publ/otc_hy1711.pdf.

2 See BIS statistical release, supra note 1 at 3.

3 See Statistical release, OTC derivatives statistics at end-December 2016 (Bank for International Settlements (BIS) May 2017), https://www.bis.org/publ/otc_hy1705.pdf at 4.

4 Ibid.

5 See BIS Quarterly Review, June 2015 http://www.bis.org/publ/qtrpdf/r_qt1506.pdf at A146.

6 The Value of Derivatives (ISDA, 2014), http://www2.isda.org/about-isda/ at 2.

contain commercial terms specific to a particular transaction. Once the framework agreement is executed, the parties can enter into numerous transactions by agreeing to the material commercial terms in a separate written confirmation, without any need to revisit the underlying terms contained in the master agreement.[7]

14 The ISDA 1992 and 2002 Master Agreements (ISDA Master Agreements) are the most commonly used master agreements for OTC transactions.[8] The ISDA Master Agreements regularly provide for dispute settlement in the courts of London and New York, under English and New York law respectively.

15 ETDs are governed most frequently by their respective exchange regulations. The parties usually do not enter into a direct contract, but rather trade via the exchange, which functions as an intermediary.[9] Consequently, there is no direct agreement between the parties. Nevertheless, it is possible to arbitrate ETD disputes as well.

TYPICAL DISPUTES ARISING OUT OF DERIVATIVES TRANSACTIONS

16 This section explores several types of disputes that may arise out of derivatives transactions.

A Disputes related to misselling and wrongful investment advice

17 Damage claims in connection with misselling may arise if one party gives specific advice in relation to a derivatives transaction entered into between the parties. More specifically, a claim for damages may arise if relevant and material information is either omitted or falsely stated, the risks associated with the specific transaction(s) are not sufficiently explained, or if the derivatives product is unsuitable for the purchaser. The exact legal basis for such claims, as well as the scope and quality of the investment advice allegedly given, will vary depending on the factual circumstances and the legal frameworks in different jurisdictions.

B Disputes related to the calculation of payment streams and settlements

18 Claims alleging defects in performance may arise if the parties disagree on the amount owed pursuant to a specific transaction. The parties usually agree on how to calculate payment streams stemming from a particular transaction. However, since these payments often depend on different variables, such as indices or floating interest rates, disputes can arise as to how the contractually agreed method to calculate a specific payment is to be properly applied. In particular, this could be the case if the index on which a derivative is based is to be adjusted over time. In such cases, disputes as to how to adjust the index might arise. Furthermore, indices are often based on multiple complex components. If one of the components becomes illiquid and can no longer be calculated, a dispute may arise as to how to replace the specific component or how to adjust the index. Lastly, as the LIBOR manipulation scandal has demonstrated, the index itself may have been calculated erroneously.[10]

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7 C. Dugué, 'Arbitration of Disputes arising from Derivative Financial Instruments and Transactions' (2000) X Riv. dell'arb. 1 at 8.

8 *Financial Transactions in a Borderless World: The Movement towards Arbitration in OTC Derivatives*, (SIAC), http://www.siac.org.sg/2013-09-18-01-57-20/2013-09-22-00-27-02/articles/309-financial-transactions-in-a-borderless-world-the-movement-towards-arbitration-in-otc-derivatives.

9 See ISDA website, Product Descriptions and Frequently Asked Questions, http://www.isda.org/educat/faqs.html.

10 See e.g. J. McBride, C. Alessi and M.A. Sergie, 'Understanding the Libor Scandal' (Council on Foreign Relations, 21 May 2015), http://www.cfr.org/united-kingdom/understanding-libor-scandal/p28729; and 'Behind the Libor Scandal' (The New York Times, 10 July 2012), http://www.nytimes.com/interactive/2012/07/10/business/dealbook/behind-the-libor-scandal.html?_r=0. See also 'Libor: what is it and why does it matter?' (BBC News, 3 August 2015), http://www.bbc.co.uk/news/business-19199683.

19 In addition, disputes in connection with settlement or termination payments can arise. When a transaction is settled, payment may depend on the current market value of the derivative. There are many complex financial methods for calculating the market value of derivatives. There is room for discrepancy, particularly as to which method is to be applied, and as to the exact method of calculation used.

C Disputes relating to the occurrence of specific events or to the calculation of dates

20 Moreover, in the case of credit default swaps, disputes might arise as to when a certain credit event occurs. Depending on the specific agreement, this may occur in the case of restructuring, bankruptcy or a drop in the borrower's credit rating. If the default entity is located in a foreign jurisdiction and is governed by foreign bankruptcy laws, it could result in uncertainty in attempting to determine exactly which standards the parties are subject to.

21 Further, in the case of a derivative that is dependent upon the calculation of a specific date, such as futures and forwards, the exercise of an option, or early termination options in swap contracts, there may be a dispute over how to calculate the relevant date. The calculation method is usually described in the master agreement, but discrepancies might arise if, for example, the parties are located in different countries with different bank holidays, or the parties agree on a slightly different calculation method for a specific transaction, as opposed to what is set out in their master agreement.

D Disputes related to quantity and quality of commodities

22 In the case of physical settlement of commodity options (i.e. the commodity is physically delivered to the option buyer upon exercising this right), disputes can arise as to the quantity and quality of the delivered commodity.

E Disputes related to particular terms of master agreements

23 Disputes arising from parties' master agreements can also relate to the broader context of the parties' relationship rather than the terms of a specific transaction. For instance, parties can differ on how netting is to be performed. The market value of dealers' claims and liabilities are netted when there are claims on and liabilities to the same counterparty. A dispute could arise regarding the issue of whether all transactions between the parties are part of the netting clauses, and how to calculate the offsetting of both payment obligations.

24 Disputes can also arise over the requirement to post collateral, or the use that the collateral holder may make of the collateral itself during the period of the transaction. Since the amount of collateral usually depends on the current market value of the transaction, a particular dispute can arise as to whether more collateral must be posted or whether collateral can be retransferred in case of changes in the market value of the derivatives.

25 Finally, disputes are likely to arise in the event of one party's insolvency. Even though collateral is usually posted in order to protect one party from the other party's default, the collateral might be insufficient, or other creditors might have claims to the collateral as well.

THE CURRENT STATE OF DERIVATIVES ARBITRATION: LAW AND PRACTICE

26 The following section considers the arbitrability of derivatives disputes. It also considers the different options available for including arbitration agreements in derivative contracts and, in this regard, also takes a closer look at the role of the ISDA Arbitration Guide. This section also explores the current use of (institutional) arbitration in both the OTC and ETD contexts.

A Arbitrability of derivatives disputes

27 The arbitrability of derivatives disputes may vary between different jurisdictions. In most countries, derivatives disputes are arbitrable per se,[11] but a number of jurisdictions restrict the arbitrability of disputes involving consumers.[12] However, counterparties operating on the market and trading among themselves are largely free to opt for arbitration as their preferred dispute resolution mechanism.

28 It is useful to be aware of differing rules in various jurisdictions regarding the arbitrability of derivatives disputes, regardless of the fact that most OTC derivatives are transacted pursuant to ISDA Master Agreements, which are governed by English or New York law. Even if derivatives are arbitrable under a particular law, a successful party may have difficulties enforcing an award in its favour in a jurisdiction where derivatives are not considered to be arbitrable.[13]

B Providing for arbitration of OTC derivatives disputes

29 OTC derivatives transactions are usually governed by ISDA Master Agreements. In the past, arbitration clauses were not commonly included in these Master Agreements. ISDA agreements were governed by English or New York law and contained jurisdiction clauses that referred disputes to English or New York courts because of their reputation as being particularly knowledgeable in this area, having extensive experience in resolving such disputes. This was also to maintain continuity in legal decisions on derivatives disputes.[14] At present, however, ISDA is actively encouraging parties to consider resolving derivatives disputes through arbitration.

(i) 2013 ISDA Arbitration Guide

30 In the past, financial institutions did not have a strong incentive to change their practice of using (mostly English and New York) courts for the purpose of resolving derivatives disputes. However, the growing number of derivative transactions involving parties based in emerging markets raises issues in connection with the enforceability of court rulings in such countries and jurisdictions.[15] In addition, the increasing number of financial sector

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[11] J. Szczekala-Liharewska, 'Arbitrability of consumer financial disputes between banks and their private clients in selected jurisdictions', Arbitration e-Review, Polish Court of Arbitration Lewiatan, No. 3-4 (14-15)/2013, 37 at 38.

[12] For instance, the European Council directive 93/13/EEC on Unfair Terms in Consumer Contracts does not explicitly prohibit arbitration of derivatives disputes per se. Instead, it provides that "requiring the consumer to take disputes exclusively to arbitration not covered by legal provisions" is unfair. Furthermore, any contractual term which leads to a significant imbalance in the rights of consumers to their detriment and is contrary to the principles of good faith should be construed as unfair. Different member states have adopted different approaches as to whether arbitration clauses with consumers are generally prohibited and, if not prohibited, how arbitration clauses entered into with consumers must be drafted in order for them not to be considered unfair.

[13] Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958), Article V.2(a).

[14] K.-P. Berger, 'Schiedsgerichtsbarkeit und Bankengeschäft' (2012) WM 1701 at 1701; 2013 ISDA Arbitration Guide at 3, http://www2.isda.org/search?keyword=arbitration.

[15] 2013 ISDA Arbitration Guide at 3 http://www2.isda.org/search?keyword=arbitration.

disputes[16] in the wake of the financial crisis, and what appears to be hostility on the part of some courts towards financial institutions,[17] has generated a push towards using arbitration as a dispute resolution mechanism.

31 Against this changing legal backdrop, and following a two-year consultation of its members, ISDA published its Arbitration Guide in September 2013. The guide provides information and guidance on the use of arbitration for the resolution of disputes arising in connection with derivatives transactions documented under the ISDA Master Agreements. Additionally, it offers a total of eleven model clauses which interested parties may use when considering alternatives to the existing regime (of litigating disputes) provided for in the ISDA Master Agreements. Each model clause includes:

- governing law provisions, which specify the law governing the Master Agreement (English or New York law) and, where applicable, the law governing the arbitration agreement;
- the choice of the seat of the arbitration (London, New York, Paris, The Hague, Hong Kong, Singapore, Geneva or Zurich);
- the choice of institutional arbitration rules (ICC, LCIA, AAA-ICDR, P.R.I.M.E., HKIAC, SIAC or the Swiss Rules);
- provisions amending the existing ISDA Master Agreement in order to ensure it is streamlined with the arbitration clause (e.g. deletion of the previous jurisdiction clause).

32 Presumably, ISDA will periodically update its model clauses to take its members' requests into account.

33 In addition, in 2010, ISDA and the International Islamic Financial Market (IIFM) published the ISDA/IIFM Tahawwut Master Agreement, governing derivatives transactions in Islamic finance, which provides parties with the option of choosing between litigation (adjudication) and arbitration clauses.[18] Use of this Master Agreement has increased during 2013 and 2014, as market participants continue to move away from using customised templates. Regulators in Saudi Arabia have created several versions of these documents (with Saudi law and forum clauses), which are mandatory for transactions entered into between Saudi banks and clients.

(ii) Arbitrating under institutional rules

34 If an arbitration clause is to be included in a contract relating to an OTC derivative, the parties may choose between ad hoc arbitration or the rules of an arbitration institution. For instance, parties may choose to arbitrate their dispute under the rules of traditional arbitration institutions such as the International Chamber of Commerce (ICC), the London Court of International Arbitration (LCIA), the Hong Kong International Arbitration Centre (HKIAC), the Singapore International Arbitration Centre (SIAC), the China International Economic and Trade Arbitration Commission (CIETAC), or the rules of other arbitration institutions.

35 Some of these institutions have adopted special procedural rules, tailored to arbitrating financial disputes. For instance, in 2003, CIETAC adopted its Financial Disputes Arbitration Rules,[19] specifically for disputes involving financial transactions.

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[16] Berger, supra note 14 at 1701; M. Keller and F. Netzer, 'Finanzmarkt, Banken und Streitbeilegung – ein Fall fuer die Schiedsgerichtsbarkeit?' (2013) Betriebs-Berater1347 at 1347.

[17] M. Boeglin, 'Schiedsabreden im Tätigkeitsbereich der Banken – Vorläufige Bestandsaufnahme und Konklusion' (1997) 15 ASA Bulletin 608 at 622; M. Wittinghofer, 'Finanzbranche entdeckt Schiedsgerichte' (Börsen-Zeitung 19 Oct. 2013) at 13.

[18] Berger, supra note 14 at 1705.

[19] CIETAC Financial Disputes Arbitration Rules, as revised and adopted in November 2014 and effective from 1 January 2015, http://www.cietac.org/index/rules/47607aa1ab746c7f001.cms.

36 Importantly, it is possible for banks and financial institutions to tailor the arbitration process to suit the special needs of derivatives disputes, even if they arbitrate using the rules of traditional arbitration institutions. This aspect of arbitration – the flexibility of the procedure and the ability of parties to customise the dispute-resolution process – is one that can be capitalised on. In addition, ICC, for example, has issued a guide for in-house counsel, which discusses considerations to assess when deciding whether or not to use arbitration, and explains how the overall process can be streamlined to fit the needs of the particular dispute at hand.[20]

(iii) Specialised arbitration institutions for financial disputes

37 A number of institutions have been set up specifically to address financial disputes through arbitration. For instance, the 'Panel of Recognized International Market Experts in Finance' (P.R.I.M.E. Finance), based in The Hague and established in 2012, marks the most recent attempt to establish an arbitration institution dedicated to resolving national and international financial disputes with a specific focus on derivatives and complex financial products. The P.R.I.M.E. Finance Arbitration Rules are largely based on the 2010 United Nations Commission on International Trade Law (UNCITRAL) Arbitration Rules, but are customised to the specific needs of arbitrating disputes in the context of financial markets.

38 P.R.I.M.E. Finance requires parties to select arbitrators from two designated lists of finance and legal experts. The fact that this list is closed may make P.R.I.M.E. Finance less attractive to parties overall, and efforts are under way to expand the list or perhaps completely abandon the closed list model, so that parties have the choice of appointing arbitrators who are not on P.R.I.M.E. Finance's expert list.[21]

39 The P.R.I.M.E. Finance Arbitration Rules also expressly permit excerpts of decisions and awards to be published, and permit the entire award to be published in anonymous form, provided neither party objects within one month of receipt of the award.[22] This relatively new feature in arbitration is intended to facilitate the development of a body of case law in this area, thereby promoting the predictability of dispute resolution in relation to financial markets and helping to create a body of established legal precedent specific to these types of transactions.

C Arbitration of ETD disputes

40 ETD transactions are usually governed by the corresponding exchange regulations. ETD disputes are resolved according to the dispute resolution method set by the particular stock exchange, and arbitration is used relatively often in this context.[23]

41 While most exchanges on which derivatives are traded have their own mandatory arbitration scheme for the exchange participants, market associations offer additional arbitration options for investors and market participants. Those proceedings are administered by market associations, such as in the commodities sector.

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[20] *Effective Management of Arbitration: A Guide for In-House Counsel and Other Party Representatives* (ICC Commission on Arbitration and ADR, June 2014).

[21] D. Klingler, 'P.R.I.M.E. Finance – the Boon and Bane of a Specialized Dispute Resolution Institution' (CapLaw, 6 Oct. 2015), https://www.caplaw.ch/2015/p-r-i-m-e-finance-the-boon-and-bane-of-a-specialized-dispute-resolution-institution/.

[22] P.R.I.M.E. Finance Arbitration Rules, 1st ed., 2012, Article 34(5).

[23] See P. Pusceddu, 'P.R.I.M.E. Finance Arbitration – A Lighthouse Safe Harbour in the Mare Magnum of Financial Dispute Resolutions' (2013) III:1 *Indian Journal of Arbitration Law* 45 at 52.

42 In fact, arbitration by market associations is common in the basic commodity trade sector.[24] London, where the first organised commodities markets evolved, is also currently a dispute resolution centre for many commodities and some of the world's major associations of basic commodity trade are based there.[25]

43 There are two types of commodity arbitration proceedings: first, disputes deriving from basic commodity trade (i.e. trade in the physical product commodity); second, disputes relating to futures trading, which deal with commodities that are bought and sold on the futures (or terminal) markets.

44 Whereas arbitration has long been established as an efficient dispute resolution tool in the basic commodity trade, in recent years it has also gained popularity in the commodity derivatives market.

45 In the United States, for example, investors are allowed to bring disputes in connection with future transactions – including commodity derivatives – before the arbitral tribunal of the National Futures Association (NFA). Under the Commodity Futures Trading Commission (CFTC) rules, the arbitration of customer claims arising from commodity futures trading or the settlement of commodity futures contracts may be pursued (i) on the exchange where the transaction occurred or would have occurred or (ii) before a registered futures organisation. The NFA is an independent self-regulating organisation for the US futures market and the only such registered organisation within the terms of the CFTC rules. NFA membership, which is mandatory for all professional participants in the futures market, provides assurance to the investing public that all firms, intermediaries and associates who conduct business with them on the US futures exchanges adhere to the same standards of professional conduct.

OPPORTUNITIES AND CHALLENGES IN DERIVATIVES ARBITRATION

46 The following section analyses current opportunities and challenges in derivatives arbitration, drawing on information collected from interviews conducted with financial institutions.

47 The interviews showed that in the Continental European markets arbitration is not yet a dominant feature of financial institutions' daily work or agreements. At present, this seems to stem from the continuing preference for litigating derivatives disputes in Europe. By contrast, and due to difficulties in enforcing court decisions, arbitration clauses are more common in derivatives transactions in emerging markets, particularly in Asia and the Pacific region, Latin America, Africa and the Middle East.

48 The results of our research indicate that parties tend to settle disputes amicably, rather than resorting to traditional litigation, when there is a continuing business relationship at stake. However, where this type of amicable settlement is not possible, a number of factors would appear to impact on whether arbitration is considered as a valuable dispute resolution method (these are explored in further detail below).

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[24] There are some commodities where disputes are normally not brought to trade associations or exchanges. See M. Swangard, 'Commodity Arbitration' in J. Greenaway et al. (eds.), *Arbitration in England* (Kluwer Law International, 2013), Chapter 7, footnote 1.

[25] Examples include the Grain and Feed Trade Association (GAFTA), the Federation of Oils, Seeds and Fats Association (FOSFA), the London Rice Brokers Association (LRBA), the London Metal Exchange (LME), the Refined Sugar Association (RSA), the Sugar Association of London (SAL) and the International Cotton Association (ICA). For an overview see J. Covo, 'Commodities, Arbitrations and Equitable Considerations', (2013) 9:1 *Arbitration International* 57; and Swangard, supra note 24.

49 Overall, the findings indicated the following: while the institutions interviewed had mixed views on the merits of arbitration, they were generally willing to arbitrate disputes when counterparties suggested including arbitration clauses in their agreements as a primary means of dispute resolution. This is important to note because the reason why arbitration is less commonly used in Europe appears to be largely due to the fact that it is not yet considered a default dispute resolution mechanism, but is instead one that banks and financial institutions are willing to use where it is proposed as an option.

A Expertise with complex financial products

50 Interviewees unanimously emphasised the importance of having adjudicators with the requisite understanding of complex financial products like derivatives. They differed, however, over whether court judges or arbitrators were more likely to possess this indispensable expertise. A number of interviewees doubted whether individuals who serve as arbitrators had sufficient knowledge of complex financial products. Yet, in view of the low quality of judgments rendered by courts on relevant disputes that have arisen in the past, the concern was also expressed that courts in certain parts of the world were not adequately equipped either to address the complexities of derivatives and structured products. One interviewee felt that the lack of expertise was a widespread phenomenon, and even extended to mediators faced with disputes over derivatives or structured products. It was also noted that, given the small pool of individuals with the requisite expertise in complex financial products, properly qualified arbitrators are likely to be in such high demand that their ability to accept appointments will quickly become limited by factors like conflicts of interest. And even if they are not disqualified on such grounds, they will have to spread their time over a large number of disputes, potentially leading to significant delays and backlogs in the process.

B Enforceability of decisions

51 As expected, the financial institutions interviewed generally tend to include arbitration clauses in derivatives agreements when counterparties are located in jurisdictions where foreign judgments are not easily enforceable. There seems to be a tendency to take this approach where counterparties from the Middle East, Russia and China are involved.

C Confidentiality vs establishment of precedent

52 The confidentiality of arbitration proceedings was certainly a factor interviewees were aware of, but it was not critical for all of them. A handful of interviewees viewed the ability of courts to establish legal precedent through decisions as more valuable overall to financial institutions than confidentiality. As expected, confidentiality and the inability of arbitrators to establish legal precedent were nonetheless viewed positively by those who were concerned that courts might strike down certain provisions of the ISDA Master Agreement at some point, which could potentially lead to a flood of claims against financial institutions.

D Speed of proceedings vs potential for appeal

53 While the relative speed and flexibility of arbitration was raised as a factor weighing in its favour, some interviewees actually considered arbitration to be not fast enough. Most of them emphasised the need for fast-track proceedings, which are available in litigation. Others did not express concerns over speed, but preferred litigation because it offered the possibility of appealing court decisions.

E Regulatory issues

54 The views of financial institutions may also be shaped by other, more specific matters. For instance, it was noted that financial supervisory authorities in Germany may have concerns about whether relevant regulatory provisions are applied by a tribunal when a derivatives dispute is arbitrated. However, whether regulatory provisions are adequately applied has not prevented other complex high-value disputes from being arbitrated thus far and may not prove to be an obstacle to increased use of arbitration to resolve derivatives disputes.

SOVEREIGN FINANCE

INTRODUCTION

1 International arbitration as a method of resolving disputes related to sovereign finance has a long history: it is a cornerstone in the landmark 1907 Hague Convention respecting the Limitation of the Employment of Force for the Recovery of Contract Debts ("1907 Hague Convention II"). Under this multilateral treaty, the signatory states agreed "not to have recourse to armed force for the recovery of contract debts claimed from the Government of one country by the Government of another country as being due to its subjects or citizens" unless the debtor state "refuses or neglects to reply to an offer of arbitration, or … fails to comply with the award".[1] By 1939, a League of Nations committee "strongly recommend[ed]" that sovereign loan contracts "should in all cases include at least a clause providing for arbitration on matters of interpretation of the contract".[2]

2 The goals of international arbitration as a means of resolving sovereign finance disputes have expanded beyond prevention of the use of armed force to focus on user satisfaction and more widespread adoption. In the context of sovereign borrowing, whether in the form of loans or capital market instruments, financial institutions have historically exhibited a general reluctance to use arbitration, although of late there have been indications of a marginally increased willingness to do so. This is particularly the case when a sovereign is subject to legal impediments related to submitting to a foreign jurisdiction. Financial institutions also may be willing to consider agreements that provide the option of submitting disputes to either arbitration or litigation (including asymmetrical clauses, which provide this option only to creditors). Some creditors may also be more inclined to accept arbitration with sovereigns following the ascendance of the restrictive theory of sovereign immunity and the assumption (which may not be correct in practice) that the New York Convention will make execution against a sovereign easier than enforcement and execution of a judgement.

3 Some sovereigns may have strong reservations against submission to a foreign jurisdiction, perhaps based on legal or historical circumstances. Other sovereigns may have ambiguous feelings on the subject. For example, on the one hand, they may prefer to avoid the courts of a country that formerly acted as their colonial master, while on the other hand, they may take comfort in submitting to such a jurisdiction because of the similarities between their own domestic legal system and that foreign jurisdiction's legal system. Some sovereigns, particularly first-time borrowers or issuers, may not have formed a conclusive viewpoint on this issue, and thus may be willing to accommodate the preferences of their lenders, underwriters, or investors.

4 Financial institutions and sovereigns have many types of agreements for which arbitration can be used as a dispute resolution mechanism. This chapter focuses on bonds and capital market instruments, which are widely used by sovereigns and document hundreds of billions of dollars of credit extended to sovereigns. Arbitration would also be available as a dispute resolution mechanism when sovereigns enter into loan agreements, loan guaranties, custody agreements, investment management agreements, derivative contracts, acquisition agreements, shareholder agreements, commodities contracts, and contracts for financial services such as investment banking. Other chapters examine many of these relationships and, in conjunction with this chapter, may be informative when a sovereign is involved.[3]

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[1] Convention respecting the Limitation of the Employment of Force for the Recovery of Contract Debts, 18 Oct.1907, 36 Stat. 2259, 1 Bevans 607, Art. 1.

[2] Report Presented by the Committee for the Study of International Loan Contracts, League of Nations Doc. C.145M.93 1939 II A (1939) at 25.

[3] Another useful source with respect to international arbitration involving sovereign parties is the ICC Report: *States, State Entities and ICC Arbitration* (2012), available at https://iccwbo.org/publication/icc-arbitration-commission-report-on-arbitration-involving-states-and-state-entities-under-the-icc-rules-of-arbitration/.

5 To the extent that parties have included arbitration clauses in loan agreements and bond documentation in the past, there is little evidence of commercial arbitration proceedings involving financing for sovereigns, as opposed to sovereign instrumentalities (e.g., state-owned companies). Nevertheless, a growing overlap has developed between commercial arbitration, on which this analysis has focused its attention, and investment arbitration, which is analysed in the report "Investment Arbitration and Banking & Finance". While some commentators have promoted the use of investment arbitration for cases related to sovereign finance, others have strongly criticised its use in this context.

SUMMARY OF QUESTIONNAIRE ISSUED TO FINANCIAL INSTITUTIONS

6 The Task Force survey of financial institutions included questions relating to arbitration in the field of sovereign finance. One section of the questionnaire addressed the drafting of arbitration clauses in general, covering the following topics:

- whether the financial institution favoured institutional or ad hoc arbitration and whether it had a preferred arbitral institution;
- whether the financial institution had a preference as to the number or method of selection of arbitrators;
- how the financial institution selects a seat;
- whether the financial institution had concerns about having access to courts for interim measures during arbitral proceedings;
- the financial institution's usage of tiered dispute resolution clauses and asymmetrical dispute resolution clauses; and
- the financial institution's views on an appeal mechanism in arbitration.

7 Subsequently, the financial institutions were presented with the following questions:

> Would your answers to the above questions change in the event that the contract in question was with a sovereign counterparty? If so, in which respects? In particular:
>
> a) Would you be more or less inclined in such a case to choose arbitration as a dispute resolution mechanism?
>
> b) Would you be likely to alter the content or nature of the arbitration clause in any respect by virtue of the fact that the contract was with a sovereign counterparty?

8 The responses from financial institutions are reviewed in section D below.

USE OF INTERNATIONAL ARBITRATION IN SOVEREIGN FINANCE

A International sovereign bonds

9 The Task Force conducted an empirical analysis of bond documents, arbitration clauses in state-to-state agreements, and arbitration jurisprudence and literature in order to identify existing practices in the use of international arbitration in relation to sovereign finance. The relationship between commercial arbitration and investment arbitration in this context was also studied.

10 In 2009, Professor W. Mark C. Weidemaier published an article reporting results from a survey of documentation for 105 sovereign bonds issued between 1991 and 2008 (with between 90 and 96 of the bonds issued during the period 1999 – 2007).[4] The collection appears to have included bonds by 70 unique issuers,[5] and bonds from at least one sub-sovereign issuer.[6] Based on his review, Professor Weidemaier made the following observations:[7]

a) Across different issuers, sovereign bond contracts are not as standardised as is often assumed. Variations include, but are not limited to, a small minority of issuers whose bonds permit investors to arbitrate.

b) Issuers that agree to arbitration appear to have various reasons for doing so. Some are barred by domestic law from submitting to the jurisdiction of foreign courts. Others include arbitration in a menu of dispute resolution mechanisms and forums from which the investor can choose. In most cases, however, the use of arbitration is driven by doubt as to the availability or efficacy of litigation in foreign courts.

c) Similarly situated issuers sometimes make different contract selections. For example, arbitration clauses are common but not standard in bonds issued by former Soviet republics that are relative newcomers to the sovereign debt markets.

d) There is additional variation in sovereign immunity terms, but a sizeable majority of the issuers (around 85%) broadly waive their sovereign immunity from execution, although many contain express reservations with respect to diplomatic and military property. The widespread use of such immunity clauses weakens the case for superior enforceability of arbitral awards. In many jurisdictions, a waiver of immunity from execution, even a broadly worded waiver without express reservations, is understood not to apply to non-commercial assets such as embassy bank accounts, diplomatic or military property, or central bank accounts.

e) Sovereign issuers with established dispute resolution terms rarely change their contract selections. Thus, despite the variations across issuers, there is limited variation in the practices of each individual sovereign issuer.

11 The Task Force reviewed bond documents[8] of 92 sovereign issuers (the 92 "sovereign bonds"),[9] in each case using documents from the most recent issuance identified from the particular issuer. Of the 92 sovereign bonds, 82 were issued between 2010 and 2015. Upon reviewing the 92 sovereign bonds, the following considerations were analysed: the selection of a dispute settlement method or methods, if any; the governing law; and provisions concerning the waiver or preservation of sovereign immunities. The following paragraphs present a summary of the results from this review.

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4 W.M.C. Weidemaier, "Disputing Boilerplates" (2009), *Temple L. Review* 1, at 24.

5 Ibid., at 38 ("I have multiple sets of disclosure documents for only sixteen issuers, averaging 3.2 disclosure documents for each of these sixteen"). The sixteen repeat issuers therefore would account for 51 bonds (3.2 multiplied by 16), requiring subtraction of 35 bonds (51 minus 16) from the total sample of 105 to infer that the sample reflects bonds by 70 unique issuers. Professor Weidemaier limited his sample to bonds governed by English law or New York law and thus excluded six bonds governed by the laws of other jurisdictions, which would have otherwise increased the sample to 111 bonds, ibid. at 24.

6 Ibid., at 27 (referring to a bond issued by the Province of Nova Scotia as included in the sample); see also ibid., note 139 (referring to a bond issued by the Province of Manitoba as being among the six bonds excluded from the sample of 105 bonds).

7 Ibid., at 25–26.

8 Bond documents generally consisted of a prospectus, offering memorandum, or similar document. In one instance, only a trust indenture for the issuance of sovereign bonds was identified; terms of the trust indenture were reviewed.

9 For purposes of this assessment, bonds issued by Abu Dhabi and Hong Kong, as well as a *sukuk* issued by Malaysia, were included as sovereign bonds.

12 Of the 92 sovereign bonds, 16 (17%) made arbitration available to bondholders and to the issuer, while two (2%) made arbitration available only to bondholders. Of the remainder, 73 (79%) provided for dispute settlement solely through litigation, and one (1%) did not specify any forum available for dispute settlement.

Table 1 Dispute settlement method applicable to sovereign bonds

Dispute settlement method	Number of bonds	Percentage
Arbitration (total)	18	20%
Arbitration (bondholders & issuer)	16	19%
Arbitration (bondholders only)	2	1%
Arbitration (issuer only)	0	0%
Litigation only	73	79%
None	1	1%
Total	92	100%

13 Of the 18 bonds contemplating the use of arbitration, seven bonds (39%) made litigation available only to bondholders (in each case, in foreign courts, *viz.* English courts), six made litigation available to bondholders and to the issuer (33%) (in four cases, in foreign courts; in two cases, in courts of the issuing state), while five (28%) provided no option for litigation.

Table 2 Arbitration clauses in sovereign bonds: the option for litigation

Arbitration clauses & option for litigation	Number of bonds	Percentage of bonds
Arbitration clause with litigation option	13	72%
Litigation Option (bondholders & issuer)[10]	6	39%
Litigation Option (bondholders only)	7	33%
Litigation Option (issuer only)	0	0%
Arbitration clause without litigation option	5	28%
Total	18	100%

14 Of the 92 sovereign bonds, 46 (50%) were governed by English law, 38 (41%) were governed by New York law, and 8 (9%) were governed by the law of the issuing state.

[10] Among the five bonds with an arbitration clause providing an option of litigation to bondholders and to the issuer, three bonds provided for litigation in foreign courts (*viz.* English courts) and two bonds provided for litigation in the courts of the issuing state.

15 Of the 18 bonds that contemplated the use of arbitration as a method of dispute settlement, 13 (72%) were governed by English law and five (28%) were governed by New York law. Meanwhile, of the 73 bonds contemplating only the use of litigation, 33 (45%) were governed by English law, 33 (45%) were governed by New York law, and seven (10%) were governed by the law of the issuing state (including a bond issued by the People's Republic of China that was governed by Hong Kong law). The one bond for which no method of dispute settlement was provided was also governed by the law of the issuing state.

Table 3 Law governing sovereign bonds

Dispute Settlement Method	English law	NY law	Issuing state law	Total
Arbitration clause	13	5	0	18
Arbitration (bondholders & issuer)	12	4	0	16
Arbitration (bondholders only)	1	1	0	2
Arbitration (issuer only)	0	0	0	0
Litigation only	33	33	7	73
None	0	0	1	1
Total	46	38	8	92

16 Of the 18 bonds which contemplated the use of arbitration as a method of dispute settlement, 13 (72%) provided for arbitration pursuant to the LCIA Rules (12 governed by English law, one governed by New York law), three (17%) provided for arbitration pursuant to the UNCITRAL Rules (each governed by New York law), one (6%) provided for arbitration pursuant to the ICC Rules (governed by English law), and one (6%) provided for arbitration pursuant to the SIAC Rules (governed by New York law).

Table 4 Arbitral rules applicable to sovereign bonds with arbitration clauses

Arbitration rules	Number of bonds	Percentage of bonds
LCIA	13	72%
UNCITRAL	3	17%
ICC	1	6%
SIAC	1	6%
Other	0	0%
Total	18	100%

17 Of the 73 bonds contemplating only the use of litigation, 57 (78%) provided for litigation in only one forum, while 16 (22%) provided for litigation in two or more fora.

18 Of the 57 bonds providing for the use of litigation in only one forum, 29 (51%) provided for litigation in English courts only, 21 (37%) provided for litigation in New York courts only, and seven (12%) provided for litigation in the courts of the issuing state only (including a bond issued by the People's Republic of China providing for the use of litigation in Hong Kong courts). In each case, the forum selected matched the governing law (e.g. bonds providing for litigation in English courts were governed by English law).

19 Meanwhile, of the 16 bonds providing for the use of litigation in two or more fora, nine (56%) provided for litigation in New York courts and the courts of the issuing state (in each case, the bond was governed by New York law); three (19%) provided for litigation in English courts and the courts of the issuing state (in each case, the bond was governed by English law); one (6%) provided for litigation in New York courts or English courts (the bond was governed by English law); one (6%) provided for litigation in New York or English courts or the courts of the issuing state (the bond was governed by New York law); one (6%) provided for litigation in New York courts and the Paris Commercial Court

(the bond was governed by New York law); and one (6%) provided for litigation in New York courts, the Paris Commercial Court or the courts of the issuing state (the bond was governed by New York law). In each instance in which the Paris Commercial Court was an available forum, the bond was issued by a francophone state.

20 Overall, of the 73 bonds providing for dispute settlement through the use of litigation only, 34 (47%) provided for litigation in English courts as one of the available options; 34 (47%) provided for litigation in New York courts as one of the available options; 20 (27%) provided for litigation in the courts of the issuing state as one of the available options; and 2 (2%) provided for litigation in the Paris Commercial Court as one of the available options.

Table 5 Litigation fora available in 73 sovereign bonds without arbitration clauses

Selected litigation forum	Number of bonds	Percentage of bonds
English courts	34	48%
New York courts	34	43%
Issuer state courts	20	30%
Paris Commercial Court	2	2%

21 The 18 sovereign bonds providing for the use of arbitration were examined for the presence of express waivers of immunity from execution and express waivers or preservation of immunity from pre-judgment attachment. Of the 18 bonds, 17 (94%) included express waivers of immunity from execution (in 14 instances, with stated exceptions). The one remaining bond (6%) was silent on the subject, stating only that the issuer would have no right to immunity from execution in local courts. (An issuer that had included an express waiver of immunity from execution had specified that such waiver would apply only to judgments, and that the enforcement of arbitral awards would necessitate a local procedure following recognition of the award by local courts.)

Table 6 Express waiver of immunity from execution in sovereign bonds providing for arbitration

Immunity from execution	Number of bonds	Percentage of bonds
Expressly waived (with or without express exceptions)	17	94%
Expressly preserved	0	0%
Silent (immunity not applicable under local law)	1	6%
Total	18	100%

22 Of the 18 sovereign bonds providing for the use of arbitration, nine (50%) expressly waived immunity from pre-judgment attachment, three (17%) expressly preserved the right to immunity from pre-judgment attachment, and six (33%) were silent with respect to immunity from pre-judgment attachment. Of the six bonds that were silent on the subject, two bonds subject to the UNCITRAL Arbitration Rules expressly excluded the application of Article 26, which would have allowed for pre-judgment attachment as a possible interim measure.

Table 7 Waiver of immunity from pre-judgment attachment in sovereign bonds providing for arbitration

Immunity from pre-judgment attachment	Number of bonds	Percentage of bonds
Expressly waived	9	50%
Expressly preserved	3	17%
Silent	6	33%
Total	18	100%

23 Of the 18 sovereign bonds providing for the use of arbitration, five (28%) provided for the joinder of parties in the event that a tribunal determined that claims were sufficiently linked, while 13 (72%) did not contain any such provisions. Of the five bonds providing for joinder, four (80%) were governed by English law and subject to the LCIA Rules, and one (20%) was governed by New York law and subject to the SIAC Rules. Of the 13 bonds without provisions for joinder, two (both governed by New York law) provided that no arbitration proceedings relating to the bond would be binding upon or in any way affect the rights or interests of any person other than the claimant and respondent with respect to such arbitration.

24 The one bond providing for joinder that was governed by New York law and subject to the SIAC Rules also contained the following provision for summary proceedings:

> If, following the time specified for service of the Statement of Claim and the Statement of Defense, as applicable (the "Statements"), it appears to the Tribunal that there is or may be no real prospect of succeeding on any or all of the claims made in the Statements or of successfully defending any or all of the claims made in the Statements, the Tribunal may determine such claim(s) by a summary procedure if it is in the interests of justice to do so. In the event that a summary procedure is adopted, the Tribunal shall proceed to determine such claim(s) as soon as reasonably practicable. The Tribunal may call for further short written submissions in relation to such claim(s) and shall only hold an oral hearing to determine such claim(s) if it feels that it is necessary to do so. The Tribunal may decide to determine only certain claims advanced in the arbitration by summary procedure.

25 In some instances, sovereign bonds whose documentation provides for dispute settlement through the use of litigation only (or does not provide for dispute settlement at all) may nevertheless be subject to arbitration if an investment treaty providing for investor-state arbitration is in effect between the issuing state and the state of which the investor is a national. The availability (and desirability) of investor-state arbitration in the context of claims related to sovereign bonds has been debated. In particular, there has been considerable debate over whether sovereign bonds may qualify as "investments" covered by investment treaties and by the multilateral Convention on the Settlement of Investment Disputes Between States and Nationals of Other States.

B State-to-state agreements

26 In addition to appearing in bond documentation applicable between sovereign states and private investors, arbitration provisions have been included in state-to-state agreements concerning sovereign finance. For example, the 1907 Hague Convention II, a landmark multilateral treaty designed to prevent use of armed force to recover contract debts, is a state-to-state agreement providing for arbitration as a method of resolving sovereign loan contract disputes.[11]

27 Arbitration clauses have also appeared in two multilateral agreements relating to sovereign finance that were concluded in 2014 and 2015. In July 2014, the governments of Brazil, Russia, India, China, and South Africa signed the Treaty for the Establishment of a BRICS Contingent Reserve Arrangement (the "BRICS CRA"), which created a framework for the provision of liquidity and precautionary instruments (*viz.,* currency swaps) in response to balance of payments pressures.[12] A total of USD 100 billion was initially committed by the five states.[13] Article 20 of the treaty establishing the BRICS CRA provides for disputes relating to its interpretation that are not resolved amicably by a governing council to be submitted to arbitration under the UNCITRAL Arbitration Rules.[14] The BRICS CRA does not specify an institution to administer any such arbitration,

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[11] See supra note 1.

[12] Treaty for the Establishment of a BRICS Contingent Reserve Arrangement, 15 July 2014 ("BRICS CRA Treaty"), Arts. 1 and 2(b) (http://brics6.itamaraty.gov.br/media2/press-releases/220-treaty-for-the-establishment-of-a-brics-contingent-reserve-arrangement-fortaleza-july-15).

[13] Ibid., Art. 2(a).

[14] Ibid., Art. 20.

requiring only that the proceeding be conducted in English before a panel consisting of three arbitrators.[15] The BRICS CRA also provides that, in any proceeding for the recognition of an arbitral award or its conversion into a judgment, the states will agree not to raise any defence that they could not raise but for the fact that they are sovereign state entities.[16] The ratification process for the BRICS CRA was reportedly completed on 30 June 2015, with the treaty coming into force 30 days later.[17]

28 In June 2015, representatives from 50 prospective founding members of the Asian Infrastructure Investment Bank ("AIIB") signed the AIIB Articles of Agreement.[18] The AIIB's initial authorised capital stock is stated to be USD100 billion.[19] In general, questions concerning the interpretation or application of the AIIB Articles of Agreement between an AIIB member and the AIIB (or between two or more AIIB members) will be submitted to the AIIB Board of Directors for a decision.[20] After the Board of Directors has issued a decision, any AIIB member may refer the question to the AIIB Board of Governors, whose decision will be final.[21] In certain circumstances, however, the AIIB Articles of Agreement provide for arbitration to be the method of dispute resolution. Specifically, any disagreements arising between the AIIB and a state that has ceased to be an AIIB member (or between the AIIB and an AIIB member after termination of AIIB operations) will be submitted to arbitration.[22] The arbitration proceedings take place before a panel of three arbitrators: one appointed by the AIIB, one appointed by the state, and the third appointed by the President of the International Court of Justice or any authority that may have been named for this purpose by the AIIB Board of Governors.[23] The AIIB Articles of Agreement do not specify which arbitral rules shall apply to, nor which institution administer, such arbitration proceedings.[24]

29 As illustrated by the BRICS CRA and the AIIB Articles of Agreement, arbitration continues to appeal to states as a method of dispute resolution in the context of sovereign finance.

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15 Ibid., Art. 20(b).

16 Ibid., Art. 20(c).

17 Brazilian Ministry of Foreign Affairs, press release 260, "Conclusion of the Ratification Process of the Treaty Establishing a Contingent Reserve Arrangement of the BRICS (CRA) and Entry into Force of the Agreement" (30 June 2015 http://www.itamaraty.gov.br; see also BRICS CRA Treaty, Art. 23.

18 Asian Infrastructure Investment Bank, news, "50 Countries Sign the Articles of Agreement for the Asian Infrastructure Investment Bank" (29 June 2015), https://www.aiib.org/en/news-events/news/2015/20150629_001.html.

19 AIIB Articles of Agreement, Art. 4(1).

20 Ibid., Art. 54.

21 Ibid., Art. 54.

22 Ibid., Art. 55.

23 Ibid., Art. 55.

24 Ibid., Art. 55.

C Arbitration cases

30 Published summaries of four ICC arbitral awards relating to sovereign finance have been found. The information available on the characteristics of the arbitration proceedings is limited, at least in part, by the fact that substantive content has been redacted (most likely to maintain confidentiality) or only summaries of the decisions provided. Nevertheless, respondents in the four arbitration proceedings were described as: an East African state, an Eastern European state, a Brazilian financial agency, and "State X". In three of the arbitration proceedings, the tribunal consisted of three arbitrators; in the arbitration proceeding against an East African state, the number of arbitrators is unknown. In the arbitration proceedings against an Eastern European state and against State X, awards for damages and costs were issued in favour of the claimants. In the arbitration proceedings involving a Brazilian financial agency, all claims and counterclaims were rejected. In the arbitration proceedings against an East African state, the tribunal declined to issue an injunction, apparently without prejudice to a possible damages award.

31 In addition to these four published summaries of ICC arbitral awards, two awards relating to sovereign finance and two awards relating to financial agreements with state-owned entities have, to some extent, become public. The respondents in these arbitration proceedings were the Democratic Republic of Congo,[25] the Republic of Congo,[26] a Bulgarian state-owned entity[27] and a Sri Lankan state-owned entity,[28] and the disputes concerned a credit agreement, promissory notes, a credit facility agreement, and an oil price hedging contract, respectively.

32 Ten disputes involving sovereign finance (including, but not limited to, disputes concerning sovereign bonds) have also been submitted to investor-state arbitration. Notable arbitration decisions from some of these investor-state proceedings are discussed in further detail in the chapter on investment arbitration.

Table 8 Investor-state arbitrations involving sovereign finance

Parties	Case number
Fedax N.V. v. Republic of Venezuela	ICSID ARB/96/3
Ceskoslovenska obchodni banka a.s. v. Slovak Republic	ICSID ARB/97/4
Booker plc v. Guyana[29]	ICSID ARB/01/9
Continental Casualty Company v. Argentine Republic	ICSID ARB/03/9
Abaclat and Others v. Argentine Republic	ICSID ARB/07/5
Giovanni Alemanni v. Argentine Republic	ICSID ARB/07/8
Ambiente Ufficio S.p.A. v. Argentine Republic	ICSID ARB/08/9
Deutsche Bank v. Sri Lanka	ICSID ARB/09/2
Poštová banka, a.s. & Istrokapital SE v. Hellenic Republic	ICSID ARB/13/8
Cyprus Popular Bank Public Co. Ltd. v. Hellenic Republic	ICSID ARB/14/16

[25] *Ergoinvest v. Dem. Rep. of Congo & Société Nationale d'Électricité* (ICC Case 11442), Award (30 April 2003).

[26] *Commisimpex S.A. (Brazzaville) v. Republic of Congo & Caisse Congolaise d'Amortissement* (ICC Case 9899), Award (3 December 2000).

[27] *A.I. Trade Finance, Inc. v. Bulgarian Foreign Trade Bank* (ECE, 22 Dec. 1997); see also Mark F. Rosenberg, "Chronicles of the Bullbank Case – The Rest of the Story" (2002) 19 J. Int'l Arb. 1.

[28] *Citibank v. Ceylon Petroleum Corp.*, unpublished award (1 Aug. 2011); see also "Ruling of the Arbitration Panel Dismissing the Claim in the Oil Hedging Case" *The Sunday Times* (14 Aug. 2011).

[29] See also Magnus Saxegaard, "Creditor Participation in the HIPC Debt Relief Initiatives: The Case of Guyana" (2002) 32 Ga. J. Int'l & Comp. L. 725.

33 No examples of overlapping commercial arbitration and investor-state arbitration proceedings involving identical parties have been identified. Nevertheless, the potential for such an overlap in the context of sovereign finance is conceivable, particularly through the operation of umbrella clauses in investment treaties, which, in some circumstances, have been interpreted as giving investor-state tribunals jurisdiction over disputes arising from allegations of breach of contract. In at least one instance, disputes involving different financial institutions that had similar contractual arrangements with the same state entity led to seemingly inconsistent outcomes in investment arbitration, commercial arbitration, and litigation in English courts.[30]

34 Occasionally, investment treaties and the investment chapters of trade agreements include special provisions relating to sovereign finance. For example, the Trans-Pacific Partnership Agreement ("TPP"), which was released as a draft text on 5 November 2015, includes an investment chapter with an annex entitled "Public Debt". The first paragraph of the Public Debt annex specifies, for the purpose of "greater clarity", that no arbitration award based on an investment protection in Section A of the chapter shall be issued in favour of a claimant with respect to default or non-payment of debt issued by a TPP party unless the claimant meets its burden of proving that such default or non-payment constitutes a breach of an investment protection in Section A.[31] The second and third paragraphs of the Public Debt annex apply to ten of the twelve TPP parties.[32] The second paragraph provides that a negotiated restructuring may be subject to claims only under the national treatment and most-favoured-nation treatment provisions in Section A;[33] while the third paragraph provides that any such claims are subject to a 270-day consultation period,[34] rather than the otherwise applicable six-month consultation period.[35] The terms of the TPP Public Debt annex match those of the Public Debt annex to the 2006 United States trade agreement with Peru,[36] which is a party to the TPP. Other US investment treaties and investment chapters of US trade agreements have included annexes with similar limitations applicable to claims by US investors relating to sovereign debt of the treaty partner (but not vice versa).[37]

D Empirical results of the survey

35 Of the 54 financial institutions that participated in the Task Force survey, 33 answered the questions on the use of international arbitration in financial agreements with sovereign counterparties. The questions specific to sovereign finance enquired: (i) whether the respondent would be more or less inclined in such a case to choose arbitration as a means of dispute settlement and (ii) whether the respondent would be likely to alter the content or nature of the arbitration clause on account of the fact that the contract was with a sovereign counterparty. Some respondents included additional comments as well.

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30 Compare *Deutsche Bank v. Democratic Socialist Republic of Sri Lanka* (ICSID Case ARB/09/2), Award (31 Oct. 2012) with "Ruling of the Arbitration Panel Dismissing the Claim in the Oil Hedging Case" *The Sunday Times* (14 Aug. 2011) (describing *Citibank v. Ceylon Petroleum Corp*., unpublished award (1 Aug. 2011)) and *Standard Chartered Bank* v. *Ceylon Petroleum Corp* [2011] EWHC 1785 (Comm.) (11 July 2011).

31 TPP, Ch. 9, Annex 9-G, § 1.

32 Ibid., note 43 (stating that paragraphs 2 and 3 of Annex 9-G do not apply to any claim against Singapore or the United States).

33 Ibid., § 2.

34 Ibid., § 3.

35 TPP, Ch. 9, Art. 9.18(1).

36 United States-Peru Trade Promotion Agreement, 12 Apr. 2006, 121 Stat. 1455, Ch. 10, Annex 10-F.

37 See, e.g., the Treaty between the United States of America and the Oriental Republic of Uruguay concerning the Encouragement and Reciprocal Protection of Investment, 4 Nov. 2005, S. Treaty Doc. No. 109-09, Annex G; United States-Chile Free Trade Agreement, 6 June 2003, 117 Stat. 909, Ch. 10, Annex 10-B.

36 With respect to whether the respondent would be more or less inclined to select arbitration as a dispute resolution mechanism in a contract with a sovereign counterparty, 22 respondents (67%) indicated they would be more inclined to select arbitration, five respondents (15%) indicated that they would be less inclined to select arbitration, four respondents (12%) indicated that they would be neither more nor less inclined, and two respondents (6%) indicated that their inclination would depend on the factual circumstances of the dispute.

Table 9 Inclination of financial institutions to select arbitration when a contractual counterparty is a sovereign

	Number of responses	Percentage of responses
More inclined to select arbitration	22	67%
Less inclined to select arbitration	5	15%
Equally inclined to arbitration and litigation	4	12%
Dependent on factual circumstances	2	6%
Total	33	100%

37 Some respondents commented on the factors that would influence their selection of a dispute resolution mechanism in agreements with a sovereign counterparty. The most commonly cited factor was neutrality, *viz*. not having to submit to the jurisdiction of the courts of the sovereign counterparty, and the ability to appoint arbitrators who are outside the sovereign's scope of influence. On the other hand, a review of dispute settlement provisions in sovereign bond contracts showed that some underwriters and investors are willing to include the option of litigating in the domestic courts of the issuing state. This is likely to be based on the belief that any resulting favourable decision may be easier to enforce.

38 The other factors mentioned by survey respondents as encouraging them to select arbitration reflect the commonly perceived advantages of arbitration, such as: (i) flexibility of the arbitral process; (ii) confidentiality; (iii) the ability to appoint arbitrators with relevant expertise; and (iv) enforceability of arbitral awards. With respect to the final point, the particular benefit of arbitration for sovereign finance is the broader and generally more expeditious recognition of foreign arbitral awards, as compared to foreign judgments. Generally, the enforcement of arbitral awards and judgments would be subject to the same limitations on grounds of sovereign immunity (while holding constant the scope of the applicable waiver of immunity from execution).

39 In addition, citing generally applicable factors, various respondents suggested that the selection of a dispute settlement mechanism would depend in part on the identity of the sovereign, including whether the sovereign counterparty was constitutionally permitted to submit to the jurisdiction of foreign courts, as well as the nature of the contract or potential dispute. Some respondents noted that, with a sovereign counterparty, they would prioritise efforts to reach a consensual resolution, including through recourse to diplomatic channels, in order to avoid any form of contentious dispute settlement process whenever possible.

40 With respect to the second question, *viz.* whether the respondent would be likely to alter the content or nature of the arbitration clause on account of the fact that the contract was with a sovereign counterparty, 15 respondents (45%) indicated that they would be unlikely to alter the content or nature of an arbitration clause while 13 respondents (39%) responded that they would be likely to do so. Five respondents (15%) did not reply to this particular question. The most common modification suggested by respondents was the addition of a waiver of sovereign immunity. Other suggested modifications included providing for a more flexible, ad hoc arbitration procedure and excluding as arbitrators residents or nationals of the sovereign counterparty.

PROS AND CONS OF USING INTERNATIONAL ARBITRATION

A Existing commentary on the pros and cons of using international arbitration

41 Much attention has been given to improving dispute settlement provisions in sovereign finance agreements. In 1935, the Assembly of the League of Nations issued a resolution inviting the League Council to designate a committee "to examine the means for improving contracts relating to international loans issued by Governments or other public authorities in the future, and, in particular, to prepare model provisions – if necessary, with a system of arbitration – which could, if the parties so desired, be inserted in such contracts".[38] The League Council did so and, in 1939, the committee published the results of its enquiry. This topic has in recent years been increasingly examined by writers on international arbitration in relation to sovereigns, with publications advancing various and, at times, conflicting views on the pros and cons of using international arbitration to resolve disputes involving sovereign finance.

B Early commentary on use of international arbitration: 1939 League of Nations Report

42 In May 1939, the League of Nations Committee for the Study of International Loan Contracts, consisting of eleven members from the public and private sectors, issued a report addressing "the extent to which the difficulties of international lending can be reduced by improvements in the legal form of international loan contracts".[39] Regarding the settlement of legal disputes, the report identified two areas for improvement: (i) determination of the law governing an international loan contract and (ii) choice of jurisdiction.[40] On the first point, the committee "fe[lt] very strongly that every international loan contract should specifically state under what law it is to be construed", while acknowledging that issues related to choice of law and changes in the law could be addressed only in a treaty.[41]

43 With respect to choice of jurisdiction, the League of Nations committee described the main challenge as "find[ing] the proper court whose decisions will have legal and moral force in cases of dispute".[42] According to the report, the courts of the state where a loan was serviced and the courts of third-party states would "generally declare themselves incompetent"[43] – a statement reflecting the theory of absolute sovereign immunity, which was prevalent at the time –[44] while actions before the courts of the debtor state were "not always calculated to yield the results which the bondholder [would be] entitled to expect".[45] After noting that the Permanent Court of International Justice ("PCIJ") could accept only state-to-state disputes, the League of Nations committee opined that "[m]ost of the legal disputes actually encountered could, no doubt, have been easily settled, if it had been possible to lay them before a tribunal previously accepted by the parties".[46] As

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[38] League of Nations 1939 Report, supra note 2, § 1. The report limits its scope to international private loans, while specifically disclaiming any intent to cover loans between governments. Ibid., § 5.

[39] League of Nations 1939 Report, supra note 2, § 7. The committee member from the United States, who was Chairman of the Foreign Bondholders' Protective Council, commented that "there are wide differences between the American and other markets", leading the committee to note that the "suggestions made in the present report may not in all respects be applicable to the American market", ibid., § 2, note 1.

[40] Ibid., §§ 72 et seq.

[41] Ibid., §§ 73–83.

[42] Ibid., § 84.

[43] Ibid.

[44] The theory of absolute sovereign immunity has generally been displaced by the theory of restrictive sovereign immunity, in which contractual waivers of immunity from jurisdiction may be enforced, even if a sovereign attempts to revoke such waiver after a dispute has arisen.

[45] League of Nations 1939 Report, supra note 2, § 84.

[46] Ibid., § 86.

examples, the committee referred to arbitration clauses that had been included in three international sovereign loan contracts, and in one contract with a sub-sovereign borrower. One of the sample arbitration clauses had resulted in an arbitration between the Bulgarian government and the trustees of the loan; according to the report, the award in favour of the trustees "was, in its entirety, accepted and executed" by the Bulgarian government.[47]

44 The 1939 report of the League of Nations committee provided a draft arbitration clause consisting of eight provisions.[48] The sample clause provided for the PCIJ to appoint three arbitrators from a standing panel of nine persons, who would also be selected by the PCIJ. The committee encouraged the PCIJ to appoint the same individuals to such tribunals in order to facilitate the development of a uniform body of jurisprudence.[49] Another provision of the sample clause set forth that the costs associated with compensating the arbitrators would be borne by the debtor state, although the tribunal had the discretion to order that such costs be borne by the claimants in the event of a frivolous action.[50]

45 The League of Nations committee concluded its discussion on the use of arbitration by emphasising that arbitration should be a means of establishing legal rights and obligations, and should not be a renegotiation:

> The Committee is unanimously of the opinion that the Arbitral Tribunal should try disputes exclusively from a legal point of view, and should in consequence confine itself to declaring what are the rights and obligations of the parties. It is necessary to emphasise this point, because the task of arbitral tribunals has sometimes been, not only to declare the law, but to make arrangements which, in point of fact, constitute modifications of the contract. Arbitration in this sense may take on the character of negotiations under the auspices of a third party, with the object of reaching a compromise acceptable to both sides. In the Committee's view, a clear distinction must be drawn between these two functions — viz., on the one hand, the arbitral award — that is to say, the definition of the rights and obligations of the parties — and, on the other, the modification of a contract either by negotiation or by decision of a third party. The role of the Tribunal in the foregoing draft arbitral clause is clearly limited to the first of these two functions — that of judge.[51]

46 Although no respondent to the Task Force questionnaire mentioned the risk of decisions grounded in equity as a reason not to select international arbitration in the context of sovereign finance, the perception of this risk persists. The comments of the League of Nations committee reflecting the concern that arbitral awards may be more prone to venture into the realm of equity, rather than being firmly grounded in the law, remain pertinent.

47 Contemporary literature on the use of arbitration to resolve disputes involving sovereign finance reflects a broad range of views on the pros and cons of international arbitration, and particularly investor-state arbitration, in this context. These pros and cons often coincide with those that are associated with arbitration generally, while some also appear to be peculiar to or more salient in the case of sovereign finance disputes, in particular.

C Contemporary commentary on the advantages of using international arbitration

48 Commentators writing specifically on topics that come under the umbrella of sovereign finance have mentioned the following advantages of international arbitration: neutrality, flexibility (including the option of selecting either publicity or confidentiality for the

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[47] Ibid. Notwithstanding the cited case involving Bulgaria, during the early twentieth century "recalcitrant states do not appear to have faced significant international pressure to comply with ex ante agreements to arbitrate disputes with private parties", W.M.C. Weidemaier, "Contracting for State Intervention: The Origins of Sovereign Debt Arbitration" (2010) 73 *Law & Contemp. Problems* 336 at 338.

[48] League of Nations 1939 Report, supra note 2, § 89.

[49] Ibid., § 90.

[50] Ibid., § 89(f).

[51] Ibid., § 91.

proceeding), arbitrator expertise, and foreign recognition of awards and decisions. Some authors have also opined that the merits of arbitration could lead to benefits that go beyond the arbitral process itself, potentially improving the functionality of the sovereign finance market from a broad perspective.[52]

49 Neutrality. As is commonly noted with respect to arbitration generally, authors endorse the merits of the neutrality of arbitral proceedings. This aspect of arbitration allows parties to sovereign finance agreements to avoid the courts of the sovereign party, as well as the courts of the state(s) of private parties, where, in either scenario, there may be a perceived risk of judicial bias or political interference.[53] This concern is likely to be more pronounced where sovereigns are involved than where the agreement is between two private parties.

50 Flexibility. Another general feature of arbitration frequently cited by authors is the freedom it gives parties to select and customise matters of procedure in the arbitration agreement to suit their particular needs. For example, parties may include or exclude the possibility of interim relief, including through recourse to courts, if they so choose.[54] As noted in the 1939 League of Nations report, parties have the opportunity to allocate all costs associated with an arbitral proceeding in their arbitration agreement.[55] Parties to a sovereign finance agreement may also value the freedom they are given to determine whether an arbitral proceeding will be public or confidential.[56]

51 Arbitrator expertise. Commentators have noted that "[w]hile judges might lack relevant experience and understanding concerning the technicalities and particular problems of international financial transactions, some of the best international financial law experts act as arbitrators".[57] The ability to appoint arbitrators with specialised expertise relevant to a particular dispute may improve the predictability of results and perhaps lead to more efficient and expeditious proceedings, particularly when compared to judicial alternatives.

52 Foreign recognition. Although occasionally couched in terms of enforceability, arbitration generally offers greater prospects of foreign recognition than a court judgment. In particular, the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, signed in 1958, had 156 parties as of October 2016,[58] whereas the Hague Convention on Choice of Court Agreements, signed in 2005 to facilitate recognition of foreign judgments, had 30 parties as of October 2016.[59] In addition, the United States Foreign Sovereign Immunities Act provides a broader exception to sovereign immunity for purposes of enforcing an arbitral award,[60] although the extent to which this distinction would prove meaningful in practice may be questionable.

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[52] See F. Suescun de Roa, "Investor-State Arbitration in Sovereign Debt Restructuring: The Role of Holdouts" (2013) *J. Int'l Arb.* 131 at 148–54; K.W. Chan, "The Relationship between the International Investment Arbitration and Sovereign Debt Restructuring" (2014) 7 *Contemp. Asia Arb. J.* 229 at 240–41; P. Griffin and A. Farren, "How ICSID Can Protect Sovereign Bondholders" (2005) 24 *Int'l Fin. L. Rev.* 21 at 24; E. Norton, "International Investment Arbitration and the European Debt Crisis" (2012) 13:1 *Chicago J. Int'l L.* 291.

[53] K. Halverson Cross, "Arbitration as a Means of Resolving Sovereign Debt Disputes" (2006) 17 *Am. Rev. Int'l Arb.* 335 at 355–56; Griffin and Farren, supra note 52, at 23.

[54] Griffin and Farren, supra note 52, at 23.

[55] League of Nations 1939 Report, supra note 2, 26 at § 89(f).

[56] See Cross, supra note 53, at 368–71; Griffin and Farren, supra note 52, at 24; Norton, supra note 52, at 302.

[57] Griffin and Farren, supra note 52, at 23.

[58] Source: https://treaties.un.org/; http://www.uncitral.org/uncitral/en/uncitral_texts.html.

[59] Source: http://www.hcch.net/index_en.php?act=conventions.status2&cid=98.

[60] Cross, supra note 53, at 356–65; Griffin and Farren, supra note 52, at 23–24; Norton, supra note 52, at 300–302; J. Simões, "Sovereign Bond Disputes before ICSID Tribunals: Lessons from the Argentina Crisis" (2011) 17 *Law & Bus. Rev. Americas* 683 at 689–90.

D Contemporary commentary on the disadvantages of using international arbitration

53 In addition to noting the advantages of arbitration in the context of sovereign finance, commentators have pointed to disadvantages as well, at times seeking to explain the traditional reluctance of market participants to use arbitration in this context. While some concerns expressed by authors focus on the manner in which parties to an agreement have decided to craft their arbitration clause,[61] the reservations described below may be generally applicable to the arbitration of sovereign finance disputes.

54 Simplicity of disputes. To the extent that decisions to use arbitration are based on the ability of the parties to select arbitrators with subject matter expertise, some authors note that disputes are commonly limited to straightforward issues, such as the failure to pay a debt.[62] Such straightforward disputes would fall comfortably within the competence of generalist judges, making redundant the possible benefit of specialised or technical expertise possessed by arbitrators.

55 Fear of decisions grounded in equity. As observed by the League of Nations committee over 75 years ago,[63] arbitration is perceived as being a method of dispute resolution in which equitable principles, rather than law, may ultimately dictate outcomes.[64] Arbitration experts typically reject this perception, and empirical evidence has also suggested this it is misplaced.[65]

56 Lack of appellate review. To the extent that sovereign finance disputes may involve large sums of money, parties may prefer to settle disputes with the full range of procedural rights available through litigation, including appellate review. Scholars have based the likely inclination of parties towards litigation for high-value disputes related to sovereign finance on empirical findings that businesses prefer litigation to arbitration, especially in "bet the company" cases.[66]

57 Costs. In contrast to litigation, the costs of an arbitration are borne by the parties to the dispute. Unless the costs are offset by other benefits provided by arbitration, which parties may or may not find desirable (e.g. lack of appeal or arbitrator expertise, if applicable), the possibility of increased costs may be a hindrance that deters parties from arbitrating a dispute.

58 Specific caveats and concerns have been raised with respect to the submission of sovereign finance disputes to investor-state arbitration. To the extent that claims would be founded on an investment treaty, which typically includes provisions for non-discriminatory treatment based on nationality, sovereign borrowers may find themselves subject to liability in a context where favouring domestic creditors could be viewed as reasonable and appropriate from an economic policy perspective.[67] Also, the absence of an appellate mechanism in investor-state arbitration may be of greater consequence for sovereign finance to the extent that consistency in decision-making, and thus predictability for the sovereign and its creditors, may facilitate and expedite the resolution

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[61] For example, some authors have expressed concern over publicity or the confidentiality of arbitration, the ability to petition for and enforce measures for interim relief, and the exclusion of any possible recourse to courts. See e.g. O. Sandrock, "Is International Arbitration Inept to Solve Disputes Arising out of International Loan Agreements?" (1994) 11 *J. Int'l Arb.* 33 at 36, 53–56; Cross, supra note 53, at 368–74.

[62] Sandrock, supra note 61, at 35, 38–50.

[63] League of Nations 1939 Report, supra note 2, at § 91.

[64] See Sandrock, supra note 61, at 35–36; Griffin and Farren, supra note 52, at 21; Cross, supra note 53, at 365–68.

[65] See C. Greenbaum, "Putting the Baby to Rest: Dispelling a Common Arbitration Myth" (2015) 26 *Am. Rev. Int'l Arb.* 101.

[66] Weidemaier, supra note 4, at 14–15, note 83.

[67] See Norton, supra note 52, at 307–308; K. Gallagher, "The New Vulture Culture: Sovereign Debt Restructuring and Trade and Investment Treaties", IDEAs Working Paper, No. 02/2011, at 17–18.

of sovereign finance disputes that involve many parties.[68] When an international institution, such as the International Monetary Fund, seeks to serve as a forum for negotiations to resolve sovereign finance disputes, the existence of arbitration proceedings could potentially undermine such processes.[69]

E Existing commentary on the use of the ICC Arbitration Rules for disputes involving states and state entities

59 In 2012, the ICC Commission on Arbitration and ADR published a report of the Task Force on Arbitration Involving States or State Entities (the "2012 ICC Report"). This task force was created "in recognition of the fact that ICC Arbitration, although a powerful dispute resolution tool, was underused in disputes involving states and state entities and that some explanation was required on the advantages it offers and on how the ICC Rules of Arbitration … operate in this context".[70] The 2012 ICC Report expressly stated that such explanation would be "better given in a report than by way of a separate set of rules for state and state entity arbitration".[71] Accordingly, rather than propose a distinct set of arbitral rules for disputes involving states or state entities, the task force reviewed existing practices in arbitrations in which one or more parties was a state or state entity, and suggested modifications to the standard ICC Arbitration clause that may be more appealing to states, state entities, and their contractual counterparties.

60 The 2012 ICC Report observed that approximately 10% of ICC cases involve a state or a state entity.[72] Approximately 80% of such arbitrations are cases originating from Sub-Saharan Africa, Central and West Asia, and Central and Eastern Europe, and these cases encompass both commercial disputes and investment disputes.[73]

61 With regard to arbitrator appointments, 85% of tribunals in ICC cases involving states or state entities were composed of three arbitrators, compared to 57.5% in ICC cases as a whole. The 2012 ICC Report proposed a variant of the standard ICC Arbitration clause requiring a three-arbitrator tribunal for disputes involving states or state entities.[74] In addition, under the ICC Rules, each party nominates an arbitrator for confirmation by the ICC International Court of Arbitration ("ICC Court").[75] The ICC Court then appoints the president of the tribunal unless the parties agree to select a different procedure.[76] The 2012 ICC Report proposed a variant of the standard ICC clause allowing the parties or party-appointed arbitrators to nominate the presiding arbitrator within an agreed time limit.[77]

62 Article 29 of the ICC Rules provides for the possibility of an emergency arbitrator to issue an order prior to the formation of an arbitral tribunal. The 2012 ICC Report notes that states and state entities may wish to remove this possibility and provides a sample ICC Arbitration clause expressly stating that the Emergency Arbitrator Provisions shall not

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[68] See Simões, supra note 60, at 713–15; W. Burke-White, "The Argentine Financial Crisis: State Liability under BITs and the Legitimacy of the ICSID System" in M. Waibel, A. Kaushal et al. (eds.), *The Backlash against Investment Arbitration* (Kluwer, 2010) 407.

[69] M. Waibel, "Opening Pandora's Box: Sovereign Bonds in International Arbitration" (2007) 101 *Am. J. Int'l L.* 711 at 759; K.W. Chan, *op. cit.* note 52, at 242; Norton, *op. cit.* note 52, at 303–304.

[70] ICC Report *States, State Entities and ICC Arbitration*, (2012), available at https://iccwbo.org/publication/icc-arbitration-commission-report-on-arbitration-involving-states-and-state-entities-under-the-icc-rules-of-arbitration/ at § 2.

[71] Ibid.

[72] Ibid., § 7. The report states that approximately 18% of BITs provide for the possibility of using the ICC Rules, ibid., § 11.

[73] Ibid., §§ 8–10.

[74] Ibid., § 15 & note 1.

[75] Ibid.

[76] Ibid.

[77] Ibid.

apply.[78] In addition, it is noted that arbitration rules or clauses may exclude the possibility of pre-judgment attachment or interim measures generally. For parties desiring the possibility of pre-judgment attachment or interim measures, an explicit waiver may be required.

63 Under Article 11(4) of the ICC Rules, decisions of the ICC Court on the appointment, confirmation, challenge or replacement of an arbitrator are final, and the reasons on which these decisions are based are not to be released. If an explanation of the reasons for these decisions is desired, the 2012 ICC Report provides a sample clause that would require the ICC Court to provide such an explanation.[79] This possibility does not extend to appointment decisions, however, because the reasons for an appointment "should normally be apparent from an appointee's CV".[80]

64 Unless otherwise provided under applicable law, ICC Arbitration is not confidential per se.[81] The 2012 ICC Report provides a sample modification to the standard ICC Arbitration clause that would require the existence of an arbitration, the arbitral proceedings, and the arbitral submissions and decisions to be kept confidential, unless already in the public domain or otherwise provided under applicable law.[82] Conversely, parties may agree on greater transparency, such as providing for publication of the award, proceedings, or party submissions. The 2012 ICC Report does not set forth a sample clause providing for such transparency, although the sample confidentiality clause would appear to be amenable to adaptation in this regard.[83] Existing arbitration clauses in sovereign bond contracts are generally silent on confidentiality, which may be appropriate since countries need to be transparent with their citizens regarding matters of public finance. In the field of investor-state arbitration, transparency is gaining traction.[84]

65 The 2012 ICC Report notes that states, state entities, and their contractual counterparties may wish to include a provision on the state's immunity from enforcement in ICC Arbitration clauses. The report alludes to interpretations by national courts of Article 34(6) of the 2012 ICC Rules (previously Article 28(6) of the 1998 ICC Rules) as a potential reason for such a provision, but does not expand on national jurisprudence.[85]

66 The 2012 ICC Report suggests that consideration be given to requiring disputes to be submitted to a form of amicable dispute resolution prior to arbitration.[86] For parties who wish to do so, a sample clause providing for obligatory mediation during an agreed period of time is provided in the report.[87] That being said, for many sovereign debt instruments, such a provision is likely to have little impact, as it may fuel concerns over outcomes based on equity.

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78 Ibid.

79 Ibid., § 21.

80 Ibid. The option of derogating from Article 11(4) of the ICC 2012 Rules is presented in the 2012 ICC Report on *States, State Entities and ICC Arbitration*, at p. 4 'Investment arbitration'; the 2012 ICC Report expressly notes, however, that modifications discussed in this section may be similarly applied to commercial arbitration, ibid. § 22. Article 11(4) has been amended in 2017 and the ICC Note to Parties and Arbitral Tribunals on the Conduct of the Arbitration, available at https://iccwbo.org/publication/note-parties-arbitral-tribunals-conduct-arbitration/, now expressly provides for a communication of reasons for Court decisions upon request of the parties.

81 Ibid., § 15.

82 Ibid., § 15.

83 Ibid., § 15.

84 See the 2014 UNCITRAL Rules on Transparency in Treaty-Based Investor-State Arbitration and United Nations Convention on Transparency in Treaty-based Investor-State Arbitration ("Mauritius Convention on Transparency"), http://www.uncitral.org/uncitral/uncitral_texts/arbitration.html.

85 ICC 2012 Report, supra note 80, at § 16.

86 Ibid., § 18.

87 Ibid.

67 According to the 2012 ICC Report, other deviations from the ICC Rules should be verified in advance with the Secretariat of the ICC Court to ensure that they are compatible with ICC's offer to administer the arbitration process.[88]

[88] Ibid., § 17. The 2012 ICC Commission's report also describes features of ICC Arbitration that may be of particular interest to states, state entities, and their contractual counterparties, ibid., §§ 25–75.

INVESTMENT ARBITRATION

OVERVIEW

1 The Task Force reviewed literature and the notes from the interviews conducted with representatives of financial institutions to determine the extent to which:

a) financial institutions consider protections afforded by international investment agreements ("IIAs") and investor-state dispute settlement ("ISDS") mechanisms at the time that investments are made in particular financial products or in particular geographical markets;

b) financial institutions and states are satisfied with current levels of IIA protection and available ISDS procedures;

c) financial institutions consider that international investment tribunals hearing disputes relating to financial regulation are more likely to rule in favour of foreign investors or, alternatively, in favour of sovereigns;

d) financial institutions consider international investment tribunals to be sufficiently sophisticated to reach fair and appropriate decisions.

2 As a general matter, the sources reviewed were of limited assistance in answering the questions posed. To a certain extent, this is not surprising. After all, the questions were directed towards better understanding actors in financial institutions as they contemplate or actively engage with ISDS mechanisms. By contrast, the literature is, for the most part, academic in nature and analyses the operation and effect of ISDS mechanisms rather than the motives of the actors who use them.

3 The first question concerned the extent to which financial institutions consider protections provided by IIAs and ISDS mechanisms *at the time investments are made.* A review of the sources did not provide any information directly on this point. However, literature discusses the relevance of such mechanisms to investors, particularly in light of the *Abaclat*[1] proceedings, which "signals the availability of ICSID arbitral tribunals to holders of security entitlements dissatisfied with the manner in which a state has accomplished its sovereign debt restructuring".[2]

4 Regardless of whether financial institutions do in fact consider potential IIA protections when entering into investments, it is clear that those involved in sovereign debt restructuring ("SDR") should certainly do so after the event.[3] For example, Konrad and Richman offer the following advice:

> To protect investments from future problems and to have all options available, current investors with potential claims resulting from state insolvencies should follow three steps:

[1] *Abaclat and others v. Argentine Republic* (ICSID Case ARB/07/5).

[2] G. Bianco, "The Bitter End of Sovereign Debt Restructurings: The *Abaclat v. Argentina* Arbitration and the Eurozone Crisis" (2013) 40:4 *Legal Issues of Economic Integration* 315 at 331.

[3] In 2013 and 2014, the first few cases registered were specifically related to the recent emergency measures implemented to counter the financial crisis in Greece and Cyprus. One of the three cases – *Poštová banka, a.s. and ISTROKAPITAL SE v. Hellenic Republic* (ICSID Case ARB/13/8) – has been terminated on jurisdictional grounds; the other two – *Cyprus Popular Bank Public Co. Ltd v. Hellenic Republic* (ICSID Case ARB/14/16) and *Marfin Investment Group Holdings S.A., Alexandros Bakatselos v. Republic of Cyprus* (ICSID Case ARB/13/27) – were pending at the time of publication of this Report.

> First, investors should identify which BIT or BITs may protect their investment… Second, investors should seek guidance as to the strength of the applicable BIT… Finally, investors should consult their lawyer before any problems with their investments arise. If a BIT does not provide for (optimal) protection there may still be scope and time for restructuring. This might allow the investor to take advantage of a more favourable treaty.[4]

5 Similarly, Y. Jung and S.D. Han note that:

> The study of SDR under the ISD regime and some of those potentially applicable legal issues…shows the wide-ranging impact and significance of the ISD regime … and raises the need for both policy-makers and foreign holders of sovereign bonds to meticulously consider their options and implications and tread their steps carefully.[5]

6 The second question concerns whether financial institutions and states are satisfied with current levels of IIA protection. Again, any such trend regarding financial institutions is difficult to identify from the literature. However, as far states are concerned, as part of its public consultation on ISDS in the context of the ongoing Transatlantic Trade and Investment Partnership ("TTIP") negotiations, the European Commission specifically asked about the inclusion of a "filter" mechanism regarding ISDS processes in circumstances where the state has taken "prudential measures", noting:

> Recently, concerns have been expressed in relation to several ISDS claims brought by investors under existing investment agreements, relating to measures taken by states affecting the financial sector, notably those taken in times of crisis in order to protect consumers or to maintain the stability and integrity of the financial system.
>
> To address these concerns, some investment agreements have introduced mechanisms which grant the regulators of the Parties to the agreement the possibility to intervene (through a so-called "filter" to ISDS) in particular ISDS cases that involve measures ostensibly taken for prudential reasons.[6]

7 This carries with it the possibility of diluting any such levels of protection in the TTIP in relation to the financial sector. Responses to the potential inclusion of such a filter in the TTIP were mixed, and may be summarised as follows:

> A couple of companies consider that a filter is justified in times of global financial crisis and sovereign debts restructuring.[7]

8 However, in general, NGOs and umbrella NGOs believe that a filter mechanism will not enhance a fairer or more equitable arbitration system, while about half the respondents in the same category suggest a broader filter not only applying to financial services but also to public policy objectives (e.g. consumer protection, environment). This view is shared by a small minority of companies and by a number of respondents among other organisations.[8]

9 Nevertheless, some other among the NGOs fear that a filter mechanism as proposed may limit and frustrate access of investors to obtain a neutral and independent decision on their cases/claims. They oppose the proposed approach to subject financial services investors to a different ISDS process and prevent them from participating in the constitution of the arbitration tribunal in the same way as other investors.[9]

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[4] S. Konrad and L.Richman, "Investment Treaty Protection for State Defaults on Sovereign Bonds" *Arbitration World* (K&L Gates, Dec. 2011), http://www.klgateshub.com/details/?pub=Arbitration-World-12-14-2011.

[5] Y. Jung and S.W. Han, "Sovereign Debt Restructuring under the Investor-State Dispute Regime" (2014) 31:1 *Journal of International Arbitration* 75 at 96.

[6] European Commission, "Online public consultation on investment protection and investor-to-state dispute settlement (ISDS) in the Transatlantic Trade and Investment Partnership Agreement (TTIP)", Report, 13 January 2015, http://trade.ec.europa.eu/doclib/docs/2015/january/tradoc_153044.pdf at 116.

[7] Ibid. at 118

[8] Ibid. at 119.

[9] Ibid.

10 Thus, regardless of whether financial institutions consider their current levels of investment protection to be sufficient, it is certainly the case that (at least in the context of TTIP), there is an ongoing debate among broader policy actors as to whether currently available levels of protection are desirable at all.

11 The Trans-Pacific Partnership (TPP) is another proposed multilateral trade agreement containing investment and financial services chapters. The draft proposed at the time of writing this Report contains a carve-out for prudential measures which specifically excludes these measures from potential ISD claims. In particular, the TPP language states:

> For greater certainty, if a measure challenged under Section B of Chapter 9 (Investment) is determined to have been adopted or maintained by a Party for prudential reasons in accordance with procedures in Article 11.22 (Investment Disputes in Financial Services), a tribunal shall find that the measure is not inconsistent with the Party's obligations in the Agreement and accordingly shall not award any damages with respect to that measure.10

12 Though the final text is not yet available, it is rather telling that the drafting parties to the TPP have explicitly excluded prudential measures from the dispute settlement provisions of the agreement.

13 The third question asks whether there is a prevailing perception that international investment tribunals dealing with financial regulation disputes are more prone to find in favour of foreign investors or states. Unsurprisingly, once again, the interview responses and literature do not tend to reveal evidence of a trend that leans in either direction.

14 Finally, the fourth question addresses whether or not investment tribunals are considered to be sufficiently sophisticated to reach appropriate decisions. Writing as far back as 1983, Delaume noted that arbitration tended to be disfavoured by financial institutions because, inter alia:

> [L]enders feel that … loan disputes are likely to raise strict legal issues which may be better dealt with by courts than by arbitrators.[11]

15 Ostranský notes that:

> Several reasons why litigation is preferred over arbitration in the sovereign bond arena have been identified. It might be the creditors' fear of equitable considerations playing a larger role in arbitration, lack of appeal and lower predictability, availability of summary judgments and interim relief in litigation and finally the "lock-in" effects of standardised "boilerplate" contracts used in the financial markets.[12]

16 However, it is interesting to note that ICSID was originally created for the purpose of solving bond disputes. As the General Counsel of the World Bank indicated in a note to the Executive Directors of the World Bank in 1962 when discussing the possible creation of ICSID:

> The present activities of the Bank, and of the President of the Bank, in the field of investment dispute settlement fall into three categories. The first comprises the two cases involving full scale mediation, namely the Suez Canal Compensation and City of Tokyo Bond cases. One of the ideas underlying the present proposals [the creation of ICSID] is to relieve the Bank of some of the extra-curricular burdens it is from time to time asked to assume, and to transfer these burdens to an organ somewhat removed from, although linked to, the Bank. To that extent, one could say that they aim at "institutionalizing" the Bank's present dispute settlement activities.[13]

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10 Trans-Pacific Partnership, 5 Nov. 2015, Article 11.11, note 11.

11 G. Delaume, "The ICSID and the Banker", *International Financial Law Review*, October 1983, 9.

12 J. Ostranský, *Sovereign Defaults and Investment Arbitration* (Thesis, University of Geneva, 2012) at 25.

13 "Note by the General Counsel transmitted to the Executive Directors", (SecM 62-17), 19 Jan. 1962 in *History of the ICSID Convention*, vol II-1 (ICSID, 1968) 6 at 7.

17 Thus, as Julien Fouret indicates, based on an analysis of the historical background to the creation of ICSID:

> Dispute resolution in the matter of sovereign bonds for the city of Tokyo was thus the first example, if not the perfect example, of the type of disputes that the future institution foreseen by the World Bank would have to deal with.[14]

18 But this historical background was unknown to financial institutions until recently and thus has rarely been relied upon by investors in their disputes. It may simply be that financial institutions in the past successfully relied on domestic courts rather than arbitral tribunals (with their perceived inadequacies), at least with regard to jurisdiction over the subject matter of the dispute. It must also be remembered that although there are very many highly skilled commercial judges, most judges do not come from the financial services industry. Therefore, there is no *prima facie* reason why a court should be better situated to deal with a dispute concerning complex financial instruments than an arbitral tribunal, which can be composed of experts from the financial services sector rather than general legal experts (i.e. judges).

USE OF IIAs TO CHALLENGE ALLEGED STATE APPROPRIATION OF, OR SEVERE INTERFERENCE WITH, FINANCIAL INSTITUTIONS

19 This section considers case decisions on the use of IIAs to challenge state appropriation of, or severe interference with, financial institutions and products. Both substantive protections and defences presented in the cases will be considered. In order to provide a broader context, a review of jurisdictional issues that affect claims of financial institutions will serve as an introduction to this topic.

A Matters of jurisdiction

(i) Introduction

20 While there is almost no limit to the issues that may affect the jurisdiction of commercial arbitration tribunals,[15] the situation is slightly simpler where investment arbitration is concerned, whether because of the rather limited textual variations between dispute resolution clauses in IIAs, the large extent to which those jurisdictional issues are based on the language of Article 25 of the 1965 ICSID Convention, the limited pool of investment arbitration practitioners and arbitrators, or a combination of these factors.

21 In practice, this means that all jurisdictional objections in relation to investment arbitration fall into one of five categories, namely *ratione materiae*, *ratione personae*, *ratione temporis*, *ratione loci* or *voluntatis causae*.

22 The following analysis looks at each of those five issues as they occur in investment arbitration proceedings dealing with claims by financial institutions or their stakeholders. We must note that a significant number of these cases are currently pending, resulting in incomplete information on those cases, as well as the potential for these cases to be subject to further developments in the future.

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[14] J. Fouret, "Dette souveraine des États et Arbitrage CIRDI, un mariage arrangé?" in G. Dufour and D. Pavot (eds), *La crise des dettes souveraines et le droit: approches croisées Canada–Europe* (LexisNexis, 2014) 335-351. Original in French : "La résolution de la question des bons de la ville de Tokyo est ainsi la première illustration, l'illustration parfaite en quelque sorte, du type de différends que devait être amenée à régler la future institution imaginée par la Banque mondiale", at 351.

[15] For a general overview of jurisdictional issues relating to commercial arbitration see Frédéric Eisemann's seminal paper "La Clause d'arbitrage pathologique" in *Commercial Arbitration: Essays in Memoriam Eugenio Minoli* (1974) 129.

(ii) Jurisdiction *ratione materiae*

23 *Ratione materiae* objections to jurisdiction have been raised in at least 18 investment arbitration proceedings involving financial institutions, 16 of which resulted in an award or decision on the issue of jurisdiction,[16] or a decision that covered both jurisdictional issues and the substantive merits of the case.[17]

24 Several issues were raised in the cases. They included whether a protected investment existed a particular economic instrument could be considered an investment for jurisdictional purposes and the effect of non-compliance with domestic law on the jurisdiction of the tribunal.[18]

25 Cases dealing with the first of these two issues include *Blue Bank*, *Continental*, *Deutsche Bank* and *Valle Verde*, although the issue in those cases typically turned on the idiosyncratic circumstances of the particular investment rather than on whether a financial institution or interests in a financial institution could qualify as an investment.

26 As a general matter, tribunals and writers agree that investments made in violation of domestic law do not qualify for investment law protection.[19] In *Alasdair Ross Anderson*, the tribunal found that claimants' deposits of funds in a particular investment qualified as "assets" under the relevant BIT. When Costa Rica failed to provide the proper vigilance and governmental regulatory supervision of the matter, claimants brought claims for, inter alia, expropriation of their invested funds. However, the BIT further required that investments be made in accordance with the host state law. Because the investment was deemed to be illegal and fraudulent by the Costa Rican judiciary, the tribunal dismissed the claims in their entirety on the basis of a lack of jurisdiction over the claims.

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[16] In investment arbitration parlance, a decision on jurisdiction is typically called "decision on jurisdiction" if any objections raised are dismissed and the case proceeds to be decided on the merits, and "award on jurisdiction" if any objections raised are upheld and the case does not then proceed to be decided on the merits.

[17] Those cases are *ABCI Investments Ltd v. Republic of Tunisia* (ICSID Case ARB/04/12), *Alex Genin and ors v. Republic of Estonia* (ICSID Case ARB/99/2), *Blue Bank International & Trust (Barbados) Ltd v. Bolivarian Republic of Venezuela* (ICSID Case ARB/12/20), *British Caribbean Bank Ltd v. Government of Belize* (PCA Case 2010-18, UNCITRAL Arbitration Rules), *Československa obchodní banka, a.s. v. Slovak Republic* (ICSID Case ARB/97/4), *Continental Casualty Company v. Argentine Republic* (ICSID Case ARB/03/9), *Daimler Financial Services AG v. Argentine Republic* (ICSID Case ARB/05/1), *Deutsche Bank AG v. Democratic Socialist Republic of Sri Lanka* (ICSID Case ARB/09/2), *Fireman's Fund Insurance Company* v. *United Mexican States* (ICSID Case ARB(AF)/02/1), *Hesham Talaat M. Al-Warraq v. Republic of Indonesia* (UNCITRAL), *Invesmart BV* v. *Czech Republic* (UNCITRAL Arbitration Rules), *KT Asia Investment Group B.V. v. Republic of Kazakhstan* (ICSID Case ARB/09/8), *Metalpar S.A. and Buen Aire S.A. v. Argentine Republic* (ICSID Case ARB/03/5), *Oko Pankki Oyj, VTB Bank (Deutschland) AG and Sampo Bank Plc v. Republic of Estonia* (ICSID Case ARB/04/6), *Poštová banka, a.s. and ISTROKAPITAL SE* v. *Hellenic Republic* (ICSID Case ARB/13/8), *Rafat Ali Rizvi v. Republic of Indonesia* (ICSID Case ARB/11/13), *Renee Rose Levy de Levi v. Republic of Peru* (ICSID Case ARB/10/17), *Valle Verde Sociedad Financiera S.L. v. Bolivarian Republic of Venezuela* (ICSID Case ARB/12/18). The cases of *Blue Bank* and *Valle Verde* are still pending and have not as yet given rise to any decisions or awards on the issue of jurisdiction.

[18] See e.g. *British Caribbean Bank v. Belize*; *Alasdair Ross Anderson and ors v. Republic of Costa Rica* (ICSID Case ARB(AF)/07/3); Rizvi *v. Indonesia* (the tribunal dismissed the case for lack of jurisdiction, finding that claimant's investment had not been granted admission in accordance with the local foreign investment law, as required by the BIT).

[19] See e.g. *Saba Fakes v. Republic of Turkey* (ICSID Case ARB/07/20), *Phoenix Action Ltd* v. *Czech Republic* (ICSID Case ARB/06/5), *Inceysa Vallisoletana S.L. v. Republic of El Salvador* (ICSID Case ARB/03/26).

27 Also, *ratione materiae* objections may question whether an actual dispute exists that can validly trigger the jurisdiction of an investment tribunal.[20] In *ABCI*, for instance, Tunisia argued, albeit unsuccessfully, that no dispute existed at the time of the submission of the request for arbitration.[21]

(iii) Jurisdiction *ratione personae*

28 *Ratione personae* objections pertain to the requirement under the ICSID Convention, and many BITs, that the investor party have a qualifying nationality and/or that it lacks a given nationality (typically, that of the state party to the dispute). Such objections may also concern the requirement that there must be a state party to the dispute.

29 *Ratione personae* objections have been made in no less than 13 investment disputes, of which two are still pending.[22] In many cases, the objections dealt with the issue of whether the investor party was actually a foreign investor or simply a domestic investor attempting to invoke international law protections,[23] but arguments were also raised regarding the viability of a claim where the claimant party was controlled by a state and was not a private investor.[24]

(iv) Jurisdiction *ratione temporis*

30 This category covers objections to jurisdiction based on claims that arise either prior to the relevant legal instrument entering into force or after the protections invoked have ceased to be binding on the state party to the dispute.

31 *Ratione temporis* objections were raised in at least seven investment disputes involving financial institutions.[25] Since those concerning pre-existing claims are clearly dependent on the language of the particular treaty,[26] it is not easy to formulate a general rule. Some of the cases that commenced after the state had denounced the ICSID Convention are still pending.[27]

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[20] This form of objection is regularly structured to reflect the language in Article 25 of the ICSID Convention, which limits the jurisdiction of ICSID to any "legal dispute arising directly out of an investment". It is very possible that the abundance of cases raising issues of jurisdiction *ratione materiae* derives from the fact that the ICSID Convention does not define "legal dispute" or "investment".

[21] *ABCI*, Decision on Jurisdiction (18 Feb. 2011), paras. 161 and 168.

[22] These cases are *ABCI Investments*, *Blue Bank*, *Československa obchodní banka*, *Continental Casualty*, *Daimler Financial Services*, *Deutsche Bank*, *Hesham Talaat M. Al-Warraq, Invesmart*, *KT Asia Investment Group*, *Metalpar*, *Renee Rose Levy de Levi*, *Saluka*, and *Valle Verde*. *Blue Bank* and *Valle Verde* are still pending, waiting for a determination that would result in either an award being issued or a decision being made on the issue of jurisdiction.

[23] See e.g. *Renee Rose Levy de Levi* and *Valle Verde*.

[24] See e.g. *Československa obchodní banka* and *Blue Bank*.

[25] They were *ABCI Investments*, *Blue Bank*, *Continental Casualty*, *Daimler Financial Services*, *Metalpar*, *Poštová banka* and *Valle Verde*. Of these, *Blue Bank* and *Valle Verde* remained pending at the time of publication of this Report .

[26] In spite of this general caveat, it has been said that "[o]pportunistic assignments designed to bring an existing dispute within the scope of ICSID's jurisdiction will not be accepted", see Christoph H. Schreuer*, The ICSID Convention: A Commentary* (Oxford University Press, 2009), Art. 25, § 361.

[27] See *Blue Bank* and *Valle Verde*, both commenced after Venezuela's denunciation of the ICSID Convention in early 2012.

(v) Jurisdiction *ratione loci*

32 *Ratione loci* objections to jurisdiction have been raised in at least seven investment arbitration proceedings involving financial institutions or financial instruments. All resulted in an award or a decision on the issue of jurisdiction, or a decision on both jurisdictional issues and the substantive merits of the case.[28]

33 The issues raised in those cases concerned whether the investment was protected, with a particular focus on whether the economic instrument or activity could be considered to have been an investment "in the territory" of the host state for jurisdictional purposes. In most cases, this issue is quite easily resolved as whether or not an investment was carried out in the territory of the host state is generally a straightforward matter to decide. However, in the case of financial instruments, some complex financial transactions do not necessarily have a single physical location that can be easily determined, and these transactions typically contain highly abstract economic mechanisms. Thus, whether or not the investments were actually made within the host state territory may not be clear-cut.

34 As a general matter, tribunals generally concur that the criteria must not be viewed in a restrictive or limited manner, but rather from a relatively abstract perspective. Tribunals have created two sets of interconnected criteria specifically tailored to financial activities to determine: (i) the identity of the beneficiary of the funds, and (ii) whether the funds were raised to support governmental action/local economic development. Hence, their approach is clearly functional, with the goal being to determine the end result and final impact of the investment, rather than focusing on the actual investment itself. This tailor-made test geared towards financial instruments is favourable to jurisdiction test and is explained by the particular nature of these instruments:

> With regard to an investment of a purely financial nature, the relevant criteria cannot be the same as those applying to an investment consisting of business operations and/or involving manpower and property.[29]

35 ICSID or UNCITRAL tribunals have generally deemed it preferable to determine who the beneficiary of the funds is,[30] and to decide if the funds were loaned to sustain the beneficiary's "various governmental needs" or to "support [its] economical development" and, on a more general basis, whether the funds were loaned in order to "manage its finances".[31]

36 The latter criterion does not mean that the government's use of the funds is required to be meticulously checked, or that the investor must have known that the money would be used for a particular goal to be achieved at the time of the creation of the product. As a matter of fact, investors do not even have to be aware that they are making an investment in the host state. According to the *Ambiente Ufficio* Decision on Jurisdiction:

> Nor is it relevant whether the individual Claimants, when purchasing the security entitlements, actually believed or were aware that they were making 'an investment in Argentina'.[32]

37 In all the cases discussed here (with the exception of the *Giovanni Alemanni* case, where the tribunal postponed its decision to the merits phase), the arbitral tribunals considered the *ratione loci* requirement to be fulfilled and upheld their territorial jurisdiction.

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[28] Those cases are *Fedax N.V. v. Bolivarian Republic of Venezuela* (ICSID Case ARB/96/3), *British Caribbean Bank*, *Československa obchodní banka*, *Deutsche Bank*, *Abaclat and ors v. Argentine Republic* (ICSID Case ARB/07/5), *Ambiente Ufficio S.p.A. and ors v. Argentine Republic* (ICSID Case ARB/08/9), *Giovanni Alemanni and ors v. Argentine Republic* (ICSID Case ARB/07/8).

[29] *Abaclat*, Decision on Jurisdiction (4 Aug. 2011), § 374.

[30] *Fedax*, Decision on Jurisdiction (11 July 1997), § 41; see also *Deutsche Bank*, Award (31 Oct. 2012), § 291 and *British Caribbean Bank v. Belize,* Award (19 Dec. 2014), § 206.

[31] *Abaclat*, Decision on Jurisdiction (4 Aug. 2011), § 374; see also *Deutsche Bank*, Award (31 Oct. 2012), § 292.

[32] *Ambiente*, Decision on Jurisdiction (8 Feb. 2013), § 504.

(vi) Jurisdiction *voluntatis causae*

38 The final category of objections consists of allegations that the dispute is not covered by a validly executed agreement to arbitrate. At least five cases involving financial institutions or interests in financial institutions raised such an objection.[33] To date, however, no tribunal deciding an investment dispute involving financial entities has declined jurisdiction on this basis.

B Substantive matters

39 The two principal standards invoked by investors in cases concerning state interference with financial institutions are (a) fair and equitable treatment and (b) the prohibition of expropriation. This is also the case where measures are adopted in times of crisis and during the restructuring of domestic economies.

(i) Fair and equitable treatment

40 Fair and equitable treatment (FET), especially in the form of protection of legitimate expectations,[34] is the principal standard that investors invoke to protect their rights in cases involving financial institutions. On a number of occasions, tribunals have accepted the notion that a foreign investor is entitled to the protection of its legitimate expectations. For instance, tribunals have found it reasonable that the investor "expects the host state to act in a consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor".[35] Or, as stated by the tribunal in *Saluka*:

> An investor's decision to make an investment is based on an assessment of the state of the law and the totality of the business environment at the time of the investment as well as on the investor's expectation that the conduct of the host state subsequent to the investment will be fair and equitable.
>
> The standard of "fair and equitable treatment" is therefore closely tied to the notion of legitimate expectations which is the dominant element of that standard.[36]

41 Other tribunals and authors have equated the FET standard (which does not include the protection of legitimate expectations as discussed above) with the international minimum standard accorded under customary law (which does provide protection to foreign investors).[37] However, a number of limitations have been developed which restrict the scope of the expectations that are subject to protection in a given case.

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[33] Those cases are *ABCI Investments*, *Československa obchodní banka*, *Continental Casualty*, *Hesham Talaat M. Al-Warraq*, and *Metalpar*.

[34] *Invesmart*, Award (26 June 2009), § 202.

[35] *Técnicas Medioambientales Tecmed, S.A. v. United Mexican States* (ICSID Case ARB(AF)/00/2), Award (29 May 2003), § 154. But see *Oko Pankki Oyj and Ors v. Rep. of Estonia*, Award (19 Nov. 2007), § 242; *MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Republic of Chile* (ICSID Case ARB/01/7), Ad Hoc Committee Decision on Annulment (21 Mar. 2007), §§ 69-71.

[36] *Saluka Investments v. Czech Republic (UNCITRAL Arbitration Rules)*, Partial Award (17 March 2006), §§ 301– 302 (citing *Tecmed*).

[37] For a general discussion on this debate, see Ioana Tudor, *The Fair and Equitable Treatment Standard in the International Law of Foreign Investment* (Oxford University Press, 2008).

42 **Expectations must take into account the law applicable to the investment at the relevant time(s).** The investor's expectations must simultaneously account for and flow from the domestic law applicable to the investment at the relevant time(s).[38] In general, an investor should not expect the state to act in a manner contrary to its law(s), and is not entitled to hold the state liable for not acting where the state was not obliged to act in the first place. The investor should not expect absolute stability in the legal sense (unless, of course, the state has made a particular commitment to the investor to this effect); a state's right to regulate will not be unreasonably impaired.[39]

43 In *Renee Rose Levy de Levi*[40] and *Invesmart*[41] the investors complained that their banks were denied emergency financing by the state. The tribunals dismissed these claims because the banks had no legal entitlement to state aid according to the applicable domestic law, and this fact was made known to the investors.

44 In *Renee Rose Levy de Levi*, the tribunal also refused to hold the state liable for withdrawing its deposits from the investor's bank, which contributed to its deterioration. The tribunal stated that there was nothing in the applicable law precluding the state, like any other depositor, from withdrawing funds.[42]

45 In *Saluka*, the tribunal dismissed the claim that the introduction of a more rigid system of prudential requirements system by the Czech Republic's central bank violated the investor's legitimate expectations. These prudential requirements were part of an EU accession programme of the Czech Republic, and therefore could have reasonably been anticipated.[43] Similarly, the shortcomings of the Czech loan enforcement legislation which adversely affected the loan portfolio of the investor's bank were known at the time of investment, and the investor could not have expected that they would be quickly addressed (and potentially amended) by the legislature.[44]

46 **The expectations must be reasonable.** The expectations claimed must be reasonable in scope, which means, in this particular context, that the investor should not expect the state to act in the best possible manner when responding to the financial crisis, or, in the words of the *Invesmart* tribunal, should only expect the state to act "in accordance with international best practice."[45] International tribunals generally decline to decide whether there was a better option available to the state. In particular, tribunals recognise that there is no international legal obligation on the part of the state to always choose the least costly alternative.[46] Even a violation of domestic law in the context of provision of state aid was not *per se* considered a treaty violation.[47]

47 According to the jurisprudence, the state may only be held liable when a certain minimum threshold of so-called "inappropriateness" is exceeded,[48] or where the investor succeeds in a showing of "egregious intent" on the part of the state.[49] As the *Al-Warraq* tribunal stated, the conduct of the state should fall within "reasonable measures expected from a well administered government in similar circumstances," and nothing more.[50]

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[38] *Invesmart*, Award (26 June 2009), § 255.

[39] *Saluka*, Partial Award, § 305.

[40] *Renee Rose Levi de Levy v. Republic of Peru*, ICSID Case No. ARB/10/17, Award dated 26 February 2014, § 338.

[41] *Invesmart*, § 269.

[42] *Renee Levy*, § 323.

[43] *Saluka*, § 358.

[44] *Saluka*, § 360.

[45] *Invesmart*, § 459.

[46] *Saluka*, § 410. *See also Invesmart*, § 430, § 486.

[47] *Saluka*, § 442.

[48] *Invesmart*, § 202.

[49] *Invesmart*, § 430.

[50] *Hesham Talaat Al-Warraq v. Republic of Indonesia*, UNCITRAL Rules, Final Award dated 15 December 2014, § 628.

48 In *Al-Warraq*, the claimant argued that the state's choice of measures was not optimal. The tribunal, however, refused to second-guess the state's policy and found that the Bank of Indonesia exercised sufficient diligence in its supervisory functions.[51] In addition, an important point made by the tribunal was that a central bank's primary duty of care is to the depositors of the bank, not to portfolio investors, and thus the investor could not have legitimately expected that the central bank owed him any kind of duty under the circumstances.[52]

49 The expectations must flow from the business environment at the time of investment. The investor's expectations must flow from the business environment at the time of the investment. This point was first emphasised in an earlier case on financial emergency, *Genin v. Estonia*,[53] where the tribunal noted that claimants made the choice (at their own risk) to invest in a nascent independent state just beginning to adapt to modern financial and banking practices.[54]

50 In a similar fashion, in *Fireman's Fund*, the tribunal noted that the investor chose to invest in the debentures of a "troubled bank" and in a country which, itself, was in the process of recovering from a financial crisis. In the tribunal's view, the intention of the claimant in *Fireman's Fund* was to gain an "admission ticket" to the "personal lines" insurance business in Mexico, and therefore the investor knowingly exposed itself,[55] to both a devaluation of the debentures[56] and the risk that the state could take significant measures to maintain the stability of the financial system.[57]

51 In the next major case on state interference with a bank, *Saluka v. Czech Republic*,[58] the tribunal specifically mentioned that the investor's expectations, in order to be protected, must "rise to the level of legitimacy and reasonableness *in light of the circumstances*."[59]

52 Finally, in *Invesmart*, the tribunal noted that the expectations of the investor must be objectively evaluated on the basis of the state's actual dealings with the investor at the relevant time. An investor's expectation, for example, cannot be based on negotiations with third parties to which claimant was not privy.[60]

53 The investor's own conduct as a relevant factor. The investor's own conduct is also recognised as a factor in considering the investor's expectations. In *Genin*, the investor was found to have failed to disclose beneficial ownership of the subject bank, contrary to the requirements of the supervising Bank of Estonia.[61] As a result, despite major procedural shortcomings on the part of Bank of Estonia, the tribunal found that the investor, through its actions, triggered a legitimate regulatory concern of the central bank, which resulted in lawful state interference with the investment.[62]

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[51] *Al-Warraq*, § 538.

[52] *Al-Warraq*, § 620.

[53] *Alex Genin, Eastern Credit Limited Inc. and A.S. Baltoil v. Republic of Estonia*, ICSID Case No. ARB/99/2, Award dated 18 June 2001.

[54] *Genin*, § 348.

[55] *Fireman's Fund*, § 180.

[56] *Fireman's Fund*, § 182.

[57] *Renee Levy*, § 323.

[58] *Saluka*, §§ 271, 273.

[59] *Saluka*, § 304, emphasis original.

[60] *Invesmart*, § 252.

[61] *Genin*, § 353.

[62] *Genin*, § 362.

54 In *Al-Warraq*, the state was not held liable for the application of the bailout scheme to which the claimant and his bank had previously consented.[63]

55 Of particular importance in the context of investment in financial institutions is the obligation of the investor to perform its own due diligence at the time of investment.[64] This obligation is especially important in the case of investing in a financially difficult situation. In *Invesmart*, the tribunal found that the investor did not demonstrate the prudence expected of a reasonable investor where the investment was conditioned upon the government's financial support.[65]

56 Legitimate expectations from specific commitments on the part of the state. The investor has to make sure that the representations have been made by a properly authorised entity, which is vested with the proper authority to ensure that the representations are binding on the state.[66] In *Fireman's Fund*, the investor took part in a state-established working group, which considered and approved a number of substantial decisions within the framework of emergency negotiations. It was understood that substantial consensus in the working group was required to permit decisions concerning the claimant's investment to be sent to the state agencies for approval.[67] However, when the investor attempted to rely upon the decisions of the working group as being commitments on the part of the state, the tribunal found that the recommendations issued by the group were "by definition not final" and therefore could not be regarded as an undertaking imputable to the state.[68]

57 In *Invesmart*, the tribunal found that the claimant's discussions with the central bank could not lead to a binding commitment on the part of the state to provide state aid, since this was a decision that fell outside the scope of authority of the central bank.[69] The actions of the Ministry of Finance, according to the tribunal, only indicated its willingness to submit the documents for state aid, but did not adequately demonstrate the state's promise to deliver aid.[70]

58 The standard of non-discrimination. This standard is another relevant aspect of FET deals, which is important in financial emergency cases. In *Saluka*, the state was found liable for discriminatory treatment of the claimant's investment. The tribunal found that the Czech central bank acted discriminatorily, providing emergency state assistance to three of four major Czech banks - not to the bank in which the investor acquired shares,[71] despite the fact that this bank did not substantially differ from the other major banks.[72] To the contrary, in *Invesmart*, the tribunal refused to find that the investor's bank and other banks that received state aid faced a similar situation,[73] and dismissed the claim.

[63] *Al-Warraq*, §§ 533-534.

[64] *Invesmart*, § 254.

[65] *Invesmart*, § 291.

[66] *Invesmart*, § 258.

[67] *Fireman's Fund*, § 152.

[68] *Fireman's Fund*, § 153.

[69] *Invesmart*, § 265.

[70] *Invesmart*, § 328.

[71] *Saluka*, § 326.

[72] *Saluka*, 344.

[73] *Invesmart*, § 404.

59 Proper communication with the investor. The consideration of proper communication with the investor involves the merging of various applicable standards. In *Saluka*, the tribunal recognised that the investor was entitled to expect the state to respond in good faith to its proposals to overcome a crisis (or crises). The state should "take seriously a proposal that has sufficient potential to solve the problem and [shall] deal with it in an objective, transparent, unbiased and even-handed way."[74] As a result, the state was found liable for its failure to cooperate with the investor in rescuing its bank, while simultaneously reacting favourably to the proposals made by the investor's competitor.[75]

60 Bank runs. Official statements made by state officials may incite panic among the depositors and severely agitate the financial situation of the investment. In *Saluka*, the tribunal found that by spreading certain information, the government contributed to the exacerbation of the investor's bank's financial distress and subsequent failure.[76] In order to reach this conclusion, however, the tribunal found that there was "reason to believe" that the government deliberately engineered the circulation of information in order to precipitate the bank's failure.

61 In *Invesmart*, the tribunal also found that the central bank's statements to the media regarding the claimant's investment were ill-considered[77] and that the resulting negative impact on the investor's bank could have been avoided.[78] However, the tribunal refused to hold the state liable for this isolated event, especially in light of the fact that the information disclosed by the central bank was generally accurate and already in the public domain.[79]

62 In *Renee Levy*, the tribunal did not find that the state provoked a bank run in any way, and refused to hold the state liable, adding that there was very little the state could do to curb the resulting panic.[80]

ii) Expropriation claims

63 Investors in financial institutions have raised expropriation as a secondary line of defence, since FET claims seem to be more successful for investments in financial institutions and products. A typical impediment for claimants is that investors are required to show that they were substantially deprived of the economic value of their investments as a result of state interference in order to claim expropriation.[81] At the same time, it is extremely difficult to distinguish the reduction in investment value which is caused by such interference from the decrease in value which is caused by financial crisis.

64 Thus, in *Fireman's Fund,* the tribunal denied the expropriation claim, reasoning that at the time of the alleged state action the value of the investment was already close to zero "due to objective economic reasons".[82] Similarly, in *Al-Warraq,* the claimant's shares in the bank were found to be worthless at the time of the alleged expropriation.[83]

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[74] *Saluka*, § 363.

[75] *Saluka*, § 413.

[76] *Saluka*, § 472.

[77] *Invesmart*, § 360.

[78] *Invesmart*, § 362.

[79] *Invesmart*, § 363.

[80] *Renee Levy*, § 336.

[81] Dolzer and Schreuer, 2d ed., page 67.

[82] *Fireman's Fund*, § 199.

[83] *Hesham Talaat Al-Warraq v. Republic of Indonesia*, UNCITRAL Rules, Final Award dated 15 December 2014, § 525.

65 In *Genin*, the claimant brought an expropriation claim because the Estonian bank had its license revoked by an Estonian state agency. The tribunal found, however, that even though the revocation was not without criticism, it did not rise to the level of an expropriation, or any other BIT violation for that matter.[84]

66 On the other hand, in *Deutsche Bank*, the tribunal considered that the hedging agreement between claimant and a state-owned entity was an asset - property having an economic interest and warranting a monetary claim, which is sufficient to meet the BIT's definition of investment.[85] On the merits, the tribunal found that the state's actions amounted to an indirect expropriation of claimant's debt claim under a hedging agreement. The tribunal disagreed "with Sri Lanka that it has an extremely broad discretion to interfere with investments in the exercise of 'legitimate regulatory authority'."[86]

67 As demonstrated in this section, there are limited categories of jurisdictional issues in ISDS. Regarding financial institutions, it should be noted that FET tends to be primarily invoked in the context of expropriation claims.

REVIEW OF IIA JURISPRUDENCE AND LITERATURE AND THE SCOPE OF "INVESTMENT"

A Jurisprudence concerning sovereign debt purchased on the secondary market

68 To the best of our knowledge, as of the date of this report, there have been five investment treaty arbitrations concerning sovereign debt products that have reached the stage of a binding decision that concerns issues material to this report.

69 The first of these decisions was *Fedax v. Venezuela*,[87] in the Decision on Jurisdiction of 11 July 1997. The "investment" in this arbitration consisted of six promissory notes that had been issued by Venezuela to acknowledge its debt to a Venezuelan corporation for the provision of services supplied under a contract with that corporation. The Venezuelan obligee endorsed the notes to a Netherlands Antilles entity. The tribunal summarised the investment in the following terms: "Venezuela had simply received a loan for the amount of the notes for the period specified therein and with the corresponding obligation to pay interest."[88]

70 The tribunal rejected Venezuela's objections to jurisdiction on the basis of two essential findings:

a) that "loans and other credit facilities are within the jurisdiction of [ICSID] under both the terms of the [ICSID] Convention and the scope of the bilateral investment treaty governing consent in this case"; and

[84] *Genin*, § 365.

[85] *Deutsche Bank*, § 285 ("The Arbitral Tribunal considers that the Hedging Agreement is an asset. It is a legal property with an economic value for Deutsche Bank. It is a claim to money which has been used to create an economic value.")

[86] *Deutsche Bank*, § 522.

[87] *Fedax N.V. v. Republic of Venezuela*, ICSID Case No. ARB/96/3.

[88] Award, § 37.

b) that the fact that the notes had been endorsed by the original Venezuelan obligee to the Claimant, and in particular that funds had not been physically transferred to the territory of the beneficiary, did not cause them to fall outside the jurisdiction of the tribunal. Rather "the important question" being "whether the funds made available are utilized by the beneficiary of the credit … so as to finance its various governmental needs".[89]

71 The tribunal considered that the nature of the particular transactions at issue "serves to distinguish them from an ordinary commercial transaction". They took into account that the notes were issued under the aegis of a law that enabled Venezuela to take credit to raise funds in order "to undertake productive works, attend to the needs of national interest and cover transitory needs of the treasury". It may be worth noting that taken together, these three purposes (and in particular the last), appear to virtually cover the full extent of the legitimate objectives of government borrowing.

72 *Fedax* remained an isolated decision, particularly regarding its second element (the secondary nature of the investment) for nearly fifteen years, until the tribunal in the case of *Abaclat and Others v. The Argentine Republic*[90] considered this same issue in relation to dematerialised government bonds in their Decision on Jurisdiction and Admissibility dated 4 August 2011. The *Abaclat* decision was closely followed by three more decisions which concerned this same issue:

- *Ambiente Ufficio S.p.A. and others v. Argentine Republic*,[91] Decision on Jurisdiction and Admissibility dated 11 February 2013,
- *Giovanni Alemanni and Others v. The Argentine Republic,*[92] Decision on Jurisdiction and Admissibility dated 17 November 2014, and
- *Poštová banka, a.s. and Istrokapital SE v. Hellenic Republic*,[93] Award dated 9 April 2015.

73 This line of decisions has stirred up a heated debate that has caused significant polarization, and is ripe for resolution.[94]

- two awards (*Abaclat* and *Ambiente*) are majority decisions, each with a strident dissenting opinion; and
- the fourth, *Poštová*, takes a position converse to the previous three decisions and consistent with the two dissenting opinions in *Abaclat* and *Ambiente*. This last decision is also subject to annulment proceedings which, although procedurally focused, will inevitably serve to further fuel the underlying substantive debate.

74 While this debate has many facets, it boils down to two essential issues,[95] namely:

a) Whether a sovereign loan, and in particular a sovereign bond in the form of dematerialised securities, falls within the ordinary meaning of the illustrative classes of "investments" listed in the definitions of a typical BIT; and

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89 Award, § 41.

90 ICSID Case No. ARB/07/5.

91 ICSID Case No. ARB/08/9, formerly *Giordano Alpi and others v. Argentine Republic*.

92 ICSID Case No. Arb/07/8.

93 ICSID Case No. ARB/13/8.

94 An extreme example is the discussion of these cases (preceding *Poštová* in time) in Professor Sornarajah's recent book *Resistance and Change in the International Law on Foreign Investment*, C.U.P., 2015, at pages 168 to 173, in which he describes *Abaclat* as "the acme of aberrations" in a line beginning with Fedax which the author described as "a unique award initiating extreme [neo-liberal] adventurism" (at page 171, 172).

95 For present purposes, we set aside a third important issue that arose in the *Abaclat*, *Ambiente* and *Alemanni* cases, namely the issue of permissibility of class (or mass) actions under BITs and the ICSID Convention.

b) Whether such a product, in particular when acquired on the secondary market, must also satisfy an objective test entailing a determination of whether the investment possesses the inherent essential specificity of an "investment". In the context of an ICSID arbitration, this question also requires a tribunal to determine the extent to which these characteristics must be separately satisfied for the purpose of falling within the scope of the ICSID Convention.

75 These two issues, while distinct, are substantially intertwined. A large majority of BITs neither explicitly mentions a dematerialised sovereign bond within their examples of protected investments on the one hand, nor do they contain an explicit requirement of characteristics which are inconsistent with the protection of such an investment on the other. In all such cases, a tribunal has a wide degree of discretion in deciding both the question of whether to apply a test of characteristic investment to the question of protection, and also in deciding to what extent to apply a self-sufficient threshold of characteristics for the purposes of the ICSID Convention (and in what form). Even where such an investment would *prima facie* fall within a listed category of "investment" in a BIT, it has been argued that possession of an investment character is an inherent requirement in any event.[96] In making such an assessment, each member of a tribunal will inevitably be affected by his or her independent presumption regarding the scope of instruments that the contracting states may have intended to protect from a policy perspective, since this determination inevitably calls for both teleological and semantic judgment. Thus, the exercise of subjective economic and political judgment could be considered to be inherent to the process of interpretation of the scope of "investment" under the Vienna Convention, with the obvious exclusion of cases where a BIT or investment contract leaves no room for interpretation.

i) Whether a sovereign loan, in particular a sovereign bond in the form of dematerialised securities, falls within the ordinary meaning of the definition "investments" listed under the definitions of a typical BIT

76 Many, if not the majority of, BITs adopt the approach of defining protected investments by means of a broad *chapeau* (e.g. an introductory statement to the effect that, for the purposes of the BIT, an "investment" shall mean "every kind of asset", "including", "without limitation", etc.) followed by a list of five (or in recent BITs six or more) illustrative categories of assets.[97] Three of these five categories may come under particular scrutiny when interpreting the application of the BIT to dematerialised securities in government bonds, depending on the precise wording of the particular treaty. The categories intrinsically concerned with assets can be described as comprising:

- interests in property;
- companies and interests in companies; and
- claims to performance having an economic value.

[96] See, e.g., Greece's arguments as summarised at § 99 of the *Poštová* award.

[97] For a more detailed treatment of these, see e.g., K.J. Vandervelde, *Bilateral Investment Treaties: History, Policy, and Interpretation*, OUP 2010, at Section 4.2.1, p. 126. Note, however, that the draft of the Trans-Pacific Partnership as of November 5, 2015, included a separate definition of investment under Chap. 11, the Financial Services chapter. Section 11.1 states: "investment means "investment" as defined in Article 9.1 (Definitions), except that, with respect to "loans" and "debt instruments" referred to in that Article:

(a) a loan to or debt instrument issued by a financial institution is an investment only if it is treated as regulatory capital by the Party in whose territory the financial institution is located; and

(b) a loan granted by or debt instrument owned by a financial institution, other than a loan to or debt instrument issued by a financial institution referred to in subparagraph (a), is not an investment;

for greater certainty, a loan granted by or debt instrument owned by a cross-border financial service supplier, other than a loan to or debt instrument issued by a financial institution, is an investment for the purposes of Chapter 9 (Investment), if such loan or debt instrument meets the criteria for investments set out in Article 9.1 (Definitions)".

77 Significant variations exist among BITs in the precise formulation of these categories. By way of illustration, the five cases mentioned above have interpreted and applied three particular bilateral investment treaties in relation to the issues in this section of the report. These are:

- the Netherlands-Venezuela Treaty of 1991 (applied in *Fedax*);
- the Argentina-Italy Treaty of 1990 (applied in *Abaclat, Ambiente and Alemanni*); and
- the Greece-Czech Republic & Slovakia Treaty (applied in *Poštová*).[98]

78 The three above listed categories are defined as follows in the BITs:

	Netherlands-Venezuela Treaty	Argentina-Italy Treaty	Greece-Slovakia Treaty
Interests in property	"movable and immovable property, as well as any other rights in rem in respect of every kind of asset"	"movable and immovable property and any other property rights such as collateral securities over the property of third parties – to the extent they may be used for investment"	"movable and immovable property and any other property rights such as mortgages, liens or pledges"
Companies and interests in companies	"rights derived from shares, bonds, and other kinds of interests in companies and joint-ventures"	"shares, quotas and other holdings, including minority or indirect holdings, in companies incorporated in the territory of one of the Contracting Parties"	"shares in and stock and debentures of a company and any other form of participation in a company"
Claims to performance having an economic value	"title to money, to other assets or to any performance having an economic value"	"bonds, private or public financial instruments or any other right to performances or services having economic value, including capitalized revenues" "credits which are directly related to an investment, lawfully created and documented pursuant to the legislation in force in the State where the investment is made"	"loans, claims to money or to any performance under contract having a financial value"

79 It should be noted that the language used in these definitions contains some potentially material differences when comparing the three. The precise wording used, and the differences between this choice of wording when compared to other BITs, can give rise to a number of issues relating to government-issued securities. Above all, this should be considered in light of the fact that such securities are increasingly both dematerialised and held under contract with a universal depository as opposed to being held in the form of direct title. This gave rise to several questions regarding:

a) The extent to which interests in dematerialised instruments, in particular when held in a fungible form via a universal depository, may be said to comprise property rights. This issue affects not only the jurisdictional question of whether or not such interests fall within the illustrative lists of protected investments, but also substantive questions such as whether or not such interests are capable of expropriation.

b) Whether the fact that the illustrative examples listed in a particular treaty include corporate debt instruments but not sovereign debt instruments might be seen as indicating an intention on the part of the state parties to the treaty to exclude the latter. (This was successfully argued, for instance, by Greece in the *Poštová* case.)

[98] The *Poštová* tribunal also applied the Greece-Cyprus BIT of 1992 in relation to Istrokapital's claim, but only *obiter* regarding the issues addressed in this memorandum.

c) Whether the fact that a treaty refers, for instance, simply to "loans, claims to money or to any performance under contract having a financial value" (as in the Greece-Slovakia treaty) as opposed to "titles to money" (as in the Netherlands-Venezuela BIT) or to "private or public financial instruments or any other right to performances" (as in the Argentina-Italy BIT) might be an indication that the state parties intended to address protection only to debt arising from a contract directly between the issuer and the investor (as was reasoned by the *Poštová* tribunal). This brings into question the extent to which the investor might be said to have rights of a contractual nature or other civil law claim against the issuer.

d) Whether such secondary market investments fail to satisfy an explicit or implicit territorial requirement. Diverse considerations have been argued to be relevant in this respect, including:

- the fact that the instrument is governed by a foreign law and/or a choice of foreign jurisdiction;
- the fact that the instrument was purchased on a foreign exchange and/or on a secondary market such that no funds have physically moved into the respondent's territory; and/or
- the fact that the instrument is held via a universal depository in a third jurisdiction (e.g. through *ClearStream* in Luxembourg).

80 It would be reasonable to expect that an international tribunal faced with interpreting a BIT to determine these issues should, as a means of understanding the terms used in the treaty in their proper context, investigate what the illustrative examples would mean to a commercially experienced lawyer qualified under the laws of the state parties involved, and in particular, those of the host state. Yet, the BIT tribunals that have been engaged thus far have not especially attempted to gain such an understanding. Instead, they have attempted to deal with these issues on a more abstract level.

81 Moreover, a conscientious tribunal with regard to interpretation would still be faced with significant interpretative difficulties. As summarised in the opening justification of a comprehensive report prepared over 15 years ago on the question of conflicts of laws in relation to security instruments:

> In most jurisdictions, neither the substantive laws governing securities transactions nor the rules determining the law applicable to such transactions have been updated adequately to reflect this market reality [of an evolution to indirect holding systems]. In other words, in most countries the legal regime currently in place to cope with the indirect holding system dates back, to a greater or lesser extent, to a time when securities were still directly held in certificated form by investors. The concepts of (physical) possession and delivery, however, do not operate satisfactorily in the context of the modern indirect holding system, as there can be no actual possession or delivery of the intangible property interests arising under that system.[99]

82 This position has now been remedied in a number of municipal laws, at least to the extent required to resolve potential complications regarding pledges and insolvency. Still, even to the extent that these have been resolved, the difficulty of interpretation is compounded by two further factors:

a) conflicts of laws principles may lead to the application of two or more national systems to these issues; and

b) many investment treaties predate the evolution of market practice to indirect holding systems.

[99] *The Law Applicable to Dispositions of Securities Held Through Indirect Holding Systems*, Preliminary Document No 1 of November 2000 prepared for the Working Group of January 2001, Hague Conference On Private International Law, at p. 3.

83 It may also be that existing awards can be seen (at least in part) as suffering from inconsistencies or logical errors. For instance, it is the logical consequence of the *Poštová* tribunal's reasoning that, while the state parties to the Greece-Slovakia BIT intended that sovereign bonds should *not* be protected, sovereign guaranteed corporate bonds should indeed be protected. It is questionable whether this view reflects either economic or political reality.

84 It may therefore be concluded that, on the basis of the present state of treaty language and national laws, resolving these issues on a purely semantic basis is likely to prove unsatisfactory or, at the very least, the results will be unpredictable. At the same time, the application of a teleological approach has been perceived as leading to contradictory and, at times, internally inconsistent or illogical results.

85 The recent process of drafting and creating treaties has begun to address these issues explicitly. For instance, the draft "Consolidated CETA Text", made publicly available by the European Commission on 26 September 2014,[100] explicitly includes restructuring of a state Parties' debt within the scope of the jurisdiction of Investor-State Dispute Resolution,[101] while explicitly excluding claims arising out of rescheduling or restructurings that have been "effected through (a) a modification or amendment of such debt instruments, as provided for under its terms, including their governing law, or (b) a debt exchange or other similar process in which the holders of no less than 75 per cent of the aggregate principal amount of the outstanding debt subject to restructuring have consented to such debt exchange or other process".[102]

86 More recently, the European Commission made a proposal for revising the chapter on "Investment" in the draft TTIP text.[103] In a similar fashion, the text also excludes claims for such rescheduling or restructuring (which it terms "negotiated restructuring"), provides for a lower threshold ("holders of no less than 66% of the aggregate principal amount") and suggests cross-instrument aggregation by referring to "debt instruments" in plural form.

87 These modifications from the CETA draft text appear to stem from the experience of the Greek restructuring of 2012. Interestingly, while the European Commission's draft proposal contains no explicit reference to restructurings, in contrast to the CETA text, the exclusion of "negotiated restructurings" implies that public debt not falling within that exclusion is, in essence, within the classes of assets protected by the investment chapter. This is clearly contrary to the reasoning of the *Poštová* tribunal. This is the case despite the fact that the definition of "investment" (page 1 of the TTIP proposal) is "every kind of asset … that has the characteristics of an investment". This was not a requirement of the treaty applicable in the *Poštová* case. Lastly, in the draft text of the TPP, there are explicit exclusions for debt restructuring, limiting claims over a negotiated restructuring solely to protections of national treatment or most-favoured-nation treatment.[104] Furthermore, a claimant is required to wait until "270 days have elapsed from the date of receipt by the respondent of the written request for consultations" before filing any claim for breach of the treaty due to the restructuring of debt (with an exception provided for claims for national treatment and most-favoured-nation treatment).[105]

[100] Draft "Consolidated CETA text", available at http://trade.ec.europa.eu/doclib/docs/2014/september/tradoc_152806.pdf.

[101] Ibid., Section 6: Investor-State Dispute Resolution, Article X.17: Scope of a Claim to Arbitration.

[102] Ibid., Annex 8-B: Public Debt.

[103] The draft text TTIP investment chapter is published unilaterally by the European Commission as an "internal document" at http://trade.ec.europa.eu/doclib/docs/2015/september/tradoc_153807.pdf.

[104] Annex 9-G, "Public Debt" of the TPP draft text, § 2, made publicly available on November 5, 2015.

[105] Ibid., § 3.

88 If these three recent treaty texts are any indication of developing state practice in general, there seems to be an acceptance, in principle, of the notion that sovereign bonds fall within the scope of a protected investment. However, it is also clear that there is a need to carve out a clear "policy space" for negotiated rescheduling and restructurings approved by (at a minimum) a stipulated majority of bondholders, so as to specifically address the perceived problem of minority "holdout" creditors.

(ii) Whether such a product, particularly when acquired on the secondary market, has the characteristics of an "investment"

89 The second essential issue identified in the debate regarding the investment protection of sovereign loan instruments is whether the application of a BIT or the ICSID Convention to a dispute requires the tribunal to determine whether such possess the threshold characteristics of an "investment". If so, it is to be determined what criteria would apply and how sovereign loan instruments may typically measure up to such criteria.

90 Under the applicable BIT. As one commentator observed, "the legal definition of investment as it appears in the BITs is not necessarily coextensive with the economic definition". The latter being defined as "an increase in capital stock, that is, an increase in the productive capacity of an economy".[106] As mentioned above, this has produced a line of both argument and precedent, inducing the notion that an investment must satisfy an objective test to show that it possesses the essential characteristics of an "investment". This remains the case regardless of whether or not it is determined to fall within one of the illustrative categories of investment listed in the definition of "investment" within a typical BIT, and regardless of whether or not the BIT itself explicitly requires the possession of such a characteristic.

91 The different issues that arise in relation to investment disputes concerning sovereign bond instruments are clearly illustrated by the respondent's arguments in the *Poštová* arbitration. As summarised by the tribunal in its award/decision, Greece argued that *Poštová*'s interests in sovereign bonds lacked the objective characteristics of a protected investment since:

a) They had been purchased by way of secondary market transactions that did not involve the flow of funds to the host state. As the respondent argued in that case, "the sums paid to the Hellenic Republic by the underwriters cannot possibly be characterized as 'advance payments' of the purchase price paid by *Poštová* Banka in the course of the GGB interests' ordinary trading, long after completion of the bond issuance and distribution process".

b) They had been speculative commercial transactions that had not involved any investment risk or any term commitment of resources.

c) They lacked the requisite territorial connection with the host state. Moreover, the *situs* of these interests, which had been held through a universal depository, was the place where that depository or clearer was established, not the seat of the issuer or place of registration of the original instrument.

92 These arguments were largely accepted by the tribunal in reaching its determination that dematerialised bond securities acquired on the secondary market after the conclusion of the "initial issue process" were too remote from the chain of economic benefit to Greece to be "permissible" objects of protection within the ordinary meaning of investment.[107]

[106] Taken from Vandervelde, supra note 97, at p. 122.

[107] *Poštová*, Award, §§ 248-371 (discussing Greece's objection to jurisdiction *ratione materiae* under both the BIT and Art. 25 of ICSID).

93 This determination is radically different from the conclusions reached at the jurisdictional stage in each of the *Abaclat, Ambiente* and *Alemanni* disputes, despite the fact that these disputes share factually similar circumstances. For example, the tribunal in *Alemanni*, drawing on the two prior decisions, robustly determined the following, at least for the purpose of disposing of the jurisdictional objections:

> It is sufficient for the Tribunal to hold that the original asset held by the underwriting banks was undoubtedly capable *ratione materiae* of falling within the definitions in Article 1; all further questions as to the precise nature of the individual assets of the individual Claimants fall under the same analysis as in paragraph 293 above, and could only be assessed by the Tribunal on the basis of full argument at the merits stage".[108]

94 Characteristics required under the ICSID Convention. The awards to date present a similar disparity of opinion concerning the question of whether such holdings satisfy the jurisdictional threshold at Article 25(1) of the ICSID Convention.

95 For instance, the tribunal in *Alemanni* determined that:

> Nothing in the ICSID Convention itself presents an obstacle to considering that bonds are capable of constituting investments; the Tribunal notes in this regard that, when the Convention was under negotiation, sovereign bonds were actually used as an example of the potential breadth of the Convention's reach in terms of what sorts of future dispute could be put before an ICSID tribunal.[109]

96 In this context, the tribunal opined that:

> During the consultations with legal experts in Bangkok, Thailand, in the context of a discussion of applicable law, the Bank's General Counsel, Aron Broches, observed: "There was no doubt that a foreign bond issue by a country constituted an investment by the foreign investors in that country but it would not necessarily be governed by local law".[110]

97 In stark contrast, the *Poštová* tribunal reasoned, in an *obiter dicta*, that, if they were to analyse the bond interests in light of the "objective" ICSID test – contribution, duration, risk – they would have determined that the claimants did not have an investment under the ICSID Convention. In reaching this conclusion, they said that they would have placed "particular emphasis" on the following circumstances:

- an investment, in the economic sense, is linked with a process of creation of value, which clearly distinguishes it from a sale [§361]; and
- the investment lacked the existence of a specific operational risk that is essential to a protected investment under an "objective" test [§371].

B Jurisprudence concerning commodity hedging agreement entered into between a state and an investment bank

98 It appears that, thus far, only the arbitral tribunal in *Deutsche Bank AG v. Democratic Socialist Republic of Sri Lanka*, ICSID Case No ARB/09/02, 31 October 2012 ("Deutsche Bank Award"), and the respective Dissenting Opinion of 23 October 2012 ("Dissenting Opinion"), have touched upon the issue of whether commodity hedging and analogous 'speculative' agreements may qualify as protected investments. Since both the Award and the Dissenting Opinion concur that the issue is best dealt with by adopting the double-barrel test (i.e. to first establish the existence of an investment under the applicable BIT and to then do so under Article 25 ICSID Convention), we have adopted the same approach in this report.

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[108] *Giovanni Alemanni and Others v. The Argentine Republic*, Decision on Jurisdiction and Admissibility dated 17 November 2014, § 296.

[109] Id.

[110] Id., citing Documents Concerning the Origin and Formulation of the Convention, Vol. II, Part 1, p. 514, at fn. 143.

(i) Commodity hedging and analogous 'speculative' agreements as protected investments under BITs

99 In the Treaty between the Federal Republic of Germany and the Democratic Socialist Republic of Sri Lanka concerning the Promotion and Reciprocal Protection of Investments of 7 June 2000 (Germany/Sri Lanka BIT), the definition of investment set out in Article 1 reads in relevant part:

> 1. The term "investment" comprises every kind of asset in particular:
> ...
> c) claims to money which has been used to create an economic value or claims to any performance having economic value and associated with an investment.

100 Similar language can be found in other treaties.

101 The *Deutsche Bank* tribunal found that the hedging agreement in dispute was a protected asset under the Germany-Sri Lanka BIT, constituting legal property with an economic value for the claimant, and a claim to money which had been used to create economic value.[111] In turn, the arbitral tribunal rejected the respondent's narrow construction of the definition of investment, which excluded hedge agreements from the Germany-Sri Lanka BIT's scope of protection.[112]

102 Relying on the interpretation of the wording of Article 1 of the Germany-Sri Lanka BIT, the Dissenting Opinion denied that the hedge agreement was a protected investment, on the basis of a finding that the two determinative criteria under the BIT – namely, that the claimant's monetary claim (i) had been used to create an economic value and (ii) was associated with an investment – had not been satisfied. According to the Dissenting Opinion, the claim did not reflect the economic value of any money that the claimant had either used or paid to its contracting party, and was merely a form of early termination penalty. The claimant's actual payments amounted to only a fraction of the claim and, therefore, could not constitute the economic value in dispute.[113] Moreover, the dissenting arbitrator found that, because the hedge agreement was only a financial instrument (i.e. a contract), the claimant's monetary claim was not associated with an investment and therefore fell outside the scope of the Germany/Sri Lanka BIT.[114] This determination was made on the basis of the finding that a contract cannot be a protected investment unless it is related to an asset that qualifies as investment (e.g. moveable, immoveable or intellectual property).

103 The *Deutsche Bank* tribunal found that the hedge agreement in dispute had a sufficient territorial connection with Sri Lanka. In the process of reaching this conclusion, the tribunal endorsed the test applied in *Abaclat,*[115] in the sense that the relevant consideration should be: how and/or for whose benefit the funds are ultimately used, and not the place where the funds were paid out or transferred.[116] In applying this test, the *Deutsche Bank* tribunal found that a territorial nexus was established because the preliminary engagement took place in Sri Lanka and it was also there that the investment had its most significant impact.[117] Funds paid by the claimant to the contracting party had been made available in Sri Lanka, were linked to activity taking place in Sri Lanka, and served to finance Sri Lanka's oil needs and, consequently, its economy.

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[111] *Deutsche Bank* Award, § 285.

[112] *Deutsche Bank* Award, § 286.

[113] Dissenting Opinion, § 27 et seq.

[114] Dissenting Opinion, § 30.

[115] *Abaclat and others v. Argentine Republic*, ICSID Case No. ARB/07/5, Decision on Jurisdiction and Admissibility, 4 August 2011, referenced and discussed above.

[116] *Abaclat*, § 374.

[117] *Deutsche Bank* Award, § 291.

(ii) Commodity hedging and analogous 'speculative' agreements as protected investments under Article 25 ICSID

104 In establishing its jurisdiction under Article 25 ICSID, the *Deutsche Bank* tribunal addressed two sets of questions. First, it applied general indicia that have developed in arbitral jurisprudence in relation to Article 25 ICSID. Thereafter, it addressed the validity of the hedge agreement as a jurisdictional issue.

105 The application of Article 25 of the ICSID Convention. As far as relevant case law on the topic, at the outset, the *Deutsche Bank* tribunal emphasised that it would apply only three of the "Salini indicia" to establish its jurisdiction in order to hear the case.[118] In its view, it was not for an arbitral tribunal to issue a finding as to whether an investment makes a contribution to the economic development of the host state.[119]

106 According to the *Deutsche Bank* tribunal, the remaining criteria, however, were satisfied. To begin with, the tribunal found that the hedge agreement in dispute involved a dedication of resources to Sri Lanka. Such a dedication of resources may take any form. In this case the tribunal found that the claimant's commitment to pay up to USD 2.5 million to its counterparty provided that the oil price exceeded a certain threshold, qualified as a contribution.[120] Moreover, the claimant had paid USD 35,523 under the hedge agreement. Lastly, the tribunal found that the claimant had dedicated substantial resources such as personnel to the execution of the hedge agreement that should also be regarded as a contribution.[121] The tribunal also found that the claimant's investment involved a risk, because it had faced the risk of paying its contracting party USD 2.5 million.[122] With regard to the duration requirement, the tribunal noted that the intended duration of the hedge agreement was 12 months, which it considered as being a sufficient period of time.[123]

107 Regarding the application of the "Salini indicia", the dissenting arbitrator did not endorse the majority's stance that a contribution to the development of the host state's economy was an impractical consideration that should be disregarded. In the dissenting arbitrator's view, contribution to the development of the host state's economy should be analysed in conjunction with the investor's dedication of resources.[124] In the case under consideration, the Dissenting Opinion reasoned that such contribution to the development of the host state's economy could not be conclusively established, yet, on the contrary, the dissenting arbitrator found that the hedge agreement had the potential to adversely impact the host state's economy.[125] In addition, there could have been no existing investment at the moment of the execution of the hedge agreement, given that such an agreement only created options depending upon uncertain future events. Relying on *PSEG Global Incorporated and others v. Republic of Turkey*, ICSID Case No ARB/02/5, the dissenting arbitrator found that options did not qualify as monetary claims.[126] The payment of USD 35,523 under the hedge agreement, therefore, did not qualify as a relevant contribution - that payment having been triggered by the development of the oil price. However, at the

[118] As stated by the *Deutsche Bank* tribunal, the "Salini indicia" consist of five criteria originally suggested by the *Fedax* Tribunal and re-emphasised by the *Salini v. Morocco* Tribunal for the purpose of defining "investment" under the ICSID Convention, "namely (i) a substantial commitment or contribution, (ii) duration; (iii) assumption of risk; (iv) contribution to economic development; and (v) regularity of profit and return, in order to determine the Tribunal's jurisdiction under Article 25(1)." *Deutsche Bank* Award, § 294.

[119] *Deutsche Bank* Award, § 295, 306.

[120] *Deutsche Bank* Award, § 298.

[121] *Deutsche Bank* Award, § 300.

[122] *Deutsche Bank* Award, § 302.

[123] *Deutsche Bank* Award, § 304.

[124] Dissenting Opinion, § 48.

[125] Dissenting Opinion, § 57.

[126] Dissenting Opinion, § 58 et seq.

moment the parties executed the hedge agreement, it was uncertain whether the claimant would be obliged to make any payment at all.[127] The claimant's dedication of human resources, in the dissenting arbitrator's view, also lacked relevance given that the financial instrument itself had to be evaluated.[128] The result of the majority view would be that almost every economic activity would fall within the scope of Article 25 ICSID, and this result would run counter to the purpose of the ICSID Convention.[129]

108 Validity of the hedge agreement as a jurisdictional issue. In its defence, the host state argued that the tribunal lacked jurisdiction under Article 25 ICSID because the hedge agreement was claimed to be invalid. This contention may be broken down into two distinct allegations, namely that the contracting state entity had acted *ultra vires* by finalizing agreements that were not incidental or conducive to its purpose and that it had engaged in economic speculation.

109 To the question whether the hedge agreement was incidental or conducive to the purpose of the state entities, the *Deutsche Bank* tribunal found that the relevant standard of review was whether a reasonable board could have genuinely considered that the transaction was incidental and conducive to the state entity's business.[130] Against the background that the state entity had been empowered for the primary purpose of undertaking hedging agreements and that it had been further authorised to change the hedging agreements based on market developments, the *Deutsche Bank* tribunal found that, at the time the state entity executed the hedge agreement in dispute, it had formed the view in good faith that such agreement was capable of falling within its corporate objectives and was therefore incidental and conducive to its business.[131]

110 To the question concerning the speculative nature of the hedge agreement, the tribunal recognised the necessity that such a distinction had to be drawn from the outset, given that the claimant had concurred with the notion that a state entity is not empowered to enter into a purely speculative agreement.[132]

111 The tribunal employed a two-pronged test to draw the line between speculation and hedging. The first being that the hedge should reduce the risk of the hedger - if a transaction increases risk or exposure, then it is speculation. Secondly, the hedger must have an underlying exposure to the physical market relevant to the hedge, and as a result the hedge manages (i.e. reduces the uncertainty of) that underlying exposure.[133] The tribunal found that both elements were present. Being an oil importer, the state entity had a physical position to protect and an underlying exposure or risk to fluctuations in the oil price. It had sought to manage this exposure through the hedging agreement. Furthermore, the hedging agreement had not increased or extended the state entity's exposure as the amount being hedged was always less than the state entity's physical exposure. Therefore, it was reflective of the already existing exposure.[134]

[127] Dissenting Opinion, § 60.

[128] Dissenting Opinion, § 61.

[129] Dissenting Opinion, § 73 et seq.

[130] *Deutsche Bank* Award, § 316.

[131] *Deutsche Bank* Award, § 321.

[132] *Deutsche Bank* Award, § 204.

[133] *Deutsche Bank* Award, § 327.

[134] *Deutsche Bank* Award, § 328.

112 In turn, the tribunal rejected drawing a distinction based on subjective criteria such as the subjective meaningfulness of the risk reduction occasioned by the hedge agreement.[135] It found that, as the meaningfulness may vary depending on the circumstances, only a court or a tribunal could establish with certainty whether the transaction is a hedge or amounts to speculation.[136]

113 In summary, there have been five investment treaty arbitrations concerning sovereign debt products that have reached the stage of a binding decision on issues which are material to this report. *Fedax* was an isolated decision on the secondary nature of the investment for nearly fifteen years, until *Abaclat* considered this same issue in relation to dematerialised government bonds. *Abaclat* was followed by three decisions concerning this very same issue: *Ambiente, Alemanni*, and *Poštová*. While these decisions caused an extensive heated debate, the disagreement essentially boils down to two issues: whether a sovereign bond in the form of dematerialised securities falls within the ordinary meaning of "investment" listed in the definition of a typical BIT; and whether such a product, in particular when acquired on the secondary market, must also satisfy an objective test entailing a determination as to whether the investment possesses the characteristics of an "investment." As to commodity hedging agreements, it seems that only one case, *Deutsche Bank*, touched upon whether these agreements may qualify as protected investments.

INVESTMENT ARBITRATION AND THE REGULATION OF FINANCIAL INSTITUTIONS

114 In this section we will set out our observations with regard to the key investment arbitration awards that have addressed claims related to the regulation of financial institutions (excluding jurisdictional issues, which are addressed in section D below). This is a relatively recent development and one that has spurred interest within the banking community.

A Summary of findings

115 There are a number of key factors that should be kept in mind when analysing the use of investment arbitration in the context of the actions taken by financial entity regulators.

116 In the first place, financial entities are, by their very nature, subject to substantial domestic regulation in virtually all countries. This is an area where there is a financial public interest in regulation and an expectation that regulation will be substantial and detailed. Therefore, the issue of when regulatory activity may give rise to an investment arbitration claim almost invariably involves a balancing of legitimate regulatory interests with interests that are not necessarily perceived as being legitimate.[137]

117 Secondly, financial entities often bear the brunt of regulations that are intended to provide support for the economy on a general level, but do not focus solely on financial entities in the process. For example, in the case of capital or foreign exchange controls, regulations may be imposed on financial institutions because they serve as a means to transfer capital and foreign exchange in and out of a country, even if the actual objective is to regulate capital outflows and inflows for all persons in the country.

118 Thirdly, there is an overlap in some situations between regulatory activities and the sale by state authorities of financial assets. Although these also frequently relate to regulation, they are not the subject matter of this analysis.[138]

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[135] *Deutsche Bank* Award, § 332 et seq.

[136] *Deutsche Bank* Award, § 335.

[137] *Renée Rose Levy de Levi v. Republic of Peru,* ICSID Case No. ARB/10/17, Award dated 14 February 2014, § 157ff.

[138] For an illustration, see *Československa obchodní banka, a.s v. Slovak Republic*, ICSID ARB/97/4, Award dated 29 December 2004.

119 In view of the public interest inherent in financial regulation, investment arbitration tribunals have generally shown deference to what is viewed as legitimate regulatory activity with respect to financial institutions. Nevertheless, there are circumstances in which a state may be held liable for the improper regulatory activities of state agencies. For example, financial entities are generally dependent on licenses from the relevant regulatory authorities and, in certain circumstances, revocation of these licenses can amount to an indirect expropriation or other breach of international investment law. In the case of *Antoine Goetz v. Republic of Burundi*,[139] in particular, the tribunal held that the respondent indirectly expropriated a financial entity through the termination of the financial entity's banking and free zone license. In that case, the tribunal held that there had been violations of the regulation by the relevant entity, but that they did not justify termination of the respondent's activities as a financial entity.[140] This approach addresses the threat or actual withdrawal of the relevant license of a financial institution, and has broad application as being a potentially major sanction in financial centres on an international level. This may lead to potential disputes, the first being between the financial entity and the regulator itself. With respect to the latter, it is not clear whether regulators in major financial centres have considered the issue, although it was a factor in *Antoine Goetz*.

120 In *Alex Génin v. Republic of Estonia*, the investor had an interest in a company (EIB) that had purchased the Koidu branch of a bank, which led to various claims being brought that were rejected, and a central claim regarding revocation of EIB's license. The tribunal held that the banking authorities "had good reason to be critical of various aspects of EIB's business and operations".[141] The tribunal held that the Bank of Estonia acted within its statutory discretion, but as to certain practices of the Estonian authorities, stated that: "while they do conform to Estonian law and do not amount to a denial of due process, can be characterized as being contrary to generally accepted banking and regulatory practice".[142] However, this did not amount to the breach of any provision of the BIT.

121 In addition to the approach adopted by the tribunal in *Saluka v. Czech Republic* (discussed in relation to FET, supra), there is an interesting analysis of the investment law standards for regulatory activities set out in the Award issued in *Renée Rose Levy de Lévi v. Republic of Peru*.[143] The *Levy de Lévi* case involved a bank in Peru which had failed in the midst of a financial crisis, and was ultimately made subject to regulatory liquidation. The claimant was a French national and alleged that other banks owned by Peruvian nationals had received more favourable treatment in certain bailout programmes.

122 In *Levy de Lévi*, the tribunal analysed the regulatory activities of the banking authorities in Peru in detail, with the majority arriving at the conclusion that there was no valid claim under the relevant BIT. In reaching that conclusion, the majority agreed with the claimant that the role of international law deals with "controlling the legality of the State's actions under the criteria of proportionality and lack of arbitrariness" and that in case of conflict, international law should prevail over national or state made (i.e. internal) law.[144] However, the majority made a distinction between the situation of several other banks (for which different levels or forms of assistance were apparently provided) and that of the bank which brought the claim. The dissenting arbitrator set out a detailed analysis and emphasised, in particular, the different treatment accorded to the other banks which he found to be in an analogous situation.[145] Therefore, there was a common understanding

[139] ICSID ARB/01/2, Award dated 8 June 2012.

[140] Id., at § 258. A similar issue seems to have arisen in *Belokon v. Kyrgvz Republic* UNCITRAL (Award dated 24 October 2014). However, the award does not appear to be publicly available.

[141] *Alex Genin, Eastern Credit Limited, Inc. and A.S. Baltoil v. Republic of Estonia*, ICSID Case No. ARB/99/2, § 357.

[142] Id., at § 364.

[143] ICSID ARB/10/17, Award dated February 14, 2014.

[144] Id., at §§ 482 and 483.

[145] Id., Dissenting Opinion,§§ 184-187.

among the members of that tribunal that regulatory conduct in the financial sector should be subject to an extremely detailed review. One important difference within the tribunal relating to the class (i.e. categorization) of financial institutions is used for comparative purposes. Both of these issues are likely to re-surface in the future.

123 In *Deutsche Bank AG v. Sri Lanka* (ICSID Case ARB/09/02 - discussed in section above), the issue related to a hedging agreement between the claimant and a state-owned entity pursuant to which the state-owned entity was required to make payments to the claimant. The respondent accepted that it did not have authority to regulate Deutsche Bank London[146] but maintained that it did have the right to regulate the hedging agreement based on its general regulatory authority. However, by using its authority to regulate Deutsche Bank Colombo, the Central Bank launched an investigation and issued a stop-payment order with respect to the hedging agreement. The tribunal, by majority decision, found that the investigation was commenced in bad faith after the respondent's government had decided not to permit payments under the hedging agreement in any event.[147] The majority of the tribunal also noted anomalies of procedure and timing,[148] and determined that there was no legal basis for the stop-payment order.[149]

124 For the majority of the tribunal, this combination of factors amounted to a breach of the fair and equitable treatment standard and expropriation of the claimant's interest in the hedging agreement.[150] In particular, regarding expropriation, the majority cited authority for the application of the principle of proportionality in regulation and stated that Sri Lanka's taking of Deutsche Bank's rights under the hedging agreement "was a financially motivated and illegitimate regulatory expropriation by a regulator lacking in independence".[151]

B Conclusions regarding investment arbitration and regulatory matters

125 As a general rule, investment arbitral tribunals have shown considerable deference to what is viewed as normal regulatory activity of states with respect to financial entities. This appears to result from the acceptance by tribunals of a need for detailed regulation of financial entities as well as certain common national and international standards with respect to those needs, and how to address them appropriately.[152]

126 Tribunals have shown much less deference where there appears to have been discriminatory or arbitrary regulatory activity by states towards foreign financial entities, or financial entities subject to foreign control.[153]

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[146] *Deutsche Bank* Award, § 467.

[147] *Deutsche Bank* Award, § 483 and 484.

[148] *Deutsche Bank* Award, § 485 to 489.

[149] *Deutsche Bank* Award, § 490. "The Stop-Payment Order does not mention on which legal basis it is issued. Mr. Nanayakkara [a government official of the Respondent] testified that it was based on Section 46 of the Banking Act. However, this Section does not confer to the Central Bank the power to suspend a contract entered into by a bank but only to take necessary measures in order to guarantee the soundness of the banking system. The Central Bank therefore acted in excess of its powers." (Citations omitted.)

[150] *Deutsche Bank* Award, § 491 and 520ff.

[151] *Deutsche Bank* Award, §524. The dissenting arbitrator disagreed on virtually all counts, ranging from the issue of whether there was investment to whether there had been an expropriation. However, with respect to the Central Bank's action, the dissent simply denies causation stating: "119. Insofar as the investigations conducted by the Central Bank are concerned, even if these can be said to have been arbitrary or unfair, these cannot without more lead to an award of the damages accorded by the majority. There being no causality between the investigation and the damages claimed by and awarded to the Claimant, it is not clear how these investigations could lead to an award of damages of 60,368,993 USD plus interest."

[152] See, e.g. *Continental Casualty Company v. Argentina*, *Renée Rose Levy de Levi v. Peru*, *Invesmart v. Czech Republic*; and with respect to certain matters – notably, the suspension of the trading of certain securities –*Saluka v. Czech Republic*.

[153] See, e.g., *Goetz v. Burundi*, *Belokon v. Kyrgyz Republic*, and, regarding certain regulatory decisions – notably, the regulator's approach to bad debts in financial institutions – *Saluka v. Czech Republic*.

127 The issues discussed above turned out to be most acute where there has been a general or a country-specific financial crisis. However, as with investment arbitration generally, there are substantial differences in approach by different tribunals in this area.

128 Most of the awards that the working group reviewed have been issued during the last three to five years. In addition, some of the issues, such as the results of the financial difficulties in 2008, or those relating to Cyprus or Greece, are still underway. This is no area where the law is settled or established. Rather, it remains to be determined, and it is important to continue to monitor the evolution of law in this context into the future.

SUITABILITY OF INVESTOR-STATE DISPUTE RESOLUTION FOR DISPUTES BETWEEN FINANCIAL INSTITUTIONS

129 Many (if not most) of the IIAs were entered into at a time when capital importing states were keen to attract foreign direct investment. A. Newcombe and L. Paradell state that IIAs were based on the fact that:

> Capital-exporting states sought to obtain better market access commitments from capital importing states for investors and investment, and to obtain progressive development in the standards of investment protection. As already noted, although there were early efforts to create an international framework for foreign investment, disagreement between capital exporting and importing states about standards of treatment for foreign investors derailed the conclusion of a multilateral treaty. As a result, capital exporting states began concluding BITs dedicated to foreign investment promotion and protection.[154]

130 Over time, the types of foreign direct investments seeking protection under IIAs have evolved from the traditional mining, oil and gas, or production sectors (brick-and- mortar industries) to include investments in financial institutions and financial products.

131 As a result, investors in financial institutions and their products are not clearly subject to the protections offered in the relevant bilateral investment treaties (BITs) and free trade agreements (FTAs). The definition of investment which is almost always contained in the first article of any BIT tends to be circular and designed to cover investments belonging to a different era. Such an ill-suited definition has not deterred investors in bringing claims, but it has made for murky waters, especially when it comes to the predictability of investment protection for financial institutions and their products.

132 On the one hand, cases such as *Fedax* (promissory notes),[155] *Abaclat* (sovereign bonds and securities),[156] *Renee Rose Levy de Levi* (interests in a local financial conglomerate owning a local bank), [157] *Alastair Ross Anderson* (deposits in a local currency exchange office),[158] and *CDC Group* (loan agreements) [159] found that jurisdiction *ratione materiae* did exist.

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[154] Andrew Newcombe and Lluis Paradell, 'Law and Practice of Investment Treaties Standards of Treatment', Kluwer Law International BV, The Netherlands, 2009, page 41.

[155] *Fedax N.V. v. Republic of Venezuela*, ICSID Case No. ARB/96/3, Decision of the Tribunal on Objections to Jurisdiction, July 11, 1997.

[156] *Abaclat and Others v. The Argentine Republic*, ICSID Case No. ARB/07/5 (formerly *Giovanna a Beccara and Others v. The Argentine Republic*), Decision on Jurisdiction and Admissibility, August 4, 2011; and see, *Ambiente Ufficio S.p.A. and Others v. Argentine Republic*, ICSID Case No. ARB/08/9 (formerly *Giordano Alpi and others v. Argentine Republic*), Decision on Jurisdiction and Admissibility, February 8, 2013.

[157] *Renée Rose Levy de Levi v. Republic of Peru*, ICSID Case No. ARB/10/17, Award, February 26, 2014.

[158] *Alasdair Ross Anderson et al v. Republic of Costa Rica*, ICSID Case No. ARB(AF)/07/3, Award, May 19, 2010.

[159] *CDC Group plc v. Republic of the Seychelles*, ICSID Case No. ARB/02/14, Award, December 17, 2003.

133 On the other hand, the recent *Istrokapital* tribunal found that Greek government bonds were not an investment under the Slovakia-Greece BIT, and thus that it did not have jurisdiction to hear the claims brought by the claimant.[160] In particular, the tribunal found that "sovereign bonds are different from forms of participation in corporations, and therefore their exclusion from the definition of investment in a given treaty indicates that the contracting parties did not intend to cover these types of assets".[161]

134 A new era of treaty negotiation is necessary to clear up uncertainties. Otherwise, a system without *stare decisis* will continue to reincarnate and recycle outdated principles of law, similar to Hydra. However, this recent case law and the background of some financial crises have prompted the drafters of various international instruments to refer specifically to financial instruments. Thus, states seem to be increasingly sceptical when it comes to sovereign debt restructuring, and allowing an international arbitral tribunal to decide on these types of issues following the actions of sovereign states.

135 Indeed, there is a noticeable trend towards restricting the scope of BITs and FTAs when it comes to financial instruments.

136 For example, in the Canada Model FIPA (2004), Article 21 restricts claims related to investments in financial institutions. Article 29 requires disputes related to financial institutions to be decided by arbitrators, with additional requirements in place as well.[162]

137 On the other hand, in the case of the U.S. Model BIT, and during the course of the preparation of the 2004 version of the U.S. Model BIT, the Subcommittee on Investment made recommendations regarding the definition of investment as it applied to particular financial products:

> Members who represent financial service firms recommend that the State Department clarify that the forms of investment enumerated in item (d), "futures, options, and other derivatives," also include "forward contracts" and "swaps". Although forward contracts and swaps fall within the definition of "other derivatives", the listing of these important financial products would provide greater certainty that they qualify as "investments" under the draft model BIT.[163]

138 However, as seen in the 2012 U.S. Model BIT, drafters did not adopt the recommendations of the Members of the Subcommittee on Investment to include forward contracts and swaps within the definition of investment.

139 It is in free trade agreements (FTAs) and multilateral trade agreements (MTAs) that the impact and the changes have perhaps been most significant, probably due to the wider scope of such treaties and the step-by-step negotiation techniques used. Thus, all the clauses are closely scrutinised and debated. Moreover, the idea of clauses having a broad scope is disfavoured, particularly in the context of financial instruments.

[160] *Istrokapital v. Hellenic Republic*, 350 ("the Tribunal concludes that it lacks jurisdiction *ratione materiae* to entertain this dispute.")

[161] *Istrokapital v. Hellenic Republic*, 333.

[162] Additionally, the Canada Model FIPA provides for specific characteristics of arbitrators deciding disputes between the Parties to the FIPA for disputes related to financial institutions (*see* Article 48(6)).

[163] Report of the Subcommittee on Investment Regarding the Draft Model Bilateral Investment Treaty.

140 For example, the Canada-EU Comprehensive Economic and Trade Agreement (CETA) has reached the stage of a successful political agreement between both parties, but has not yet been ratified. Financial services and investment provisions have played a prominent role during the negotiations and remain a disputed area. As to ISDS, the CETA has taken a progressive approach towards defining the rights that are capable of protection:

> Unlike other agreements, the standard of "fair and equitable treatment" in CETA is neither a floor or a minimum standard nor an evolving concept. Rather, a clear, closed text defines precisely the standard of treatment without leaving unwelcome discretion to arbitrators. Both the EU and Canada have to agree to review the standard for it to be revisited.[164]

141 As to expropriation, the CETA states that an indirect expropriation only occurs when "the investor is substantially deprived of the fundamental attributes of property such as the right to use, enjoy and dispose of its investment".[165]

142 The approach of the CETA drafters, if ratified, will prevent the traditional exercise of subjective economic and political judgment, which is arguably inherent to the process of interpretation of the scope of "investment" under the Vienna Convention (cases where a BIT or an investment contract leaves no room for interpretation).

143 The TPP approach is even more rigid, providing a specific definition of investment with respect to loans and debt instruments,[166] clarification of the FET provision,[167] a carve-out for prudential measures,[168] and time limitations as to particular claims, such as expropriation.[169]

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[164] The European Commission, *Investment Provisions in the EU-Canada Free Trade Agreement (CETA)* (Sept. 26, 2014), available at: http://trade.ec.europa.eu/doclib/docs/2013/november/tradoc_151918.pdf.

[165] Id.

[166] See TPP Article 11.1 (as of November 5, 2015): "investment means 'investment' as defined in Article 9.1 (Definitions), except that, with respect to 'loans' and 'debt instruments' referred to in that Article:

(a) a loan to or debt instrument issued by a financial institution is an investment only if it is treated as regulatory capital by the Party in whose territory the financial institution is located; and

(b) a loan granted by or debt instrument owned by a financial institution, other than a loan to or debt instrument issued by a financial institution referred to in subparagraph (a), is not an investment;

for greater certainty, a loan granted by or debt instrument owned by a cross-border financial service supplier, other than a loan to or debt instrument issued by a financial institution, is an investment for the purposes of Chapter 9 (Investment), if such loan or debt instrument meets the criteria for investments set out in Article 9.1 (Definitions)."

[167] TPP, Art. 9.6.

[168] TPP, Art. 11.11.

[169] TPP, Annex 9-G.

REGULATORY MATTERS

INTRODUCTION

1 In the context of financial institutions, the term "regulatory matters" refers to a broad spectrum of issues arising out of the regulation of the institutions themselves and of certain activities. Such regulation encompasses the application and enforcement of conduct of business rules, the regulation of financial products and markets, as well as prudential supervision. In most jurisdictions, financial regulation is extensive and often concerns matters of public interest. It is also a potential source of disputes that may involve claims on the part of customers or investors against a financial institution, as well as claims on the part of a financial institution against a regulator for allegedly improper action. For the purpose of this study on arbitration of regulatory matters involving financial institutions, the Task Force focused on three areas.

2 The first of these areas concerns the arbitrability of disputes between clients or investors and financial institutions involving alleged regulatory breaches. Generally, disputes arising in connection with agreements between parties where one is a financial institution should be capable of being arbitrated in the same way as those related to any other commercial agreement. However, historically, claims that have given rise to issues of arbitrability have been based on breaches of statutory provisions considered to be within the scope of the public interest or involving the interests of third parties, such as securities laws. More recently, the trend in many jurisdictions has been to view the financial consequences of a dispute based upon a regulatory breach as being arbitrable. This general assertion is, nevertheless, subject to some exceptions, which vary from jurisdiction to jurisdiction, and typically are not limited in their application to disputes involving financial institutions. These exceptions can include issues such as consumer protection, insolvency situations, and public policy considerations.

3 The second topic examined is the use of investment arbitration by financial institutions or their shareholders to seek remedies against potentially improper actions taken by regulators. This is a developing area that has attracted considerable interest in the banking sector. The study of these cases has sought to identify trends to help indicate when the action of a regulator will be considered legitimate and when it will not, on the basis of the few decisions available to date. Although the observations are very briefly summarised here, the findings are set out in further detail in the analysis on investment arbitration.

4 Finally, the Task Force has sought to identify specialised arbitration institutions that administer disputes between clients and financial institutions, including some which have a regulatory dimension. Arbitration is generally not considered to be the appropriate forum to determine whether a financial institution has breached regulatory provisions. Those determinations are typically made in judicial or administrative proceedings. Arbitration can, however, provide an efficient forum for addressing the civil consequences of these breaches, particularly for disputes between customers and financial institutions. This report briefly describes two mechanisms, in the United States and Hong Kong, which allow investors to initiate arbitration proceedings against financial institutions as an alternative to court proceedings.

OVERVIEW OF EMPIRICAL FINDINGS

5 Out of 49 respondents, only 12 institutions (or corporate groups) responded to some or all of the questions in the regulatory section of the questionnaire.

6 Eight of the institutions responding to the regulatory section of the survey stated that they did see arbitration playing a role in the resolution of disputes arising out of breaches of regulatory provisions, applicable in the financial sector.[1] Three institutions responded negatively to this section of the survey. More specifically, one institution responded that the use of arbitration to resolve disputes relating to regulatory matters was an interesting idea that would require further consideration, while another institution stated that this idea had never been considered within the bank.

7 Among the financial institutions responding to this section of the survey, six stated that the use of arbitration for regulatory matters would be limited solely to the civil and financial consequences of regulatory breaches. In their responses, some specified that the type of claim that could be addressed in arbitration proceedings would be, for example, a claim for compensation on the part of a customer against a financial institution. There were only two responses indicating that the use of arbitration in the context of regulatory disputes could be broader than simply addressing the civil and financial consequences of a regulatory breach. However, neither respondent expanded on what else could potentially be covered.

8 One of the questions in the survey was whether financial institutions had encountered issues of arbitrability in connection with disputes in the banking and financial services sector. Of the institutions that responded to this question, nine indicated that they had not encountered arbitrability issues. Only one indicated that it had experience with arbitrability issues.[2] These issues had been related to a guarantee, but no further detail was provided by the respondent.

9 When asked whether they had experience with arbitration proceedings in relation to regulatory matters, almost all of the nine financial institutions that responded to the question stated that they had no experience with arbitration of such disputes. Only one institution stated that it had experience with this kind of dispute.[3] The nature of the dispute was not specified, but the interviewee indicated that the dispute had been commenced on the basis of an arbitration clause, and had been conducted under the auspices of the Costa Rican Chamber of Commerce.

10 Respondents to the questionnaire identified the following advantages of arbitration:

- non-public hearings and the potential for building confidentiality into the process;
- expertise of the arbitrators;
- independence/neutrality of the arbitrators;
- flexibility of the procedure, including the process of evidence collection, and cooperation between the parties in agreeing to the procedure;

[1] Among those respondents there were some more nuanced answers such as the comment (in an anonymous response) that the interviewee did not see this as a possibility in the "*near term*." Another anonymous response specifically referred to the possibility of arbitrating regulatory matters under the P.R.I.M.E. Finance Rules. This interviewee also commented that, in its jurisdiction, there was a trend towards specialised financial dispute resolution. A local court in the relevant country had announced that it would establish a division of the court dedicated to financial disputes with specialised judges. The respondent further elaborated that a special institute in that jurisdiction handled consumer cases. A further anonymous interviewee indicated that a national Commission in its jurisdiction had recently issued new rules for (non-mandatory) arbitration as a dispute settlement mechanism for banks and their clients. However, this mechanism had not yet been used.

[2] This was the response provided by a regional multilateral financial institution.

[3] This response came from the interview of a regional multilateral financial institution.

- inapplicability of state doctrine and principles of comity in connection with investment arbitration; and
- enforcement of the award under the New York Convention of 1958.

11 One possible explanation for the disparity between the total number of respondents and the number of institutions that addressed this section of the questionnaire is that regulatory matters involve questions of public policy and, accordingly, have not traditionally been considered arbitrable in some jurisdictions. Nevertheless, the response of this small sampling of financial institutions shows a willingness to consider arbitration in connection with disputes relating to the civil and financial consequences of regulatory breaches in proceedings brought by customers of financial institutions against those institutions. This is consistent with the conclusions of the arbitrability study discussed below.

ARBITRABILITY OF REGULATORY MATTERS IN KEY JURISDICTIONS

A Scope

12 The Task Force considered whether regulatory issues involving a financial institution could appropriately be resolved through arbitration. In particular, the Task Force examined the situation where a regulator has uncovered activity on the part of a financial institution which is prejudicial to one or more of its clients or to investors, and sought to determine whether arbitration could play a role in resolving any resulting civil claims. Further, we have studied the issue as to whether such disputes could be, or have to be, resolved by an imposed scheme or through one suggested by the regulator or the state. The primary focus has been to develop a broad outline of the practical approach taken in several jurisdictions rather than to engage in an academic analysis of the issues involved.

13 The Task Force did not consider the arbitrability of either: action taken by a regulator against a financial institution; or action taken by an aggrieved financial institution against a regulator (see, however, section below regarding investment arbitration in connection with the actions of a regulator).[4]

B Arbitrability of claims based on statutes involving matters of public interest

14 The regulation of financial markets is a matter of public interest, characterised by increasingly more extensive regulation, and an increase in sanctioned behaviour. Sometimes, rights of third parties are involved, making this issue even more intricate and complex. That increase in sanctioned behaviour may have had an impact on transactions, thereby potentially giving rise to civil claims involving a financial institution. Arbitrability, for the purpose of this section, involves a consideration of whether such disputes can be validly submitted to arbitration, or whether, for example, applicable legislation in the place of the regulatory infringement requires all related disputes to be resolved in the local courts.[5]

[4] Lawyers in the following jurisdictions were requested to respond to the questionnaire on arbitrability: Argentina, Australia, Brazil, Canada, China, Egypt, France, Germany, Hong Kong, India, Ireland, Japan, Russia, Singapore, South Africa, Switzerland, UK and USA. The objective of the questionnaire was to identify the extent to which arbitrability issues exist, particularly as they concern regulatory matters in jurisdictions with significant financial institution activity.

[5] In this context, we will examine issues that are often referred to as "objective arbitrability" (arbitrability *rationae materiae*), which pertain to the subject matter itself, as well as issues of "subjective arbitrability" (*rationae personae*) that relate to the capacity of a party to agree to resolve disputes through arbitration. The issue of the applicable law used to determine questions of arbitrability is beyond the scope of this paper.

15 Despite the increasing public interest in market regulation, disputes arising from financial and securities transactions are now generally regarded as arbitrable. As Judith Gill and James Freeman have noted:

> Financial transactions are, after all, a core commercial activity, and the resolution of commercial disputes is the very essence of commercial arbitration. The categories of dispute now regarded as non arbitrable are generally some way removed from financial disputes in their nature.[6]

16 Developments in the United States, a jurisdiction with major financial markets, illustrate how judicial authorities have become more comfortable over the years with the arbitration of financial and securities disputes, particularly where there has been a breach of a statutory obligation.[7]

17 Section 22 of the 1933 United States Securities Act, a statute enacted to protect investors,[8] confers jurisdiction for violations of the act on U.S. courts. In 1953,[9] in *Wilco* v. *Swan*, the U.S. Supreme Court interpreted this provision to mean that violations of the act were not arbitrable, since an arbitration clause would involve an investor waiving the advantages conferred by the statute. This ruling was premised on the notion that the courts were better situated to protect an investor's rights. However, in 1974 the Court distinguished this decision, thereby permitting arbitration in the case of international securities disputes.[10]

18 A series of decisions in the 1980s marked a decisive change in approach. In this context, a decision from 1985 involving antitrust law, a different area of public interest, merits mention in light of its importance in limiting the non-arbitrability doctrine that had prevailed in earlier U.S. decisions, and which tended to confine arbitration solely to commercial and contractual matters. In *Mitsubishi Motors Corp*. v. *Soler Chrysler-Plymouth*, the U.S. Supreme Court decided that disputes relating to antitrust law could be submitted to arbitration[11] on the basis that there was no presumption against the arbitration of statutory claims. The Court further stated that policy concerns required the enforcement of international agreements and that there was no reason to assume arbitration could not provide an appropriate remedy or relief.

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6 J. Gill and J. Freeman, J. Golden and C. Lamm (eds.), *International Financial Disputes – Arbitration and Mediation*, Oxford (2015), at § 9.51.

7 J.D.M. Lew, L.A. Mistelis, et al., *Comparative International Commercial Arbitration*, Kluwer Arbitration, (2003), Ch. 9 Arbitrability, paras, 9-36, where the authors state as follows: "In Mitsubishi v. Soler the US Supreme Court held that in an international context the ambit of arbitration may be wider than in a national context. Though the case only dealt with US law, the decision describes what is now the prevailing view. The case also evidences a second general trend: the increase in the types of disputes which can be referred to international arbitration. While originally arbitration was often limited to claims arising directly out of a contract, *gradually more and more claims based on statutes, for example regulating important parts of the national economy in the public interest, have become arbitrable*".(emphasis added). See also §§ 9-41. See also B. Hanotiau, "Arbitrability of Financial Disputes," in *ASA Special Series No. 20*, G. Kaufmann-Kohler and V. Frossard (eds.), *Arbitration in Banking and Financial Matters*, ASA (2003), pp. 33-44, pp. 37 to 40.

8 Following the stock market crash of 1929, both the Securities Act of 1933 and the Securities Exchange Act of 1934 were adopted in order to protect investors. Both statutes conferred jurisdiction on the courts to decide securities disputes.

9 *Wilko v. Swan*, 346 U.S. 427 (1953). This case involved an action for damages brought by an investor against a broker for misrepresentations under US federal securities laws. For a summary of the key decisions on the issue of the arbitrability of securities law claims and the evolution of the case law, see G. Born, *International Commercial Arbitration*, 2nd Ed., Kluwer Arbitration (2014), pp. 964 *et seq*. See also N. Blackaby and C. Partasides, with A. Redfern and M. Hunter, *Redfern and Hunter on International Arbitration*, 5th Ed., Oxford (2009), p, 129; J.D.M. Lew, L.A. Mistelis, et al., supra note 7, paras. 9-48 to 9-54; I. Bantekas, "Arbitrability in Finance and Banking," *Arbitrability: International and Comparative Perspectives* in L. Mistelis and S. Brekoulakis (eds.), Chap. 15; International Law Library, Vol. 19, Kluwer, (2009), pp. 293 to 316, p. 297 *et seq*.; J. Kerr, Jr. "Arbitrability of Securities Law Claims in Common Law Nations," *Arbitration International*, Vol. 12, No. 2 (1996), p. 171, pp. 171 to 174; B. Hanotiau, supra note 7, pp. 37 *et seq*.

10 *Scherk v. Alberto-Culver Co.*, 417 U.S. 506 (1974).

11 *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth Inc.*, 473 U.S. 614 (1985).

19 Following the approach in the *Mitsubishi Motors Corp.* case, in 1987, the Supreme Court held in *Shearson/American Express* v. *McMahon* that the 1934 Securities Exchange Act did not preclude arbitration and that arbitration was a valid forum for RICO claims,[12] as the overlap between RICO's civil and criminal provisions did not render treble damages claims non-arbitrable.[13] Following *Shearson/American Express*, many lower courts declined to follow *Wilco v. Swan* and in 1989 the Supreme Court reversed the decision as incorrectly decided, upholding the validity of arbitration clauses in the context of both domestic and international securities disputes.[14]

20 The responses to the survey indicate that, similar to the U.S. position, disputes arising from financial and securities transactions are now generally regarded as arbitrable in most jurisdictions, even where they involve civil claims based on statutory provisions of a regulatory nature.[15] In most of the jurisdictions reviewed, there appears to be minimal case law specifically dealing with the arbitrability of claims arising in connection with regulatory breaches on the part of a financial institution; however, an analogy can be drawn to the area of competition law, which appears to have more established case law. In this area of regulation, many jurisdictions now distinguish between sanctions imposed by a regulator (which would not be arbitrable) and claims relating to the civil and financial consequences of the conduct that has led to the imposition of fines or some other penalty (which would be arbitrable).[16] Support for this approach can be found in academic literature on the subject of arbitrability of financial disputes.[17]

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[12] RICO refers to the Racketeer-influenced and Corrupt Organizations Act.

[13] *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220 (1987).

[14] *Rodriguez de Quijas v. Shearson/American Express Inc.*, 490 U.S. 477 (1989).

[15] In some countries, like Switzerland, this results from a specific statutory provision on arbitrability. The Swiss Federal Private International law Act, Article 177, provides expressly that "… *any dispute involving an economic interest may be the subject-matter of an arbitration*". This provision has been interpreted broadly; G. Born, *op. cit*. note 9, pp. 959 to 960. Nevertheless, some disputes involving an economic interest still might not be arbitrable (for instance some matters related to the Swiss Debt Enforcement and Bankruptcy Act). German law also establishes a general rule of objective arbitrability using "economic interests" as a criterion. Section 1030, § 1 of the Civil Procedure Code (*Zivilprozessordnung*) provides that "[a]ny claim involving an economic interest can be the subject of an arbitration agreement". The term "economic interest" has been given a broad interpretation in Germany including, but not limited to, the payment of a sum of money, claims and actions for the change of a legal relationship, prohibitory actions and actions for revocations raised to protect business interests; Trittmann and Hanefeld, *Arbitration Agreement, § 1030 – Arbitrability*, in Böckstiegel, Kröll and Nacimiento (eds.), 'Arbitration in Germany: The Model Law in Practice', 2nd Ed., (2015), 94, p. 97. However, under German law, in accordance with article 37(h) of the Securities Trading Act (*Wertpapierhandelsgesetz*) only merchants (meaning corporations, individual entrepreneurs and other business entities) and corporate bodies organised under public law have the capacity to enter into an arbitration agreement in relation to *future* disputes that are related to securities. This restriction also applies to the giving of financial advice. In other jurisdictions, arbitrability is defined in relation to less specific criteria, such as the possibility to settle a dispute based on rights that the relevant party is free to dispose of or the fact that the dispute does not concern matters of public policy. Examples of legal systems in the latter category are France (Articles 2059 and 2060 of the Civil Code), or Brazil, where Article 1 of Law 9.307/96, provides that "Persons capable of entering into contracts may settle through arbitration disputes related to freely transferable patrimonial rights". See also B. Hanotiau, supra note 7, pp. 35 to 36, where the observation is made that the majority of legal systems come within the latter category.

[16] G. Born, *op. cit*. note 9, pp. 975 *et seq*.; see also J.D.M. Lew, L.A. Mistelis, et al., *op. cit*. note 7, para, 9-43; N. Blackaby and C. Partasides, with A. Redfern and M. Hunter, *op. cit*. note 9, pp. 125 to 128; J.F. Poudret and S. Besson, 'Comparative Law of International Arbitration', 2nd Ed. Sweet & Maxwell (2007), paras. 347 to 352. Developments in French case law on the arbitrability of competition law matters provide a good example. It is now accepted that an arbitral tribunal may decide claims for damages based in contract or in tort insofar as the arbitrators confine themselves to examining the

21 Nevertheless, the basic premise that financial disputes are arbitrable is not unqualified. Assuming that a dispute relating to the civil and financial consequences of a regulatory breach would generally be arbitrable,[18] responses to the survey indicate that such arbitrability could be impacted by public policy considerations.

22 Non-arbitrable disputes often involve non-commercial matters; criminal or certain family law matters (such as divorce) are obvious examples of situations where significant public policy concerns understandably preclude the possibility of private arbitration.[19] However, as indicated above, this notion is not confined to solely non-commercial disputes, and issues of capacity to conclude an arbitration agreement (often referred to as subjective arbitrability) also result in restrictions. An important example for the purpose of this report, as mentioned below, is the existence of a restriction on the ability to arbitrate consumer disputes in some countries.

23 Whether or not a financial dispute is arbitrable, other legal mechanisms may apply, such as Ombudsman schemes (see section D below), which can affect how such disputes are resolved in practice,

C Public policy

24 Given the emphasis that is placed on consumer protection as a matter of policy in many countries, it is understandable that such concerns can be reflected in dispute resolution. Respondents across a range of jurisdictions noted restrictions on arbitrability where one party is a consumer, which would generally include investors who are high net worth

civil and financial consequences of the anti-competitive conduct without ordering measures of redress, such as injunctions or fines, in response to the relevant violations of competition law. See *Labinal v. Mors and Westland Aerospace*, CA Paris, 19 May 1993, *Rev. Arb.* 1993, p. 645, note C. Jarosson; E. Gaillard and J. Savage (eds.), *Fouchard Gaillard Goldman on International Commercial Arbitration*, Kluwer (1999), §565 and 566; C. Seraglini and J. Ortscheidt, *Droit de l'arbitrage interne et international*, Montchrestien (2013), § 109 to 111 and 655. This position, which was first developed in the context of international arbitration, was subsequently extended to domestic arbitration. Similar positions have been reached by the courts in other jurisdictions such as Switzerland, Germany and England. The OECD Competition Committee has observed that "To our knowledge, the question of the arbitrability of the civil consequences for a breach of competition law is no longer debated in Europe"; DAF/COMP (2010) 40; p. 39 (available at http://www.oecd.org/competition/abuse/49294392.pdf). A similar position regarding the arbitrability of statutory claims was reached by the Supreme Court of Canada in a landmark decision which raised copyright issues; *Desputeaux v. Editions Chouette Inc.* 2003 SCC 17; see B. Casey, *Arbitration Law of Canada: Practice and Procedure* (2nd Ed.), Juris (2011), § 3.10, "Public Policy Considerations and Statutory Claims".

17 B. Hanotiau, supra note 7, pp. 42 to 43. Professor Hanotiau examines the situation where a market authority has exclusive competence linked to the protection of public savings. In such a situation the market authority may have exclusive powers to issue injunctions with respect to practices that are contrary to the interests of investors and/or to impose penalties where mandatory market rules have been breached. These matters would not be arbitrable, but an arbitrator may decide issues of a contractual nature that do not involve issues of market protection generally. See also J. Gill and J. Freeman, J. Golden and C. Lamm (eds.), *op. cit.* note 6, at §§ 9.58 - 9.59.

18 General principles such as these, which relate to objective arbitrability, assume that basic criteria concerning the validity and scope of the arbitration agreement and the capacity of the parties are met. They also assume the solvency of the financial institution and the absence of fraud or coercion.

19 J. Gill and J. Freeman, J. Golden and C. Lamm (eds.), *op. cit.* note 6, at § 9.51.

individuals.[20] Such restrictions may relate to consumer contracts generally (rather than just to those between consumers and financial institutions) and can take a number of forms, typically directed towards expanding a consumer's options when a dispute arises. For example, it may be the case that arbitration agreements between consumers and financial institutions are not enforceable unless certain conditions are met. These conditions may include, for example, the consumer agreeing to arbitrate after the dispute has arisen, the clause providing for submission to arbitration (having been individually negotiated), and/or the amount in dispute being over a certain threshold.[21]

25 The arbitrability of a dispute may also be called into question where there is a broad public interest in its outcome.[22] In such cases, the involvement of the courts may be considered warranted and the dispute may not be capable of settlement by arbitration.[23] Alternatively, there may be a specific statutory provision prohibiting the arbitrability of certain disputes.[24]

D Other legal mechanisms

26 In some countries there are legal mechanisms or schemes in place for resolving certain types of disputes involving financial institutions. Many respondent jurisdictions had statutory schemes through which affected clients could be compensated following regulatory sanctions. Some of these schemes were mechanisms for investor compensation (in most cases triggered by the regulator), rather than schemes enabling the client to pursue a related claim. Examples of such schemes highlighted by respondents included:

a) the ability of a regulator to levy sanctions, including the disgorgement of any financial benefit derived by the financial institution from its misconduct;

b) the ability of a regulator to seek a restitution order from a court, pursuant to which a financial institution may be required to compensate those who have suffered loss;

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[20] The arbitrability of consumer claims in the EU is addressed by the Unfair Terms in Consumer Contracts Directive, Council Directive 93/13/EEC (5 April 1993), which provides, in essence, that clauses in consumer contracts which commit the consumer to resolving a dispute which has not yet arisen exclusively by arbitration are unfair, and, consequently, invalid. The Directive has not been interpreted in the same way in all EU jurisdictions which has led to differences in the scope of the restrictions on arbitration agreements with consumers within the EU; see J. Gill and J. Freeman, J. Golden and C. Lamm (eds.), *op. cit.* note 6, at § 9.74. Outside Europe, restrictions on arbitration agreements with consumers exist in many jurisdictions and in some countries the limitations apply to standard form contracts. For example, in Argentina restrictions on arbitration clauses exist both with respect to disputes regarding the rights of consumers and in respect of standard form contracts (which are frequently used by financial institutions) pursuant to article 1651 of the Civil and Commercial Federal Code. In Brazil, the arbitration law does not expressly address the arbitrability of consumer disputes, but it does provide that arbitration clauses in "adhesion contracts" are only effective if the party adhering to the contract commences the arbitration or expressly consents to it by signing a separate document and/or the relevant arbitration clause appears in the contract in bold lettering (Article 4(2) of Law 9.307/96).

[21] Examples of jurisdictions where arbitration clauses in consumer contracts are subject to conditions include France, Germany, Ireland and Brazil.

[22] As discussed above, given the public interest in securities regulation, historically, securities disputes have not been considered arbitrable in many jurisdictions, but that position has changed; see J. Gill and J. Freeman, J. Golden and C. Lamm (eds.), *op. cit*. note 6, at §§ 9.54 to 9.59 and the authorities cited in note 9. Germany remains a jurisdiction where there is a specific restriction with regard to the arbitrability of securities disputes, which applies to parties that do not qualify as merchants; see note 15.

[23] As is the case in Australia; see *Comandate Marine Corp.* v *Pan Australia Shipping Pty. Ltd.* (2006) 157 FCR 45 at 98; *Nicola v. Ideal Image Development Corporation Inc.* (2009) 261 ALR 1, 61.

[24] An example having been Egypt, which had a Ministerial Decree No. 8310 of 2008, amended in 2011, pursuant to Decree No. 9739 of 2011 dated 5 October 2011, under which disputes relating to any right concerning real estate, including its possession and ownership, were not arbitrable; a matter of relevance in some secured lending transactions. Currently, pursuant to Decree No. 9739 of 2011 dated 5 October 2011, the Ministry of Justice may only issue an opinion or recommendation identifying matters of concern and claims relating to constitutional, criminal law or personal matters are not arbitrable.

c) rules requiring a firm to establish and operate a consumer redress scheme where there has been a failure which has led to consumer loss;

d) the requirement of a regulated business to maintain and operate complaints processes and to ensure that complaints are dealt with fairly; and

e) Financial Services Ombudsman ("FO") schemes, where the FO is empowered to make an award if it is satisfied that a complaint falls within its jurisdiction and fulfils the requirements.[25]

27 Of the above, it should be noted that only FO schemes involve the client pursuing a claim, and that FO schemes are generally:

a) voluntary, save that an FO award would prevent subsequent court action on the same basis if it were to be accepted, but would not do so if the award was rejected;

b) not dependent upon any regulatory investigation or sanction; and

c) subject to eligibility criteria, both in relation to the nature of the business and its value, and are aimed principally at smaller disputes involving individuals and small businesses.

28 As FO schemes are generally voluntary, where a client or investor decides not to take advantage of such a scheme, arbitration of a claim would not be precluded, provided there was a valid arbitration agreement.

29 Not all countries have bespoke schemes of redress available for the recovery of losses associated with conduct sanctioned by the relevant regulator and some have specific avenues for complaint rather than redress schemes.[26] In addition to specific schemes and regulatory powers which exist to provide investor or consumer protection, some jurisdictions also provide statutory rights of action, where contravention of a rule is actionable if a party who suffers a loss as a result brings a legal claim/action. The potentially sanctionable behaviour of a financial institution under such rights of action varies across jurisdictions and can be limited to certain conditions,[27] or can be more general in scope.[28]

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[25] In the case of England, all of these types of scheme are provided for, through the activities of the Financial Conduct Authority (FCA), which derives its powers from the Financial Services and Markets Act 2000 (FSMA). In Germany, a number of different bespoke dispute resolution schemes have been implemented in areas where financial institutions are active, but these mechanisms seek to facilitate amicable settlement and do not preclude the pursuit of an ordinary civil claim through court or arbitration proceedings. In Australia, the Financial Ombudsman Service (FOS) operates as an alternative to judicial redress for certain disputes between consumers and member financial service providers. Typically, FOS allows the parties to make submissions before making a 'recommendation' which, if it is not accepted by the parties, will proceed to a 'determination' by an Ombudsman, adjudicator or an FOS Panel. The monetary cap on awards made by FOS is AUD 309,000. Separately, where licensed financial institutions provide financial services to retail clients, the financial institution must have an internal dispute resolution process that complies with the standards approved by Australia's corporate markets and financial services regulator.

[26] For example, Brazil, China, Egypt, France, India, Japan, Russia, South Africa and Switzerland do not have such bespoke schemes for the recovery of losses, but many of them have specific avenues for complaint rather than redress schemes.

[27] In England, the Financial Services and Markets Act 2000 (FSMA) contains provisions which give rise to rights of action, for example, where an authorised person carries on a regulated activity other than in accordance with the required permission, where there is a breach of the rules requiring a prospectus to be published before certain securities are offered to the public, and where false or misleading statements are included in, or where there are material omissions from, listing particulars or prospectuses. Another example of a jurisdiction where there is a statutory right of action is Japan. In Japan, the Financial Instruments and Exchange Act (Law No. 25 of 1984, as amended) contains provisions which give rise to rights of action, for example, where there is a breach of rules requiring a prospectus to be delivered to investors before securities are acquired by the investors through a public offering, and where a prospectus contains a false statement about a material particular, omits a statement as to a material particular that is required to be stated, or omits a statement of material fact that is necessary to make the same not misleading. Similarly, in Hong Kong, a client of a financial institution has a statutory right of action under the Securities and Futures Ordinance (Cap. 571)

E Other issues

30 In general, respondents indicated that national law did not distinguish between domestic and international arbitration in the respondent jurisdictions, although there were some exceptions, which could have a potential impact on the arbitrability of a dispute.[29]

31 In deciding whether a matter is arbitrable or not, it is a fairly universal principle that the arbitral tribunal has the power to consider the issue of arbitrability, following the provision in the UNCITRAL Model Law allowing the tribunal to rule on its own jurisdiction. However, in many cases, if the matter is pursued, it will ultimately be a matter for the local court to decide.

F Conclusions

32 This study has given a broad outline of some key issues regarding the arbitrability of disputes involving financial institutions in the context of regulatory action. The following general conclusions have been drawn:

a) Subject to normal restrictions such as validity and scope of the arbitration agreement and capacity of the parties, civil disputes involving financial institutions are generally arbitrable, even though the issue giving rise to the dispute may have been the subject of regulatory investigation and/or sanction. The findings of the regulator may be relevant to, or referenced in, the arbitration, but the tribunal would decide the issues by reference to the applicable burden of proof in the conventional way.

b) Some jurisdictions have specific rules affecting the arbitrability of disputes involving financial institutions, notably for public policy reasons, including the protection of consumers.

c) Arbitration may not be the only forum to address a dispute. Many of the respondent jurisdictions have statutory schemes by which affected clients could be compensated following regulatory sanction. Several jurisdictions provide a statutory right of action to clients affected by the actions of a regulated financial institution (although they vary in scope); and with some exceptions, the jurisdictions surveyed do not tend to distinguish materially between domestic and international arbitrations. Fairly universally, responses indicated that the arbitral tribunal has the power to consider the issue of arbitrability.

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through the civil courts if he/she has suffered a financial loss caused by any form of market misconduct. In Australia, the Australian Securities and Investments Commission Act 2001 (Cth) provides a statutory right of action to a person who suffers loss or damage by conduct in relation to financial services where the contravention relates to unconscionable conduct in trade or commerce, misleading and deceptive conduct in trade or commerce, false or misleading representations in trade or commerce, or harassment and coercion in connection with the supply or possible supply of financial services to a consumer or the payment of financial services by a consumer. The Corporations Act 2001 (Cth) also contains provisions that provide an avenue for redress for affected clients to bring claims against financial institutions for defective disclosure.

[28] For example, in Ireland, section 44 of the Central Bank (Supervision and Enforcement) Act of 2013 provides that failure by a regulated financial service provider to comply with any obligation under financial services legislation is actionable by any customer of the regulated financial service provider who suffers loss or damage as a result of such failure.

[29] For example, in France the distinction between domestic and international arbitration is of importance to the issue of the arbitrability of disputes, since more restrictive principles are applied with regard to a domestic arbitration in comparison with international arbitration. This is due to the much narrower definition of public policy applied in international arbitration. As a consequence, most international commercial matters, including disputes involving banking and financial matters, are considered to be arbitrable in an international arbitration proceeding, which is seated in France. This was the conclusion reached by a Working Group on Arbitration in Banking and Financial Matters, established by the *Comité français de l'arbitrage* (chaired by Georges Affaki), Final Report, May 2014, at p. 18, § 13.

INVESTMENT ARBITRATION AND THE REGULATION OF FINANCIAL INSTITUTIONS

33 As indicated in connection with the review of the arbitrability of regulatory matters, the Task Force concluded at the outset that it was not realistic to examine the prospect of challenging the actions of regulators in arbitration proceedings at the municipal law level. This is generally the domain of administrative law and, even if the claim could be framed in such a way as to render it arbitrable, it is unlikely that there will be an arbitration agreement. However, where a shareholder of a financial institution can satisfy all of the threshold requirements to establish the jurisdiction of an investment arbitral tribunal pursuant to a multilateral or bilateral investment treaty, international law claims can be made which seek to establish that the actions of a regulator have violated the relevant standards of investor protection. This is a relatively recent development and one that has attracted considerable interest within the banking community. The number of investment arbitration claims of this nature continues to grow.

34 A review of the investment arbitration decisions that are publicly available, particularly in the context of the regulation of financial institutions, has been set out in the section on investment arbitration.

35 In broad terms, the main findings can be summarised as follows. Given their nature and role in the economy, financial institutions are highly regulated in most countries, including in the areas of prudential supervision and the way in which they conduct business. There is a significant public interest underlying the regulation of financial institutions and an expectation that regulations will be rigorous and extensive. Accordingly, investment arbitration claims concerning regulatory actions tend to require the balancing of legitimate regulatory interests with interests perceived as being illegitimate. The dividing line between the two has not yet been clearly defined, but a certain degree of deference on the part of arbitral tribunals to the exercise of "police powers" can be observed. However, arbitral tribunals have shown much less deference to states where there appears to have been discriminatory or arbitrary behaviour on the part of regulators in relation to foreign financial entities, or financial entities that are subject to foreign control.

SPECIALISED ARBITRATION MECHANISMS FOR CLAIMS ARISING IN CONNECTION WITH REGULATORY MATTERS

36 It was apparent from the study of arbitrability that, generally, claims of parties seeking compensation for the civil or financial consequences of a regulatory breach on the part of a financial institution would be arbitrable in most jurisdictions. An examination of the use of arbitration to resolve such claims did not reveal the existence of arbitral institutions handling them to a significant extent. That is not to say that the rules of an institution such as P.R.I.M.E. Finance would not be well suited to addressing such disputes, particularly where they involve complex matters. In such a case, the prospect of having arbitrators who are experts in the field would constitute a significant advantage.

37 The Task Force focused on two institutions administering claims against financial institutions: (i) The Financial Regulatory Authority (FINRA) in the United States; and (ii) the Hong Kong Financial Dispute Resolution Centre (FDRC) in Asia. These two institutions administer, at least to some extent, civil claims for compensation arising out of conduct that may amount to regulatory breaches on the part of financial institutions. These consist, for the majority, of small claims brought by retail investors. Both FINRA and the FDRC have procedures in place which appear to be streamlined and cost-effective enough to make the resolution of these disputes through arbitration a feasible alternative to court proceedings.

A FINRA

38 Customers may (and do) initiate FINRA arbitration proceedings in relation to claims arising out of regulatory breaches, some of which involve brokerage firms that are part of major banks. As large banks are often connected to brokerage firms within a group of corporations, FINRA arbitration claims have been initiated by customers against the brokerage firm in order to recover losses based on a variety of common law and statutory claims and, in some instances, alleged regulatory breaches on the part of the bank. This has given rise to disputes about the meaning of the word "customer", an issue that has been studied at length by scholars and addressed by the courts.

39 FINRA is a non-governmental, self-regulatory organization (SRO) created in 2007 and authorised by the U.S. Congress to protect investors and regulate the securities industry in order to ensure market integrity.[30] FINRA is the result of a merger of the National Association of Securities Dealers (NASD) and New York Stock Exchange Regulation, intended to produce greater efficiency under a single set of rules for broker-dealers.[31] After this consolidation, "FINRA became the largest non-governmental regulator for securities firms doing business in the United States".[32] FINRA's role is multifaceted, and includes market oversight, regulation, investor education, enforcement and arbitration. In 2017, FINRA brought 1,369 disciplinary actions against registered brokers and firms; levied USD 64.9 million in fines; ordered USD 66.8 million in restitution to harmed investors; and referred more than 800 fraud and insider trading cases to the SEC and other agencies.[33]

40 Handling nearly 100 percent of securities-related arbitrations, FINRA maintains facilities to hold hearings in more than 70 locations, including at least one in each of the 50 U.S. states, London and Puerto Rico.[34]

[30] As described in § 15A of the Securities Exchange Act of 1934 (Exchange Act) (about SROs). See 15 U.S.C. § 78o-3(b)(2) (2012); http://www.finra.org/about.

[31] Release, Securities and Exchange Commission, SEC Release No. 34-55495, "Notice of Filing of Proposed Rule Change to Amend the By-Laws of NASD to Implement Governance and Related Changes to Accommodate the Consolidation of the Member Firm Regulatory Functions of NASD and NYSE Regulation, Inc"., 1-2 (Mar. 20, 2007), available at http://www.sec.gov/rules/sro/nasd/2007/34-55495.pdf; Release, SEC Release No. 34-56145, "Order Approving Proposed Rule Change to Amend the By-Laws of NASD to Implement Governance and Related Changes to Accommodate the Consolidation of the Member Firm Regulatory Functions of NASD and NYSE Regulation, Inc.", 1 (July 26, 2007), available at http://www.sec.gov/rules/sro/nasd/2007/34-56145.pdf.

[32] S.F. Ali and A. Da Roza, "Alternative Dispute Resolution Design in Financial Markets - Some More Equal than Others: Hong Kong's Proposed Financial Dispute Resolution Centre in the Context of the Experience in the United Kingdom, United States, Australia, and Singapore", 21 *Pac. Rim L. & Pol'y J.* 485, 502 (2012).

[33] http://www.finra.org/newsroom/statistics.

[34] http://www.finra.org/about/what-we-do.

41 Even though FINRA provides a forum for the adjudication of disputes, it is not a party to arbitrations. Arbitrations are between private parties, and the types of claims that are most often arbitrated under the FINRA Rules involve "Breach of Fiduciary Duty", followed by (in order of descending frequency): "Negligence", "Failure to Supervise", "Misrepresentation", "Breach of Contract", "Unsuitability", "Omission of Facts", "Unauthorized Trading", "Churning", and "Margin Calls".[35] Many customers bring a combination of these claims in their arbitration submissions.[36] As described in the chart below, thousands of claims are arbitrated under the FINRA Rules each year.[37]

YEAR	CASES FILED	CASES CLOSED
2017	3,456	3,735
2016	3,681	3,635
2015	3,435	3,489
2014	3,822	3,838
2013	3,714	4,498
2012	4,299	4,877
2011	4,729	6,099
2010	5,680	6,241

42 Customers of member securities brokers and brokerage firms can initiate FINRA arbitration for various kinds of securities-related prohibited conduct, including regulatory violations.[38] Further, there are also arbitration proceedings in which the customer explicitly cites "violations of the rules" as a claim. For example, in *Meldrum v. TD Ameritrade, Inc.,*[39] the customer alleged that TD Ameritrade had "violated trading rules", among other claims.[40] The other option that customers have is to initiate a customer complaint when a violation occurs.[41] FINRA will investigate the Investor Complaint and may take disciplinary action against the brokerage firm (and individual brokers), resulting in fines, suspensions, referral to the SEC, and in some cases, restitution (although there is no guarantee that funds will be returned to investors).[42] Under certain circumstances, the arbitration panel may also refer potential misconduct to FINRA's regulatory arm. FINRA cautions customers and investors as follows:

> If you want to make FINRA aware of any potentially fraudulent or suspicious activities by brokerage firms or brokers, then the best course of action is to use FINRA's Investor Complaint Center. However, if you want to recover damages, such as money or securities, filing an arbitration or mediation case offers you a way to seek damages.[43]

[35] http://www.finra.org/arbitration-and-mediation/dispute-resolution-statistics.

[36] Id.

[37] Table compiled using statistics from: http://www.finra.org/arbitration-and-mediation/dispute-resolution-statistics .

[38] See Prohibited Conduct, FINRA, http://www.finra.org/investors/prohibited-conduct; see also FINRA Rule 3000 (regarding "supervision" requirements).

[39] FINRA Arbitration Case No. 07-02659, decided 12 March 2008.

[40] See generally *Davis v. Wells Fargo Advisors LLC*, No. CV-13-01963, 2014 U.S. Dist. LEXIS 48361, *7 (D. Ariz. 8 April 2014) (holding that customers had to arbitrate their claims, which included an alleged " violation of the applicable rules of the Financial Industry Regulatory Authority" as Count I); *Landow v. Wachovia Secs., LLC*, 966 F. Supp. 2d 106, 130-31 (E.D.N.Y. 2013) (noting customer's previous FINRA arbitration, which included "violation of NASD and NYSE rules" in the claim); (*Landow v. Wachovia Sec., LLC*, FINRA Arbitration Case No. 10-04510, decided 28 June 2011).

[41] http://www.finra.org/investors/investor-complaint-center.

[42] FINRA Investor Complaint Program Brochure at p.1, available at http://www.finra.org/investors/investor-complaint-center.

[43] https://www.finra.org/arbitration-and-mediation/overview.

43 Virtually all brokerage firms are members of FINRA, and are therefore subject to FINRA arbitration jurisdiction in connection with their business activities.[44] While customers cannot initiate FINRA arbitration against other types of financial institutions,[45] such as large multinational banks, in some cases brokerage firms are housed within a group of corporations that includes a large bank as a parent.

44 This raises a question that has been the source of much debate: who qualifies as a customer for the purposes of accessing FINRA Arbitration?[46] FINRA Rule 12100 defines "customer", but says only that "[a] customer shall not include a broker or dealer".[47] Many, including courts, have found this definition alone to be "too broad".[48] Moreover, customers are beginning to see arbitration as a valuable alternative to traditional litigation.[49] This has left the courts with the task of determining the appropriate legal boundaries and narrowing the scope of the definition, which they have occasionally done on an inconsistent basis, using a case-by-case determination.[50] At the very least, "[t]here is no dispute over the fact that investors are customers of their brokers under FINRA".[51] However, the question remains: does the relationship extend to activities that are not investment-related, such as banking or giving financial advice?[52]

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[44] http://www.finra.org/industry/member-regulation; see also SEC Release No. 34-50700, "Concept Release Concerning Self-Regulation" 2 (28 November 2004), available at: http://www.sec.gov/rules/concept/34-50700.htm ("Self-regulation is a key component of U.S. securities industry regulation. All broker-dealers are required to be members of a self-regulatory organization (SRO), which sets standards, conducts examinations, and enforces rules regarding its members".)

[45] See FINRA Investor Complaint Program Brochure at pp. 3, 7-8, available at http://www.finra.org/investors/investor-complaint-center.

[46] J.W. Burge and L.K. Richards, "Defining 'Customer': A Survey of Who Can Demand FINRA Arbitration", 74 *Lousiana L. Rev.* 173, 175-76 (2013).

[47] FINRA Code of Arbitration Procedures for Customer Disputes Rule 12100 (i); see Burge & Richards, supra note 46, at 189.

[48] Burge & Richards, supra note 46, at 189; see also *Fleet Boston Robertson Stephens, Inc. v. Innovex, Inc.*, 264 F.3d 770, 772 (8th Cir. 2001) ("[The defendant] argues that by negative inference this definition means a 'customer' is everyone who is not a broker or dealer. We agree with the district court that this definition is too broad").

[49] See B. Black, "Is Securities Arbitration Fair to Investors?," 25 *Pace L. Rev.*, No. 1 (Fall 2004); Teresa J. Verges, "Opening the Floodgates of Small Customer Claims in FINRA Arbitration: *FINRA v. Charles Schwab & Co.*, Inc.," 15 *Cardozo J. Conflict Resol*. 623 (2013-2014).

[50] Burge & Richards, supra note 46, at 189.

[51] Id., at 190.

[52] Id. at 200-01. In *Citigroup Global Markets, Inc. v. VCG Special Opportunities Master Fund, Ltd.*, the Court of Appeals for the Second Circuit held there was a factual issue as to whether a customer relationship existed. The defendants had sought to compel FINRA arbitration against a brokerage firm because, based on a long-term relationship with the firm, its employees had "recommended and set the terms for" a credit default swap between the defendants and Citibank. However, in *Wachovia Bank. National Ass'n v. VCG Special Opportunities Master Fund, Ltd.*, involving a similar credit default swap with the same defendants and Wachovia Bank, the same Court of Appeals concluded that there was no customer relationship. Because the brokers who participated in the transaction did not provide recommendations, but only provided business services, the court held that the brokers did not have an "advisory, brokerage, or other fiduciary relationship" with the defendants. 598 F.3d 30, 39 (2d Circ. 2010). Recognizing that "[a] simple, predictable, and

45 FINRA has delineated and streamlined arbitration procedures, which depend on the size of the claim. For claims over USD 100,000, FINRA requires an in-person hearing by a panel of three arbitrators.[53] For smaller claims, between USD 50,000 and USD 100,000, there is generally a hearing with a sole arbitrator.[54] In addition, for claims up to USD 50,000, there is a Simplified Arbitration Process pursuant to which the arbitrator decides the case based on the parties' submissions without a hearing.[55] Filing fees can be waived upon a showing of financial hardship,[56] and claims that are settled (or are withdrawn) more than 10 days before the hearing date may be eligible for a partial refund.[57] FINRA's streamlined procedures are, therefore, cost-sensitive, making them suitable for small investor disputes.

B The Hong Kong FDRC

46 Created in 2012, the Hong Kong FDRC is a non-profit organization that provides mediation and arbitration services for certain small investor claims against financial institutions in Hong Kong. It administers the Financial Dispute Resolution Scheme (FDRS). Under this scheme, investors whose claims satisfy the eligibility criteria may take advantage of a low-cost and efficient dispute resolution mechanism, involving mediation in the first instance and, at the option of the investor, arbitration if the dispute is not settled during the mediation phase.[58]

47 The origin of the Hong Kong FDRC can be traced back to the Lehman Brothers-Related Investment Products Dispute Mediation and Arbitration Scheme (Lehman Brothers Scheme). Between 2003 and 2008, structured derivatives products ("minibonds") linked to the credit of the U.S. investment bank Lehman Brothers Holdings Inc. were sold to retail investors in Hong Kong. Given the risks associated with such products, they were usually sold to institutional investors. After the collapse of Lehman Brothers, the Securities and Futures Commission (SFC) received complaints from retail investors that Hong Kong

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suitably broad definition of 'customer'" had become necessary to end wide-reaching litigation over the meaning of the term, last year, the Court of Appeals for the Second Circuit finally held that "'a customer' under FINRA Rule 12200 is one who, while not a broker or dealer, either (1) purchases a good or service from a FINRA member, or (2) has an account with a FINRA member". *Citigroup Global Mkts. v. Abbar*, 761 F.3d 268, 275 (2d Cir. 2014). This definition has been used by courts in other Circuits. *See Wilson-Davis & Co. v. Mirgliotta*, Case No. 1:16-cv-3056, 2017 U.S. Dist. LEXIS 64970, at * 11 (N.D. Ohio Apr. 28, 2017), *aff'd Wilson-Davis & Co. v. Mirgliotta*, 721 Fed. Appx. 425, 428 (6th Cir. 2018); *Hunsinger v. Carr*, Case No. 14-cv-2302, 2016 U.S. Dist. LEXIS 68437, at *16 (E.D. Pa. May 24, 2016); *BMO Harris Bank, N.A. v. Lailer*, Case No. 16-cv-545-JPS, 2016 U.S. Dist. LEXIS 101139, at *10 (E.D. Wisc. Aug. 2, 2016). Other courts, including the Fourth and Ninth Circuit Courts of Appeals have similarly held that the term "customer" should not be restricted to those receiving investment or brokerage services, but should more broadly be defined to include those "who purchase … commodities or services from a FINRA member in the course of the member's FINRA-regulated business activities, i.e., the member's investment banking and securities business activities."; *Goldman, Sachs & Co. v. City of Reno*, 747 F.3d 733, 741 (9th Cir. 2014); *UBS Fin. Servs. v. Carilion Clinic*, 706 F.3d 319, 325–26 (4th Cir. Va. 2013) (emphasizing that "FINRA's purposes are not limited to investor protection", and that plaintiff fell within the definition of "customer" because it purchased underwriting and broker-dealer services related to auction-rate bonds from defendants); *UBS Financial Services v. Zimmerman*, Case No. 5:16-cv-155-FL, 2016 U.S. Dist. LEXIS 80575, at *14 (E.D.N.C. June 21, 2016) ("For an individual investor to successfully claim his status as a FINRA member's 'customer,' he must purchase goods or services directly from a FINRA member").

53 http://www.finra.org/arbitration-and-mediation/overview.

54 Id.

55 Id.

56 http://www.finra.org/arbitration-and-mediation/arbitration-fee-waivers.

57 http://www.finra.org/arbitration-and-mediation/summary-arbitration-fees.

58 The 2017 FDRC Annual Report (available on its website) indicates that, in 2017, the cases submitted concerned allegations of the following nature: 33.3% mis-selling (omissions); 54.2% operational issues (omissions, negligence and maladministration); 8.3% misrepresentation (investment performance, administrative matters and product nature) and 4.2% system malfunction.

banks had engaged in misleading practices to sell the minibonds to them.[59] Some investors were ignored by the banks when trying to negotiate a settlement, and the other dispute resolution mechanisms (litigation, small claims tribunal, etc.) were too costly to provide an effective remedy.[60] Reports of the Hong Kong Monetary Authority (HKMA) and the SFC eventually led the Financial Service and Treasury Bureau to make a proposal which sought to establish the Hong Kong FDRC in order to administer proceedings between eligible claimants and financial institutions, as defined in the FDRC Terms of Reference in relation to the FDRS (FDRC ToR), within a capped monetary limit.[61]

48 The FDRC ToR initially restricted eligible claims to an amount not exceeding HKD 500,000 (including interest) and arising either out of a contract between an eligible claimant, defined as an individual or sole proprietor, and a financial institution entered into or arising in Hong Kong, or an act or omission of the relevant financial institution in providing a service to the eligible claimant where it has acted as agent.[62] The limitation period for claims was 12 months. Many claims submitted to the FDRC were rejected on the basis of such criteria.[63] Following a consultation with all stakeholders, which began in late 2016, the FDRC ToR were revised and important changes were introduced to enlarge the intake criteria as well as to enable parties to submit claims to the FDRC on the basis of mutual agreement.[64]

[59] According to one author, the aftermath of the Lehman Brothers' bankruptcy involved more than 20,000 retail investors in Hong Kong who suffered losses from investments in structured products. See J. D'Agostino, 'The Hong Kong Financial Dispute Resolution Centre – Specialist arbitrators required to perform a delicate balancing act?' (2011), Kluwer Blog.

[60] S.F. Ali and J.K.W. Kwok, 'After Lehman, international response to financial disputes – a focus on Hong Kong', p.164. 10 Rich. J. Global L. & Bus. 151 (2011).

[61] The Terms of Reference (ToR) for the Financial Dispute Resolution Centre (FDRC) in relation to the Financial Dispute Resolution Scheme (FDRS) are available on the Hong Kong FDRC website. The most recent version of the FDRC ToR entered into force on 1 January 2018.

[62] Prior to the revision of the ToR (version January 2018), an "Eligible Claimant" was defined as an individual or sole proprietor who has, or who has had, a customer relationship with a financial institution or who has been provided with a financial service. A financial institution was defined as a "financial institution or a financial services provider authorized by the HKMA or licensed by the SFC", but excluding financial institutions that only carry on certain specific activities such as the provision of credit rating services. To be eligible for resolution under the FDRS, a dispute had to, *inter alia*, satisfy the following criteria: (i) be of a monetary nature; (ii) involve a claim not exceeding HKD 500,000 (including interest); and (iii) arise out of a contract between an Eligible Claimant and a financial institution that was entered into or arose in Hong Kong, or the act or omission of the financial institution in connection with the provision of a financial service to the Eligible Claimant where the financial institution acted as agent. As of 1 January 2018, the monetary limit on claims was raised to HKD 1,000,000.

[63] Consultation Paper (October 2016), paragraphs 2.8 and 2.17, available on the FDRC website.

[64] Consultation Paper (October 2016) and the Consultation Conclusions (August 2017), also available on the FDRC website.

49 Among the changes made to the intake criteria were the raising of the cap on eligible claims to HKD 1,000,000 (including interest) and the extension of the limitation period to 24 months from the date of purchase of the relevant financial instrument or first knowledge of the loss (whichever is later).[65] These changes entered into force on 1 January 2018. Further, effective 1 July 2018, the definition of eligible claimant has been enlarged to encompass small enterprises, including financial institutions.[66] As a result of the 2018 revisions of the FDRC ToR to enhance its services, parties may mutually agree to refer claims that exceed the intake criterial in relation to the monetary cap or the limitation period (referred to as an "Extended Eligible Dispute").[67]

50 The FDRS Mediation and Arbitration Rules (FDRS Rules), applied by the FDRC, aim at resolving a dispute before it reaches the arbitration stage.[68] The investor decides whether or not to file a claim with the FDRC, or, in the alternative, to pursue their claim(s) before the courts or under the rules of another institution. Under the general regime (for a "Standard Eligible Dispute"[69]), where a claim is deemed to be eligible, it proceeds to mediation. If the mediation fails, only the investor can decide to commence arbitration proceedings against the relevant financial institution. It is not necessary for the investor to obtain the consent of the financial institution to arbitrate. However, as a result of the 2018 revision of the FDRC ToR, subject to the agreement of the eligible claimant, the financial institution may now refer a dispute to the FDRC and/or make a counterclaim.[70] Further, on the basis of the agreement of the parties, in the case of an Extended Eligible Dispute, the parties may opt for mediation only or arbitration only under the auspices of the FDRC.[71]

51 In the event the claimant initiates arbitration proceedings, the FDRS Rules provide for a simplified procedure with an expedited timetable. One of the unusual features of the FDRS Rules is that the arbitration fees (fixed in the Rules) are lower for the claimant than for the financial institution respondent.[72] Disputes are resolved by a sole arbitrator, chosen by the parties from the list of arbitrators or, in the absence of an agreement by the parties, chosen from the list by the FDRC.[73]

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[65] FDRC ToR (2018), §2.1 definition of "Maximum Claimable Amount" and §12.1.1 (e) in relation to the financial threshold for claims and §2.1 definition of "Limitation Period". A further change in the 2018 revisions has been to permit the FDRC to accept applications for claims which are under current court proceedings.

[66] The definition of "Eligible Claimant" (Article 13.1 of the ToR) was amended to include "Small Enterprises", including financial institutions", effective 1 July 2018. A "Small Enterprise" is defined in the FDRC ToR (2018) as a limited company or partnership with annual turnover (or group annual turnover) of less than or equal to HKD 50 million, gross assets (or group gross assets) of less than or equal to HKD 50 million and no more than 50 employees (at the level of the company or its group).

[67] FDRC ToR (2018), § 12.1.2, which sets out the criteria for an "Extended Eligible Dispute". A consent document signed by both parties is required.

[68] Annex IV to the FDRC Terms of Reference (2018).

[69] FDRC ToR (2018), § 12.1.1, which sets out the criteria for "Standard Eligible Disputes".

[70] FDRC ToR (2018), § 12.1.2, which sets out the criteria for an "Extended Eligible Dispute" and the definitions in § 2.1 of "FI Claim" and "FI Counterclaim". A consent document signed by both parties is required.

[71] FDRC ToR (2018), §18.4.1, which refers to the definition of an "Extended Eligible Dispute" in § 12.1.2 (cases exceeding the monetary limit or the limitation period or where the claimant is a financial institution). A consent form signed by both parties is required to opt out of the usual "mediation first, arbitration next" approach.

[72] FDRC ToR (2018), Annex I, Schedule of Fees, Table A: Fee Scale (For cases of Standard Eligible Dispute) and Table B: Fee Scale (For cases of Extended eligible Dispute). An exception to this rule is made where the claimant is a financial institution which qualifies as a Small Enterprise under the 2018 ToR, in which case the fee is shared equally between the parties.

[73] FDRS Mediation and Arbitration Rules (2018), Article 3.4.1.

52 Generally, legal representation is not permitted during the arbitration.[74] The FDRS Rules seek to provide for a dispute resolution mechanism that can be handled by a "lay person".[75] An arbitrator is given certain powers under the FDRS Rules which are intended to enable him/her to conduct balanced proceedings, including the power to call for parties to provide information and/or documents to ensure the record is complete.

53 It is the intent that, in most cases, a "documents only" arbitration procedure will be adopted in order to reduce time and costs. In-person hearings can be ordered by the arbitrator at his or her discretion, but only in circumstances which justify a hearing and where the parties agree to assume the additional costs associated with such a hearing (as fixed by the FDRS Rules, which are divided equally among the parties in the case of an in-person hearing, in contrast to a "documents only" procedure).[76] The arbitrator may permit the parties to have legal representation and issue rules and directions relating to the other aspects of the arbitration proceeding.[77] One feature of FDRC arbitration that may be appreciated by financial institutions is the existence of a broad confidentiality obligation, which remains in effect following the conclusion of the arbitration proceedings.[78]

54 To date, the focus of the Hong Kong FDRC's caseload has been on mediation. According to the 2016 Annual Report, since the commencement of its operations until the end of 2016, the FDRC had administered 142 applications for mediation and only 14 arbitrations.[79] It appears that the very high rate of settlement of claims in the context of the mediations administered by the FDRC has resulted in fewer claims being referred to arbitration.[80] It is also possible that the monetary cap prevents larger claims that are more likely to go to arbitration from being brought under the FDRS. With the revision of the FDRC's intake criteria in 2018 and the possibility of claims being submitted that do not meet the criteria on the basis of mutual agreement of the parties, the number of arbitrations may increase over time.

C Conclusion

55 Where a financial institution has been sanctioned by a regulator, there will generally be a decision available with respect to the relevant conduct and, in some jurisdictions, such decisions also set out findings of fact. The dispute with an investor or customer of the financial institution will usually revolve around establishing a quantifiable loss that was caused by the relevant regulatory breach. This reason alone may be sufficient to justify addressing such claims in the context of a more streamlined procedure.

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74 FDRS Mediation and Arbitration Rules (2018), Article 3.8.3 (c), which applies to "documents-only" procedures.

75 J. D'Agostino, 'The Hong Kong Financial Dispute Resolution Centre – Specialist arbitrators required to perform a delicate balancing act?' (2011), Kluwer Blog.

76 FDRC ToR (2018) §20.2.1 and 20.2.2. The fees and costs are set out in Annex I of the ToR. In a "documents only" arbitration, the fee paid by the Claimant is HKD 5,000 and HKD 20,000 by the financial institution. By contrast, each party must pay an additional fee of HKD 12,500 where an in-person hearing is ordered.

77 FDRS Mediation and Arbitration Rules (2018), Article 3.9.2. This provision also states that where the parties are agreed on having an in-person hearing, "the Arbitrator may make directions for the further conduct of the arbitration, including adopting the HKIAC Administered Arbitration Rules or other rules, and may amend any such rules as the Arbitrator considers appropriate".

78 FDRS Mediation and Arbitration Rules (2018), Article 3.11.1. A breach of the confidentiality requirement can give rise to an injunction or damages (FDRC ToR (2018) § 23.8 and 23.10).

79 FDRC Annual Report for 2016, p. 2 (available on the FDRC website). The statistics in the 2017 FDRC Annual Report show that a further case was submitted to arbitration in that year and a second case was under consideration for arbitration.

80 The success rate for the mediations is reported in the 2016 Annual Report, at p. 2, to be over 80% from the commencement of the FDRC's operations to the end of 2016. For 2017, the FDRC reported a 90% success rate for the mediations cases completed and closed in that year (2017 Annual Report, p. 32).

56 As the cases of FINRA and the FDRC bring to light, many of the claims in the securities regulation area involve retail investors, who cannot afford to finance lengthy proceedings either before a court or before an arbitral tribunal. Both sets of rules seek to accommodate their needs in a way that could make arbitration an effective way of resolving such disputes. The prospect of resolving disputes with customers/investors in non-public arbitration proceedings may also be appealing to a financial institution, since regulatory matters generally involve reputational risk.

57 Although not strictly within the scope of the study of specialised arbitration institutions, the 2015 initiative of the Arbitration Club Financial Sector Branch (in London) bears mentioning in the context of regulatory matters. The resulting Financial Services Expedited Arbitration Procedure, intended to be compatible with the rules of major arbitral institutions including ICC,[81] provides for expedited arbitration proceedings with tribunals comprised of either a sole arbitrator or three members.[82] For small claims of customers/investors against a financial institution addressing the civil consequences of a regulatory breach, an efficient and cost-effective procedure such as this one could provide an attractive alternative to court proceedings, particularly given the possibilities for tailoring the procedure to suit the circumstances of the specific case. More recently, the ICC adopted its own expedited procedure for claims under USD 2 million, which parties can opt into with respect to claims above that threshold.[83] Nevertheless, in contrast to a regulatory scheme such as the one implemented by the FDRC, it is likely that expedited cost-efficient proceedings under the rules of a major arbitral institution would in many cases involving regulatory breaches be based upon a post-dispute submission agreement.

[81] Preface to the Arbitration Club Financial Sector Branch, Financial Services Expedited Arbitration Procedure, § 2. The objective of these rules has been to respond to concerns expressed in the financial services sector that "conventional arbitral processes and institutional rules are not necessarily conducive to the certainty and expedition that business users in the sector require". The working party that prepared the rules consulted with major arbitration institutions such as ICC, the International Centre for Dispute Resolution, the London Court of International Arbitration, HKIAC, P.R.I.M.E. Finance and the Swiss Chambers' Arbitration Institution. The procedure was launched on 30 April 2015.

[82] In the case of a sole arbitrator, proceedings would take approximately 21 weeks, starting from the service of a request for arbitration until an award is issued, plus the length of a hearing (if required). The proposed timetable for a three member tribunal is approximately 22 weeks, plus the length of a hearing (if required). It is possible for parties to streamline the proceedings further by adopting a "documents only" procedure or by restricting rights of cross-examination at hearings.

[83] The ICC Rules of Arbitration in force as of 1 March 2017, Article 30 and Appendix VI.

INTERNATIONAL FINANCING

INTRODUCTION

1 There are four types of international financing transactions which encompass financings by way of loans (excluding debt securities) or guarantee facilities:

a) Unsecured syndicated lending, which involves multiple lenders represented by an agent bank, and possibly several tiers of financiers whose respective rights are determined under inter-creditor arrangements.

b) Secured lending, involving parent or subsidiary guarantees and security on assets, bilateral or syndicated.

c) Project finance, which is generally characterised by the fact that lenders lend on a non-recourse basis to a project company – meaning that they have no rights against the sponsors and are secured primarily by the cash flows and the physical assets of the project. Once construction is completed, with the involvement of multiple parties, it is the lenders' right to step in and take over project completion and operation in the event of a failure by the borrower to perform adequately.

d) Trade finance, which covers the following types of transactions:

i) short-term trade finance transactions (e.g. letters of credit, including standby LCs);
ii) factoring/forfaiting/receivables financing agreements, bank payment obligations (BPOs);
iii) medium-term trade finance transactions (e.g. revolving LC issuance facilities, buyer/seller credit/guarantee facilities, sub- and silent participations and confirmations);
iv) long-term trade finance transactions (as per (ii) above but with long-term maturities instead of medium-term ones); and
v) hybrid trade finance instruments: letters of indemnity, counter-trade/off-set agreements, pre-export financings.

2 The Task Force sought to achieve the following:

a) Map currently prevailing preferences for means of dispute resolution in international financing transactions, irrespective of the identity of the participants, noting any significant geographical variations and identifying any apparent evolution in such preferences.

b) Address the findings identified pursuant to item a) in order to discuss both the benefits and downsides of international arbitration; on that basis, identify situations where the preference for traditional litigation by means of the court system is appropriate, as opposed to situations where the parties may want to reconsider their preference for traditional litigation.

c) Identify practical initiatives that could be implemented by stakeholders, in order to promote the use of arbitration when such recourse is justified.

3 Based on their experience and research, members of the Task Force noted a clear reluctance by financial institutions to use arbitration in transactions within their scope, in favour of recourse to traditional litigation.

4 However, it is noted that such reluctance, which appears to be greater in unsecured and secured lending transactions as opposed to project finance and trade finance transactions, is largely cultural and driven by inertia.

5 In that regard, there have been signs of a change in attitude towards arbitration by both multilateral lenders and commercial lenders in parts of the world where arbitration is often used in both project finance as well as secured/unsecured loan transactions. This may be a direct consequence of the financial crisis of 2007-2008.

6 In fact, arbitration is already favoured by financial institutions over traditional litigation when a party or security is located in a jurisdiction where courts are considered unreliable, and no agreement can be reached on the choice of a court deemed acceptable by both parties.

7 A particular concern arises with regard to disputes concerning security - more specifically, the adequacy of arbitration for such disputes. This is due to the customary perception that the intervention of a national court is necessary to implement and enforce a decision regarding the security at issue. That perception is not always correct, for the reasons described below:

a) The perception that any disputes relating to a surety agreement are not arbitrable is unfounded (subject to idiosyncrasies of the applicable law).

b) In matters involving insolvency proceedings, the arbitral tribunal's decision on enforcement remains subject to compliance with insolvency court decisions regarding matters over which it has mandatory and exclusive jurisdiction (i.e. validity of the security posted during the look-back period, approval of the statement of secured claims, etc.) as well as the insolvency proceedings timetable (i.e. stay of enforcement of assets); the rights of third party creditors are thus in no way threatened by the choice to use arbitration.

c) Thus, the primary issue is not whether such disputes are arbitrable, but rather whether choosing arbitration makes sense under the specific circumstances.

d) More specifically, some types of security, if not enforced voluntarily, rely on the intervention of a national court for their enforcement; and when dealing with such types of security, the choice to arbitrate will typically make no sense.

e) However, when the security at issue is in essence a "self-enforcing" security, there is no inherent reason for disputes arising out of such security to be referred to a national court as opposed to an arbitral tribunal; the attractiveness of arbitration in any given transaction will depend on the specific features of the transaction (i.e. the quality and reliability of courts available as an alternative to arbitration, the desirability of ensuring that any particular litigation is brought before a specific nation's court(s), or alternatively, the desirability to avoid such nation's court(s) or court system).

CURRENT ATTITUDES TOWARDS, AND USE OF, ARBITRATION IN INTERNATIONAL FINANCING TRANSACTIONS

8 The information collected from Task Force members and financial institutions surveyed shows a great variety of positions on the topic of the use of arbitration in the field of international financing transactions.

A Traditional resistance to arbitration (particularly in the institutional context)

9 A point of consensus among many interviewees was the prevailing perception that arbitration is not favoured in financial disputes. This type of perception has a strong effect on the use of arbitration in this field, particularly in an industry that is strongly influenced by market practice and standardization. Indeed, it is quite remarkable that several financial institutions have admitted that their comparatively limited recourse to arbitration is primarily motivated by the effects of this very perception.

For example, several excerpts from statements provided by interviewees are included in quotations below:

> 1. In terms of impediments to the use of arbitration in its field, the Bank sees the traditional resistance to arbitration in the financial sector as the primary obstacle - basically, it would be necessary to overcome the perception that arbitration is not used in financings.
>
> 2. The policy has been there forever and is not questioned.
>
> 3. The main obstacle to more use of arbitration in the financial sector is the prevailing practice in the financial community.
>
> 4. A pre-conceived notion that litigation at an international court would be more appropriate for banking transactions.
>
> 5. I see no significant hurdles apart from the lack of familiarity and understanding of arbitration of many of our peers.

10 Unless there are strong countervailing factors which favour the use of arbitration, financial institutions will generally not challenge the traditional and dominant approach of referring disputes to traditional litigation before state courts.

11 The comments provided were general in scope and not specific to the field of international financing transactions, but are certainly just as applicable in this context, as discussed in further detail below.

B General reluctance of policies/practices

12 Many, but by no means all, of the institutions surveyed have a well-established policy as to their preferred dispute resolution mechanisms for the type of transactions concerned. Other institutions select dispute resolution mechanisms on a case-by-case basis depending on the particular circumstances of the transaction concerned. When there is a formal policy, it generally provides for traditional litigation as the preferred or required option, subject to exceptions that allow arbitration in specific situations. For a majority of financial institutions, when the most appropriate means of dispute resolution is decided on a case-by-case basis, such assessment almost always results in a decision which favours traditional litigation over arbitration.

13 However, a change has occurred since the 2007-2008 financial crisis, and loan market associations such as the Loan Market Association (LMA) - including former African Loan Market Association (ALMA) and Asia-Pacific Loan Market Association (APLMA) - have started to include arbitration clauses in standard loan agreements and documentation as an option in certain regions.[1]

14 There is a general consensus among interviewees that the preference to use arbitration is restricted to either: (i) specific matters or activities involving extreme complexity or technicality and requiring expertise, or (ii) the need to avoid the jurisdiction of courts perceived to be unreliable. Some multilateral development banks prefer arbitration in order to avoid waiving their immunity from state court jurisdiction.

15 A minority of financial institutions systematically favour arbitration; they appear to be institutions operating in markets where recourse to national courts would prove ineffective.

[1] The Loan Syndications and Trading Associations' (LSTA) standard documentations do not include arbitration clauses and typically refer disputes to US jurisdictions.

C Arbitration in secured or unsecured lending transactions

16 As far as secured or unsecured lending transactions are concerned, whether bilateral or syndicated among a number of lenders (in line with the practice of the syndicated loan market generally), the current practice strongly favours traditional litigation over arbitration.

17 The reason for this preference is, in many cases, the outwardly straightforward nature of the contentious action, which is simply aimed at obtaining relief in the face of a defaulting debtor. Arbitration is not perceived as providing any advantage over traditional litigation for such actions.

18 However, it is important to note that even in this context, some interviewees would favour arbitration if arbitration would appear to be the more effective option for reasons specific to the transaction. For example, one such scenario involves the need to enforce the decision in a jurisdiction where arbitral awards will garner easier recognition than decisions issued by foreign courts, as a result of the 1958 New York Convention.

19 A commentator has also suggested that it would be advantageous to refer cases involving a loan agreement when the debt *situs* may be affected by the imposition of exchange controls preventing the borrower from servicing its debt to arbitration. While national courts are generally prevented from questioning a foreign government's decision regarding exchange controls (on the basis of deference and/or state doctrine, or equivalent), arbitration limits the borrower's ability to rely on such a defence.[2]

D Arbitration in project finance transactions

20 Arbitration attracts considerably more interest in project finance transactions than in the context of lending transactions. This is due to the fact that project finance transactions will often involve parties and security that are located in (or are otherwise subject to) the jurisdiction of courts that are perceived by lenders to be inadequate to handle the disputes that may arise in such transactions. However, a few financial institutions systematically include arbitration clauses in project finance transaction document(s) and/or agreement(s).

21 Recourse to national courts may be inevitable, for example in the context of security over assets where local courts may have exclusive jurisdiction (security over land was the specific example given by some interviewees). This issue is further discussed below.

22 Arbitration may be valuable in loan agreements between the lender and the borrower in cases where the borrower's default is the direct result of actions or omissions of other project participants (i.e. a contractor, off-taker, etc.) Provided that the arbitration clause allows multiparty proceedings or that the project participants have entered into an umbrella arbitration agreement, and depending on the terms of the arbitration clause/agreement, the borrower may then join the third party project participant as a party to the arbitration proceedings initiated by the lender against the borrower. More frequently, the lender may have an option to accept the involvement of the third party project participant in an arbitration between the lender and the borrower. Although the loan agreements and the contracts with the third party project participant(s) are distinct from the original agreement, implementing a single, streamlined dispute resolution scheme may prove beneficial to lenders when the choice of separate state courts under the various loan agreements would lead to the fragmentation of project unity.

[2] M. Davies, 'The Use of Arbitration in Loan Agreements in International Project Finance: Opening Pandora's Box or an Unexpected Panacea?', (2015) 32 *Journal of International Arbitration*, Issue 2, pp. 143–171.

E Arbitration in trade finance

23 In trade finance transactions, a majority of banks and about one half of the trading companies have confirmed that their preferred dispute resolution mechanism remains traditional litigation, notwithstanding the fact that most of the trading companies' professional associations (FOSFA, GAFTA, ICA and Sugar) recommend standard contract terms for business/trading for their members, and these terms provide for arbitration mechanisms that are frequently contained in the underlying commercial transactions documents, in particular in bills of lading and charter parties.

24 Among the reasons provided in favour of arbitration, banks and trading companies mention (i) the ability to enforce the award in jurisdictions different from those where the arbitration procedure took place, due to reciprocal recognition and enforcement of arbitral awards, (ii) issues of confidentiality, (iii) choice of expert arbitrators, (iv) the ability to select a neutral forum, and (v) the finality of the award.

25 Given the role of international trade as a key driver in the process of increasing internationalization (globalization), this Report aims to provide an insight into how trading companies and their financiers approach the issue of dispute resolution, both among themselves and generally. It is frequently said that international (cross border) contracts on the topic of the sale and purchase of movables - whether they are commodities such as crude oil and its by-products and coal, minerals such as iron, agricultural products or finished or semi-finished goods - are financed predominantly through letters of credit, which are invariably issued by banks. This traditional method of financing provides an acceptable solution to the natural reluctance of (i) a seller to part with his goods without first being paid, (ii) a buyer to pay the price for the goods before he has obtained possession and/or ownership, and (iii) the financier, who obtains security for the repayment of its financing to the seller/exporter or the buyer/importer by way of the documents which transfer the right to possession and/or title in the goods to the holder of those documents. Because the goods are often perishable and/or are susceptible to rapid price movements, it is self-evident that in case of a dispute the parties (and other interested parties in the transaction, such as shippers) will prefer a dispute resolution mechanism which provides swiftness as well as security. The issue is whether arbitration or traditional litigation more effectively satisfies these requirements.

F Relevant experience of multilateral development banks

26 It is important to note that many multilateral development banks demonstrate a strong preference for, and comfort with, arbitration as a means of dispute resolution. In some cases, they are prevented by their constitutive documents from accepting the jurisdiction of national courts for their outgoing financing activities, which makes arbitration the preferable means of dispute resolution for such activities. Their preference for arbitration as a means of dispute resolution is a primary example of the changing landscape in the field of international financing transactions, and can serve as a leading source of experience and changing practice for all financial institutions involved in similar transactions.

G Geographical trend

27 The experience of Task Force members and financial institutions' interviews also suggest certain geographical trends. Arbitration essentially appears to be more popular in transactions located in Latin America, the CIS or Africa.

H Sovereign or public factor

28 The sovereign factor is widely reported by interviewees as a key factor in favour of selecting arbitration as a means of dispute resolution, either because the lending financial institution is owned by a sovereign state, or even when there is a public counterparty, such as in PPPs.

SPECIFIC EMPIRICAL FINDINGS

A Most frequently cited reasons as to why financial institutions are reluctant to engage in arbitration

29 The reasons most frequently cited by financial institutions to explain why they are reluctant to use arbitration in the context of disputes involving international financing transactions are threefold.

30 The first set of reasons relates to market resistance. Interviewees refer to market practices in the financial sector, and suggest that resistance to arbitration affects both lenders, including syndicated lenders, and counterparties. There is a strong tradition of choosing New York or London courts. As mentioned above, financial institutions also stress lack of familiarity and lack of knowledge of their peers as a crucial impediment to shifting the market towards the use of arbitration as a primary dispute resolution mechanism.

31 Secondly, certain features of arbitration are perceived as being less efficient or not as well adapted to financial disputes as traditional litigation. Such features/perceptions include the following:

- arbitral proceedings are lengthy;
- a summary judgment is not available;
- interlocutory measures are not as easy to secure and to enforce as they are before state courts;
- the high level of costs is often cited, as a general factor;
- court litigation creates legal precedent(s), giving greater clarity and predictability to the likely outcome of future disputes with related or similar facts;
- arbitration panels are not bound by precedent; and
- judges, especially in New York and English courts, are well-regarded as having a great deal of experience with financial products and the financial industry as a whole.

B Main reasons for financial institutions' choice in favour of arbitration

32 When arbitration is chosen, the motivation will generally be that the institution prefers arbitration in order to avoid having to refer disputes to unreliable courts. The primary reasons which are given to justify the preference of arbitration in such cases are mainly procedural in nature and intrinsic to the process of arbitration (i.e. flexibility of procedures and timing, possible confidentiality, ease of enforcement, etc.) and also include the professional qualities and expertise of arbitrators, as well as the neutrality of the arbitral forum.

C Main reasons in favour of litigation

33 Some financial institutions value traditional litigation over arbitration because of the presence of certain features pertaining to litigation and not to arbitration, such as litigation's ability to generate legal precedent, and a perception that the range of available interim measures on assets is more restricted in the context of arbitration. But the greatest concern, by far, focuses on the perceived higher cost of arbitration.

34 There is also one concern that is specific to all varieties of secured financings: resorting to arbitration seems to present few or no advantages in connection with a surety that, in order to be realised, would require the creditor to go to state courts. However, that is not to say that recourse to arbitration is not available for such matters; subject to any idiosyncrasies of specific jurisdictions, such disputes are arbitrable. Further, even in the presence of such a surety, it may be beneficial for the *main financing agreement*, and possibly other sureties, to be referred to arbitration if it is possible to avoid court involvement in doing so, and if the courts that would otherwise be chosen are not acceptable to all parties. By way of example, there is no difficulty in having an arbitral panel review the validity of an accelerated decision of the facility, while referring the *enforcement* of an ancillary surety to the state courts may prove far more challenging.

D Potential influence of the transaction's features

35 Nature of the transaction. Complexity, multiparty involvement and the preference to keep certain matters out of the public eye are key factors which favour the choice of arbitration, and this explains why arbitration is preferred as the dispute resolution method of choice in project finance transactions more than in lending transactions.

36 Location of the parties/project/assets. In secured lending, the location of the secured assets of both the borrower and the guarantors is of primary concern, but it is not *per se* a decisive argument in favour of the choice to arbitrate – it is mostly relevant insofar as the national courts in the relevant location(s) are not deemed adequate to the particular financial institution (this is discussed below in further detail).

37 In project finance, the location of the financed project assets and the place or origination of the cash flows that are used to repay the lenders, together with the location of the public entities giving licenses or approvals, as required, are central considerations.

38 Security. As discussed above, referring a matter to arbitration in the context of security agreements that will require the compulsory involvement of a national court in order to enforce the security would significantly reduce the incentives of choosing to arbitrate; particularly to the extent that it would bifurcate disputed matters between parties into those that are arbitrable and non-arbitrable. It should be noted, however, that self-enforcement is available in a very large number of jurisdictions on movable assets and, while the requirement of a national court's judgment remains in a number of other jurisdictions for charges on real property, court adjudication may be avoided. By way of example, countries requiring mandatory court approval for enforcement of all types of security interests include those in Italy and Egypt, while self-enforcement is prohibited on business charges only in France and OHADA countries. It can be avoided in other countries either through a public notary (Poland) or for commercial transactions (Japan). Regarding charges on real property, alternatives to national court involvement are available in the United Kingdom, France, Luxembourg, certain states in the United States of America, Hong Kong and Switzerland.

39 However, self-enforcement of collateral, which does not require the intervention of a court, is increasingly available for lenders *vis-à-vis* borrowers or security grantors/sureties on a large number of assets in a number of jurisdictions, including on real property,[3] as an alternative to court approval of foreclosure or sale at auction. This is possible only to parties having provided for a mechanism to determine the enforcement price, or if there is a quotation of the secured assets on an organised market. In all such cases the choice of arbitration, as opposed to litigation, is available to resolve any dispute arising out of the self-enforcement process and may be considerably more attractive.

40 Whether it is an attractive alternative in any given transaction will depend on the specific features of the transaction: the quality of the courts available as an alternative to arbitration, the desirability of ensuring that any litigation is decided before a given national court, or on the contrary, the desire to avoid a situation where third parties could join forces against the lender (for example by making converging arguments that the contractual pre-conditions to an acceleration of the debt and an enforcement of the security were not yet satisfied, or that the enforcement proceeds are below the fair value of the secured assets). The possibility of inter-creditor disputes spilling over to security disputes should also be borne in mind.

41 There still exist important types of assets and many jurisdictions where there are significant hurdles to self-enforcement of collateral, and where an appearance before the courts of the country where the assets are located remains mandatory for validity and enforceability of the security agreement *vis-à-vis* third parties. This remains a requirement irrespective of the law chosen by the parties to govern the security, even if the choice of another law is available. In such cases, selecting arbitration would appear to be entirely unjustified (subject to any idiosyncrasies of the local court system justifying a combination of various dispute resolution mechanisms).

42 In matters involving insolvency proceedings, the arbitral tribunal's decision on enforcement remains subject to compliance with insolvency court decisions on matters over which it has mandatory and exclusive jurisdiction (i.e. validity of security posted during the look-back period, approval of statement of secured claims, etc.) and the insolvency proceedings timetable (stay of enforcement of assets). The rights of third party creditors are thus in no way threatened by the choice to arbitrate.

43 Quality of local courts. In many jurisdictions, judges are unlikely to be as capable of handling highly technical and/or specialist issues as expert arbitrators, such as contractual subordination, parallel debt, *pari passu* obligations, etc. Furthermore, in some cases, political pressure can interfere with the adjudication of sensitive legal issues such as material adverse changes clauses (MAC clauses), or enforcement of anti-corruption and sanctions legislation. The increasingly aggressive enforcement actions by sanctions authorities has led many lenders to seek contractual representations and warranties from borrowers regarding the borrower group's compliance with sanctions and anti-corruption laws in recent loan documentation. Furthermore, the extraterritorial reach of certain laws might create legal difficulties before local courts. Standard loan documentation(s) focusing on certain regions have actually recognised this issue and include arbitration provisions (e.g. Standard Term Facility Agreements produced by the African Loan Market Association).

44 Involvement of third parties in the borrower-lender relationship. In secured structured finance transactions, third parties are likely to be involved in the borrower-lender relationship. Some involvement is related to security arrangements requiring a third party collateral manager, or pledged listed financial securities and cash account holders. Lending arrangements bring about hedge contracts with hedging banks, and as the case may be, credit insurance arrangements or liquidity facilities. Furthermore, several tiers of financiers

[3] The availability of self-enforcement for security on real property is available in a number of jurisdictions.

may be involved whose respective rights are determined under inter-creditor arrangements. In projects; other entities such as constructors, maintenance entities, suppliers and off-takers will also be involved.

45 As payment obligations of the debtor are often intertwined with obligations of various stakeholders in the project, it may be wise for an umbrella arbitration agreement to be agreed upon by all participants in the transaction in order to facilitate resolution of multi-party issues under the auspices of a single arbitration forum. However, financial institutions surveyed on this topic have not shown any significant interest in this option, and in some cases clearly rejected it.

46 Size and composition of the lending syndicate. Although each lender in the syndicate makes its own credit decision and has a direct relationship with the borrower, there is a strong market practice in lending documentations of strict contractual discipline among lenders in the syndicate through qualified majority decisions (except in urgent circumstances where the agent bank's decision is made without prior consultation of lenders). In this respect, the number of lenders in the syndicate and the number of jurisdictions in which they are located do not influence the choice for arbitration which concern borrower-lender relationships. However, when the syndicate comprises of local and international lenders, this may encourage the choice of a neutral venue. It is also noted that standard documentation rules will not organise alignment of financiers in presence of multisource financings, as is common in LBO financings or project finance. Furthermore, there may be legal issues among lenders in the syndicate, in particular in relation to the liability of defaulting lenders and agent banks.

E Potential features that could render international arbitration better adapted to needs of financial institutions

47 The actual involvement of the institutions surveyed in arbitration proceedings tends to be very limited. The project finance context appears to have generated more cases of arbitration proceedings than international lending. The reason for this seems to stem from the complexity of the matter, the perception being that arbitration is only warranted for the more complex and technical matters (such as project finance projects), and less so for the arguably more straightforward lending transactions. The individuals interviewed who have actual substantive experience with arbitration report a positive experience with regard to the process.

48 In trade finance, most interviewees indicated that they valued the opportunity to select themselves one arbitrator, when the tribunal would consist of three arbitrators. Most interviewees indicated a desire to have arbitral bodies/institutions establish lists of suggested arbitrators with expertise in given areas of practice to assist them with their selection. These lists would also specify their nationalities, academic studies/qualifications, professional qualifications, past/present work experience, arbitration experience, and language skills.

INTERNATIONAL FINANCIAL INSTITUTIONS, DEVELOPMENT FINANCE INSTITUTIONS, EXPORT CREDIT AGENCIES

INTRODUCTION

1 International Financial Institutions (IFIs), bilateral Development Finance Institutions (DFIs) and Export Credit Agencies (ECAs) are important players in the financial world. IFIs, DFIs and ECAs often work closely with private sector financiers (such as commercial banks) in project and export financing. Given the bargaining power they tend to wield on financing documentation, including the adoption of dispute resolution mechanisms, it was considered worth exploring their attitude towards international arbitration.

2 One would expect that IFIs, DFIs and ECAs have a strong interest in using international arbitration as a means of dispute resolution in their business - because of advantages in enforcement or because (in the case of IFIs) it suits their international status. The Task Force sought to verify whether this assumption was correct, and if not or only partially the case, what were the reasons. While the empirical research proved such assumption to be correct in that arbitration was actually the primary dispute resolution mechanism used by IFIs, DFIs and ECAs, there were certain areas of particular relevance where improvements could be made.

3 Although IFIs, DFIs and ECAs do not appear to have many actual cases of international arbitration, these groups of financial institutions are found to be relatively open to international arbitration (in comparison with private sector financial institutions) for various reasons:

a) these financial institutions frequently operate in emerging countries where foreign courts' judgments cannot be easily enforced;

b) these financial institutions (or at least some of them) tend to have a number of transactions with sovereign governments; and

c) some IFIs do not wish to depend on national jurisdictions to protect their privileges and immunities.

GENERAL APPROACH TO ARBITRATION

A Policies and Guidelines

4 Regional IFIs and ECAs[1] tend to have no written policy regarding dispute resolution mechanisms for cross-border contracts. Some have an internal "practice note" instead of a strict policy. Similarly, the DFIs interviewed also have no explicit written policy or guidelines on dispute settlement mechanisms for cross-border contracts, but they generally have an established practice on this issue. One global IFI takes a consistent approach to dispute resolution, using a standard dispute resolution clause for contracts with its own customers.

[1] While a number of interviews were conducted, the Report and Supplemental Materials do not purport to be a comprehensive account of the views of all IFIs, ECAs and DFIs. See the non-exhaustive list of institutions interviewed in Annex II (p.27) of the ICC Report on *Financial Institutions and International Arbitration*, available at https://iccwbo.org/publication/financial-institutions-international-arbitration-icc-arbitration-adr-commission-report/.

5 Regional IFIs appear to take varied approaches depending on the nature of the transactions in question. However, the majority of the regional IFIs favour international arbitration in their lending/investment operations. This appears to stem from their Charter documents, stipulating their privileges and immunities arising from their "super-national" status (see section B below). By contrast, it appears that in their borrowing transactions they cannot insist on arbitration as the mode of dispute resolution, and can therefore be exposed to judicial proceedings.

6 There are of course exceptions to the above. Some regional IFIs which are comfortable with local courts within their "countries of operation" provide for the jurisdiction of the national courts. One regional IFI tends to use, for loans to sovereign borrowers, dispute resolution clauses that are tiered or designed to increase the likelihood of a consensual resolution, including through diplomatic channels. The clauses ultimately provide for resolution in the national courts of the sovereign borrower, but the institution has never had a sovereign borrower default. For loans to the private sector, the institution tends to "follow the market" when it comes to dispute resolution provisions. Its preference is to resolve debt obligations in a court for two reasons: a) courts can grant prejudgment remedies (such as garnishments, attachments and seizures of collateral), and b) arbitral orders/awards must be validated by a court of law in order to have compulsive effect. This institution is thus able to submit controversies to courts in a jurisdiction with an experienced, reliable judiciary.

7 A global IFI, specialised in providing political risk insurance, has a standard dispute resolution clause for contracts with its own customers and its own set of detailed *ad hoc* arbitration rules. Among the factors that led this institution to choose arbitration for the resolution of disputes is the fact that its standard applicable law provision chooses a denationalised law (to the extent that issues are not covered by the contract or the institution's founding convention), which is compatible with international arbitration, but not with litigation before state courts.

8 By contrast, there seems to be no clear tendencies for ECAs. Many appear to favour litigation in London or New York. Others are more open to arbitration. Some ECAs have both lending and political risk insurance operations. In financing operations, those ECAs tend to insist on submission by borrowers to international courts (i.e. courts in a jurisdiction other than the borrowers' countries, so long as international courts' judgments are enforceable in the borrowers' countries). In political risk insurance operations, their practice tends to require arbitration.

9 In their lending operations with borrowers active in developing countries across the globe, the great majority of DFIs agree on arbitration as the dispute settlement mechanism, in particular if there are issues concerning the mutual recognition of foreign court judgments in the jurisdiction of the borrower. Jurisdiction of the courts, in particular those of the jurisdiction governing the main contracts (e.g. English courts if English law is the governing law of the loan agreement or New York courts if New York law is the governing law), is also frequently agreed on, if permitted by the relevant jurisdictions involved, often as an option in addition to arbitration at the lender's choice. Local courts of the host country are sometimes the forum of choice in agreements on local collateral.

B Influence of the institution's status

10 Depending on its particular status, a multilateral, international, government-owned or development finance institution will tend to favour/disfavour arbitration or certain jurisdictions, on the basis of various reasons.

11 As multilateral institutions, regional IFIs enjoy privileges and immunities in their member countries, which they wish to protect by avoiding subordination to national jurisdictions. The choice in favour of arbitration is also influenced by the fact that they undertake projects in many emerging countries. Because of concerns regarding fair trials in some host countries, the practice of IFIs is to provide for a neutral forum in arbitration

proceeding. The forum should be a recognised centre for international arbitration where the arbitration tribunal should be able to act without undue interference. IFIs generally do not agree to an arbitration venue in the country hosting the project. There are however exposed to judicial proceedings with respect to their borrowing activities for which they do not have immunity from suit.

12 Some government-owned ECAs appear to favour their home countries' national courts. One ECA appears to include arbitration as an alternative remedy alongside a borrower's submission to jurisdiction if, *inter alia,* (i) the host country does not recognise foreign judgments, or foreign judgments are subject to *de novo* review on the merits; (ii) local courts are either not functioning as independent judicial *fora* or are practically non-existent; or (iii) local courts will not recognise foreign governing law clauses.

13 For DFIs, sovereign immunity does not seem to play a major role in the selection of an appropriate dispute settlement mechanism. Considerations of the neutrality of the forum and the enforceability of international arbitral awards and/or foreign court decisions in the borrowers' jurisdiction (developing countries across the globe) as well as the eventual enforcement of (local) collateral seem to have the biggest influence on this selection. For one DFI, the tendency to go for arbitration is higher if governmental funds are involved.

14 A global IFI specializing in political risk insurance appears to take an approach to dispute resolution that is shaped both by its status and by the nature of its product line.

C Influence of other parties' preferences

15 The dominant view concerning regional IFIs and ECAs is that their decisions to include an arbitration clause (or choose a particular arbitral institution or form of an arbitration clause) will not depend or be influenced by third parties playing a role in the transaction (guarantors, insurers, credit mitigation providers, etc.). However, some IFIs tend to hear "the market practices" when it comes to their private sector operations. One regional IFI appears to prefer international arbitration and this is notwithstanding the view of third parties playing a role in the transaction (as discussed above, there are instances where it is exposed to judicial proceedings in respect of its borrowing activities). The decision to include an arbitration clause (and its form) is made in its lending operations without reference to third parties. However, such decision may be influenced by third parties when it is involved in borrowing transactions. Another regional IFI appears to listen to the market and will negotiate dispute resolution clauses within acceptable limits.

16 The dominant view of ECAs follows outside counsel recommendation. When they are advised that international courts' judgments (such as from London or New York) are difficult to be enforced in debtors' countries, they tend to adopt international arbitration.

17 DFIs also rely on external counsel in finding an appropriate dispute resolution mechanism for the individual financing operation, bearing in mind that the ultimate goal is always to agree on a dispute settlement clause leading to an enforceable arbitral award or court decision. In practice, apart from other members of a banking syndicate, the dispute resolution mechanism is rarely proposed by counterparties.

18 A global IFI specializing in political risk insurance has a consistent practice of proposing *ad hoc* arbitration under its own arbitration rules in its contracts with customers notwithstanding the views of any third parties.

D Selecting arbitration in interbank disputes

19 A regional IFI seeks to protect its privileges and immunities with the provision for arbitration and in the event of an actual interbank dispute it stands to benefit from the advantages of arbitration discussed herein.

20 One ECA's practice is to analyse the matter on a case-by-case basis. The decision depends on the nature of the co-creditors - whether they are private, public, or multilateral - and its credit exposure.

21 A DFI emphasises that beside the courts of its own jurisdiction it regards the courts in the jurisdictions of the governing law of its financing contracts as capable and efficient institutions, so that it sees no need to resort to arbitration in interbank disputes (as opposed to disputes with its customers). In this context enforceability seems to be less of an issue, because the other banks are mostly located in countries where the relevant court decisions are recognised and enforceable.

22 Factors to be considered in determining the appropriate mechanism for the resolution of disputes between financial institutions:

a) For a regional IFI, the most significant obstacle appears to be the deeply rooted tradition to choose New York courts as the best method to resolve disputes. Most institutions try to follow standard practices and the market among financial institutions has chosen New York courts as dispute resolution preferred method.

b) Also, for a regional IFI, its own immunities and privileges, as well as the existing relationship between the financial institutions, the need to maintain future dealings and confidentiality, these are all taken into consideration when deciding the appropriate mechanism for the resolution of disputes.

c) An ECA's practice appears to depend on the nature of the co-creditors (e.g. private, public, multilateral) and its credit exposure.

d) For a DFI, in view of the long-term relationship with the other financial institutions, arbitration appears to be better, but mediation would be the best solution if, even after the dispute, these institutions wish to maintain joint projects or want to work together.

23 Obstacles which may prevent arbitration from being the preferred method of dispute resolution in disputes among financial institutions:

a) For regional IFIs and DFIs, the most significant obstacle appears to be the deeply rooted tradition to choose international courts as the method to resolve disputes.

b) Even for a regional IFI who favours arbitration as preferred method for resolving disputes among financial institutions with equal bargaining power, the following elements could be considered as obstacles: potential for bias by arbitrators, lack of knowledge of the subject matter constituting the dispute and the costs.

24 Appropriateness of arbitration for disputes between financial institutions:

a) A regional IFI considers that some disputes, given their gravity and importance, can be settled amicably in order to avoid the cost of arbitration.

b) An ECA considers challenges by a co-creditor to the exercise of remedies under "reserved rights" not suitable for arbitration between financial institutions.

c) Some DFIs disagreed with the idea that disputes are not suitable for arbitration as a matter of principle.

E The presence of sovereign counterparties

25 In the presence of sovereign counterparties, regional IFIs tend to choose arbitration and exempt themselves from national jurisdiction. ECAs also prefer arbitration because in the case of a sovereign counterparty, it will be more difficult to enforce international courts' judgments. It is to be noted, however, that in reality most of the sovereign debt problems are resolved in the "Paris Club" of OECD.

26 DFIs' view appears to be similar; one of them emphasizing that arbitration is the only available neutral dispute resolution mechanism in state-to-state relationships.

27 Alterations may be made to the arbitration clause where the contracting party is a sovereign entity.

28 Regional IFIs and ECAs tend to pay more attention to "waiver of sovereign immunity" clauses.

29 An ECA appears to narrowly define the ambit of such a clause, or explore the applicability of a BIT or similar agreement. A DFI tends to look for appropriate waivers of immunity, another one points out that in this context political solutions will be sought in case of a dispute.

F Influence of other factors

30 A regional IFI's view is that litigation is more appropriate to resolve obligations to pay. Obligations to pay are straightforward and courts can grant prejudgment remedies (e.g. garnishments, attachments, and seizures of collateral). In contrast, arbitration could be more appropriate for complex issues that require more expertise and are not subject to ready resolution. It considers that in a project completion dispute for example, the project completion issues and similar questions call for a high degree of expertise and deliberate consideration – and such competence may not be readily available in a local court.

31 An ECA favours litigation for three reasons. First, it can obtain a summary judgment without needing to go to trial on a simple matter - a loan transaction being very straightforward. Secondly, court resolution does not have a high cost like arbitration does (e.g. institutional and arbitrator fees). Thirdly, an arbitrator's expertise is not needed in a straightforward transaction where a borrower borrowed money and did not pay it back. A dispute over a debt obligation does not require consideration or application of extraneous principles.

32 Apart from the general answers above, a DFI considered the following elements to be important before opting for either litigation or arbitration:

- time (if there is a possibility of a time advantage by choosing arbitration);
- expertise (if it is a very complicated contract such as swap/derivative contracts an expert panel in arbitration may be a better option than judges who might not be familiar with the subject of the dispute);
- costs (if there is a significant cost advantage when choosing either arbitration or litigation); and
- confidentiality (if there are circumstances in which confidentiality of a certain dispute is preferred and therefore arbitration chosen).

33 One DFI appears to prefer litigation rather than arbitration due to a perception of higher costs. Other DFIs emphasise that they often or always want to see an arbitration clause in their development finance contracts and/or rely on advice by counsel in the specific regional/country context (also see above). In reconciling these views, it seems that arbitration is seen as a suitable and welcome additional option at the point in time when the dispute settlement clauses are agreed. However, in the very rare (see further below) case that an actual dispute arises there will be a reassessment of the respective advantages and disadvantages of arbitration versus litigation if both routes are available in the individual dispute (which is often the case, as arbitration and litigation are often agreed upon as alternatives, see further below).

34 For regional IFIs, the advantages of arbitration are: enforceability (with the New York Convention); expertise of arbitrators in the domain arbitrated; choice of arbitrators who understand the sector; neutrality of venue; better understanding by arbitrators of the

complex disputes which may include complex financial transactions; certainty of rules to be applied; faster than judicial proceedings; finality of the award (based on drafted arbitration clauses); lack of political pressure and confidentiality. However, one regional IFI adds that within developed regions such as the EU, arbitration offers no added value in the case of lending transactions (our potential claims are just about getting our money back, this is simple).

35 Potential disadvantages which play in favour of judicial proceedings are: arbitration is costly; sometimes not as fast as expected owing to difficulties encountered in enforcing arbitral award; or some jurisdictions refusing to honour the arbitral award.

36 ECAs' views are largely the same as above. One ECA adds confidentiality, rapidity, enforcement abroad as the key advantages of arbitration. As for the advantages of litigation, another ECA adds that its strong preference for litigation in a reliable court is driven by the following views:

a) It can obtain a "summary judgment" without need to go to trial (final hearing) on the merits since a loan transaction is very straightforward: "you borrowed the money and you didn't pay it back."

b) Court resolution does not have a cost (no institutional or arbitrator fees).

c) It does not want a "common sense" resolution of a debt. Very simply, the money was lent, was owed and was not repaid. That does not require consideration or application of extraneous principles. It does not want to hear from an arbitrator that the debtor "owes half the debt".

37 In an international context, DFIs refer to the advantages of enforceability of the arbitral awards, neutrality of the forum, efficiency and speed of the arbitral proceedings, confidentiality (if advisable in specific cases) and expertise of the arbitral tribunal.

38 Similarly, a global IFI specializing in political risk insurance identifies at least three advantages to arbitration: (i) the potential for dispute resolution in a neutral seat (outside the host state); (ii) non-public hearings and the ability to provide for confidentiality; and (iii) the potential for nominating arbitrators with relevant expertise. Among these factors, the potential for selecting a neutral seat is considered to be the key advantage.

SPECIFIC PREFERENCES WITH REGARD TO ARBITRAL PROCEEDINGS

A Institutional or ad-hoc arbitration

39 IFIs, DFIs and ECAs seem to prefer institutional arbitration over *ad hoc* arbitration. One of the exceptions is the global IFI specializing in political risk insurance, which has its own set of *ad hoc* arbitration rules.

40 In disputes with financial institutions, most regional IFIs and ECAs prefer institutional arbitration, but some might choose *ad hoc* arbitration depending on the nature of the co-creditor (private, public, multilateral) and their credit exposure. One DFI preferred institutional arbitration, while another signalled flexibility.

41 Concerning the selection of an arbitral institution/arbitration rules, regional IFIs and ECAs tend to select internationally recognised institutions (such as ICC, LCIA, etc.) Among some DFIs, ICC and LCIA are possibilities, but other institutions are also eligible in accordance with external legal advice.

42 With respect to internal policies (if any) providing for a particular arbitral institution to be chosen in priority, one regional IFI provides for arbitration under the United Nations Commission on International Trade Law (UNCITRAL) Rules in its public sector transactions. This has already been pre-agreed for all transactions with regional member countries. For private sector transactions, the practice is to use either the London Court of International Arbitration (LCIA) or the International Chamber of Commerce (ICC).

43 ECAs tend to favour internationally recognised arbitral institutions such as ICC, LCIA, SIAC, HKIAC, AAA, etc.

44 While there is no explicit written policy, the standard practice of two DFIs suggests ICC as preferred arbitral institution. With regard to contracts subject to English law, two DFIs mentioned the LCIA.

B Selection and expertise of arbitrators

45 On the method for selecting arbitrators, many regional IFIs and ECAs tend to follow recommendations from the arbitral institution or from counsel. Their preferred method is for each party to appoint one arbitrator, and for the two co-arbitrators to appoint the chair. The quality, competence and independence of the arbitrators are a real concern. On the whole, DFIs seem to have no specific view on this question, but one of them emphasised the professional legal know-how and reputation as basis for the selection of arbitrators.

46 The *ad hoc* arbitration rules of a global IFI contain requirements for members of the arbitral tribunal. The relevant rules provide that the arbitrators are to be persons of high moral character with recognised competence in the fields of law, commerce, industry or finance, who may be relied upon to exercise independent judgment. These rules also specify that the arbitrators may not be nationals of the home country of the investor or of the host country.

47 Both the regional IFIs and ECAs take the view that arbitral institutions should be encouraged to keep lists of arbitrators with banking expertise. For one regional IFI it would be useful to have lists of specialised arbitrators recommended by the arbitral institutions (the selection of arbitrators would be made by the parties but a list would be useful as a "quality label"). According to one ECA however, the banking industry is so vast, including regulatory, lending, operations, etc., that it wonders whether there is a critical mass of "international project finance" specialists who could be recognised by the industry as credible arbitrators.

48 While most DFIs deem such lists useful, one DFI considers the know-how of arbitrators in specific banking products as not necessarily of primary importance.

C Number of arbitrators and seat of arbitral tribunal

49 Most IFIs and ECAs prefer three arbitrators instead of one, for reasons of risk mitigation. A similar position is taken by some DFIs, one referring to the size of the project as an important element in this regard. The arbitration clauses of one regional IFI provide for the use of one arbitrator for less complex or smaller financial transactions and three arbitrators for more complex and bigger financial transactions. In public sector transactions, its applicable General Conditions provide for the use of three arbitrators irrespective of the amount or complexity of the transaction.

50 Neutrality of venue and applicable law play a big role when selecting the arbitration seat. England (especially London) tends to be the chosen seat in agreements for which the applicable law is English law or for commercial and banking transactions for which English law tends to be applied. For one DFI the neutrality of the seat plus convenience for the bank are decisive criteria. Such places as Zurich, Vienna, London and Paris are also considered suitable seats for an arbitral tribunal. Depending on the governing law, the bank's seat and London are also used by another DFI.

51 The *ad hoc* arbitration rules of the global IFI with its own set of rules provide that the tribunal shall consist of three arbitrators, unless the parties agree otherwise. Those rules select The Hague as the seat. When reviewing arbitration clauses in the underlying transaction documents, this global IFI prefers to see the seat outside the host country, but this is not a legal requirement for its political risk coverage.

D Attractiveness of appeal mechanisms and tiered arbitration clauses

52 An appeal mechanism in arbitration is not considered necessary by a number of regional IFIs. When there is an arbitration clause, their preference is for the dispute to be finally resolved by arbitration and the final nature of the arbitral award is reflected in the arbitration clauses. For some ECAs and DFIs, an appeal mechanism could defeat the purpose of rapidity of arbitration and could perhaps render less "serious" the work of the arbitrators in the first instance. Similarly, the global IFI specializing in political risk insurance expressed no interest in any appeal mechanism.

53 Most regional IFIs, DFIs and ECAs do not seem to use tiered dispute resolution clauses, for example in using mediation before a case is submitted to arbitration. However, some regional IFIs seem to use tiered dispute resolution clauses for sovereign debt deals, designed to increase the likelihood of a consensual resolution. The global IFI specializing in political risk insurance does not use tiered dispute resolution clauses in its guarantee contracts. However, this institution's founding convention provides for negotiation and conciliation before arbitration in respect of disputes between the IFI and member countries where a claim has been paid.

E Clauses on use of interim measures

54 Most regional IFIs have concerns about having access to courts for interim measures if financial institutions resort to arbitration. One sentiment is that interim measures are easily granted, due to a lack of enough in-depth analysis of the subject matter, and the courts tend to leave it to the arbitration panel to decide. One institution, enjoying immunity from suit (until final judgment) in its lending operations, does not allow any interim measures to be brought against it by other parties. However, it reserves the right to bring injunctions and seek other interim measures against borrowers/third parties in a court of law in order to preserve the status quo or prevent further deterioration of a subject matter.

55 In contrast, DFIs, ECAs and the global IFI specializing in political risk insurance do not seem to have specific concerns on this point. For one DFI, the advantages of arbitration outweigh any disadvantages in this regard.

F Asymmetric dispute settlement clauses

56 Regional IFIs have a preference for asymmetrical dispute settlement clauses that give financial institutions an option to submit disputes to arbitration or to the courts of a given state, in particular in private sector transactions. In lending transactions, in addition to arbitration as the dispute resolution mechanism, the IFI retains the option to bring litigation proceedings against the borrower (as a lender's option only) and in this regard requires the borrower to submit to the relevant court's jurisdiction. Asymmetrical clauses ensure that it has access to arbitration and the courts while precluding the counterparty from access to the court.

57 ECAs have largely the same approach, so long as such a clause is recommended by outside counsel as enforceable in the relevant jurisdiction. DFIs also endorse a practice to agree on court litigation as an additional option for the settlement of disputes for the lender in addition to arbitration (or arbitration instead of litigation) if the applicable laws permit. By contrast, the global IFI with its own set of *ad hoc* arbitration rules does not have a preference for asymmetrical clauses.

EXPERIENCE WITH ARBITRATION PROCEEDINGS AND ENFORCEMENT OF AWARDS

58 Most regional IFIs and ECAs had very few or no arbitration cases in the last three to five years. Judicial proceedings have been more frequent, albeit in very small numbers, as some counterparties in spite of the arbitration provisions in the agreements still resort to court proceedings.

59 DFIs likewise had very few or no proceedings, but in the case of one financial institution that had such experience, arbitral proceedings have occurred much more frequently than court proceedings.

60 The global IFI specializing in political risk insurance has never been involved in arbitration proceedings. Accordingly, the detailed *ad hoc* arbitration rules of this IFI have never been applied. It explains that this is due to its proactive approach to dispute resolution, which involves early intervention and assisting parties to disputes in amicably resolving their difficulties.

61 Accordingly, opportunities for actual participation in arbitration proceedings, be it as a party representative, as a witness, expert or counsel, seem to be limited.

62 With regard to the enforcement of arbitration awards, regional IFIs take the view that arbitration awards are easier to enforce when both parties accept the outcome of the arbitration. Enforceability is more difficult if one party perceives the arbitration as not properly carried out. An aggrieved party may seek an appeal notwithstanding the final nature of the arbitral award.

63 In some instances, administrative hurdles are encountered in executing an arbitral award in a country which is not the country from which the arbitral award originates. One DFI refers to a positive experience with enforcement in one case, despite intensive resistance.

POTENTIAL IMPROVEMENTS IN INTERNATIONAL ARBITRATION

64 When questioned on the most significant hurdles which could prevent them from using more consistently international arbitration, regional IFIs and ECAs raised the following concerns:

- costs;
- quality/competence/independence of the arbitrators (see paragraph 74 above on the idea of institutional lists operating as a "quality label"; a requirement that the arbitrators master the languages of the transaction documents would be useful and could give arbitration a plus compared to domestic courts);
- time (in the absolute, and in terms of predictability; arbitration does not compare too well to the English courts in this respect, for instance).

65 For one regional IFI, the traditional resistance to arbitration in the financial sector is the primary obstacle to the use of arbitration. It would be necessary to overcome the perception that arbitration is not used in finance. Moreover, it does have a concern that arbitrators tend to be too Solomonic (which is not always the correct approach in case of an enforcement of money claims upon the borrower's default) and perceives that the outcome of some recent state-to-state arbitrations have not put arbitration in a positive light.

66 In relation to a regional IFI's borrowing activities, its lenders usually impose the use of judicial proceedings. In these instances it is prevented from using international arbitration. Apart from these instances, cost and enforceability of the arbitral awards may be viewed as potentially deterring factors, yet the benefits of the arbitration process tend to outweigh the cost.

67 For some DFIs, costs and time efficiency are the most significant hurdles to arbitration. One of them expressed doubts as to the enforceability of asymmetric dispute resolution clauses in several jurisdictions, leaving development finance institutions no option to select the most appropriate forum in a specific situation. The absence of default or summary judgment in arbitral proceedings was also an area of concern.

68 For global IFIs which specialise in political risk insurance, arbitration is the selected method of dispute resolution for all customer contracts.

69 The following suggestions on how the arbitration process could be more attractive to financial institutions were made by the institutions surveyed:

a) The costs of arbitration proceedings could be reviewed, perhaps to establish caps on arbitrators' fees and seats' costs on the basis of the amount in dispute, for instance.

b) The arbitration rules should be established for expedited procedures. A roster of arbitrators who are experts in the financial sector would be a useful attractive tool.

c) Expenses incurred in arbitration proceedings should be reviewed towards making them more cost effective. There could also discussions aimed at making arbitral awards more easily enforceable and sensitising the magistrates and judges of national jurisdictions. The finality of the arbitration process would thereby gain wider acceptance.

d) An arbitration procedure for a typical loan payment default claim without prospect of counterclaims should be more expeditious (money was lent, money was not paid when due, and money is now due).

e) Measures against the perception of arbitration as being relatively expensive compared to conventional litigation would contribute to a broader acceptance.

70 The specific options which IFIs, ECAs and DFIs would like to have available in arbitration proceedings (for instance, summary or expedited proceedings, mediation proceedings before an arbitral proceeding, or rules on joinders of third parties/consolidation of cases) which would increase the chances of an institution including an arbitration clause in an agreement or series of agreements are the following:

a) An interesting option would be to establish a roster of arbitrators who are experienced in financial matters.

b) Options such as summary or expedited proceedings for use in financial transactions would be an even bigger incentive to choose arbitration. In general, any option that could ultimately benefit the parties regarding timeframe and costs would be highly considered at the moment of choosing arbitration as dispute resolution mechanism.

c) One DFI regards the introduction of default or summary judgment-type arbitral proceedings or accelerated proceedings tailored to the specific needs in proceedings on money claims, typically following a borrower's default, as measures particularly suitable for increasing the use and attractiveness of arbitration in international lending operations.

ASSET MANAGEMENT

INTRODUCTION

1 This chapter describes the meaning of "asset management" and the role it plays in the banking and finance industries and in the economic world in general, assesses the typical types of disputes that arise in this context, and endeavours to identify the players (i.e. categories of clients and financial institutions) and their perceptions regarding international arbitration.

2 In this context, the term asset management has been used to include private banking and family office practice. The issues typically arising therefrom are essentially identical, and the nature and scope of the analysis is not affected by the fact that one could potentially draw a distinction between these areas of the banking industry. For that reason, we will use the term "asset management" - which is most common - to encompass this broader area.

OVERVIEW OF FINDINGS FROM THE INTERVIEWS[1]

(i) Whether the special character and nature of "asset management" and "private banking" have a significant bearing on the determination to use a certain type of dispute resolution system (state court litigation or arbitration)

3 The answers ranged from "not necessarily" or a simple "no" to a clear positive recommendation of "arbitration as an adequate dispute resolution system in disputes between investment firms" although the interviewee was "more reluctant in relation to disputes between an investment firm and a retail client" to recommend arbitration.

4 Special requirements for the arbitration clause were also considered as relevant in determining the proper method for dispute resolution, particularly in the client context where certain factors might make arbitration more likely to be impracticable. In this respect, concerns related to consumer protection were also manifested when evaluating the preferred method for dispute resolution. In fact, banking institutions tend to avoid resorting to arbitration in jurisdictions where consumer protection does not favour it, or in jurisdictions that recommend mediation as the primary alternative to state court litigation (thus preventing the use of arbitration).

5 At the same time, positive experiences were also reported in national courts, particularly for disputes with large scale claims and, under those circumstances, the specialised expertise of judges in traditional litigation was not an issue. Concerns with arbitration clauses were also reported to the extent that they might be considered suspicious to clients who are unfamiliar with this type of dispute resolution mechanism. By the same token, the cost of arbitration was perceived as substantially higher than the cost of traditional litigation.

[1] The interviews with approximately 50 financial institutions inter alia forms the basis of the ICC Report on *Financial Institutions and International Arbitration*, available at https://iccwbo.org/publication/financial-institutions-international-arbitration-icc-arbitration-adr-commission-report/. See the non-exhaustive list of institutions interviewed in Annex II (p.27) of the Report.

6 The location of the client's assets was also reported as a factor to take into account in order to ascertain whether arbitration is the more appropriate choice for the resolution of the dispute.

7 A particular bank opined that the decision to use arbitration would depend on the type of management and the ownership of assets: when assets owned by the bank are managed by third parties, that bank would prefer to resort to traditional litigation in the event of a breach of contract, but if it is the bank that manages the assets of the third parties, the use of arbitration will be preferred because it will safeguard the bank's privileges and immunities.

8 Notably, the higher level of expertise possessed by decision makers in the field of asset management dispute resolution was a key consideration in determining the adequacy of arbitration in that context, particularly in jurisdictions where the courts do not have such specialised knowledge.

(ii) Whether advisory and discretionary services in asset management raise any special concerns, and whether they play a role in the decision to use arbitration to resolve disputes as opposed to traditional litigation

9 The answers ranged from a simple "unsure" or "no" to a statement at the opposite end of the spectrum which suggested that instead of resorting to an institutionalised system of dispute resolution, the "nature of the services would be better protected in an arbitration procedure".

10 Moreover, an opinion was expressed that the confidentiality of arbitration may be beneficial because the legal precedent generated through adjudication may sometimes raise concerns related to future disputes.

11 At the same time, for some interviewees, the regulatory framework which applies to advisory and discretionary services in asset management may present an advantage, and may further support the use of arbitration.

12 On the other hand, it was expressed that arbitrators, when engaged, tend to review the matter at hand in its fullness and complexity, thereby putting the parties in the arbitration in a situation where their specific business relationship is reviewed in detail. This may result in additional time and effort, consequently leading to higher monetary costs and more time spent.

(iii) Whether it would be advisable to use arbitration as a means of dispute solution in the context of asset management

13 Generally speaking, the interviewees do not recommend the use of arbitration unless absolutely necessary due to the complexities inherent in the dispute. Concerns were raised because "one might anticipate problems in selecting an arbitral mechanism that is perceived as fair and impartial by the client, besides doubts about the arbitrability of such disputes".

(iv) Whether it would be advisable to use arbitration as a means of resolving asset management disputes between investment firms, with a professional client or an eligible counterparty

14 Some interviewees expressed the view that disputes virtually never escalate - in particular to the point of court proceedings. It is the modus operandi (market practice) that even parties who are competitors in this field do not litigate against each other. Therefore, arbitration was not seen as having a major role in this field. However, this view was not shared by others who recommend the use of arbitration among investment firms, and with eligible counterparties.

15 Use of arbitration between an investment firm and a retail client. Responses were not unanimous. One non-EU entity opined that "it makes sense when one of the counterparties is a non-resident, but the procedure would be rather complicated and costly." At the same time, one EU entity emphasised that, "while not having any views on the issue – disputes between an investment firm and retail client (consumer) ought to respect the new ADR/ODR EU regulation." On the other hand, some said that they would not recommend or tend to recommend the use of arbitration due to consumer protection concerns.

16 Use of unilateral or asymmetrical arbitration clauses. Amongst the interviewees, there was a group of individuals that expressed reluctance towards using asymmetrical arbitration clauses or unilateral forum selection clauses. This opinion was explained and justified in several ways. In some instances, the validity of such clauses has been banned by the courts of the respective jurisdiction. Some interviewees opined that asymmetrical arbitration clauses may be viewed as being biased in favour of the financial institution drafting the clause, while others considered the use of such clauses to bring more complexity to the matter and possibly require additional advice. One interviewee stated:

> [H]aving a choice is preferable over not having one, but these clauses can present an enforcement risk in some jurisdictions.

17 However, some banking institutions and a development bank did not express any reluctance towards the idea of resorting to such clauses, with the latter particularly preferring this option in its private sector operations.

18 Actual experience with arbitration in asset management. No interviewee indicated having any sort of arbitral experience involving any of the issues identified and arising from the specificities of asset management. However, there was a specific exception to this general lack of experience. This relates to the confidentiality issue which is further discussed below. Although some interviewees expressed that confidentiality is considered a key element in dispute resolution in asset management, one particular interviewee displayed no concern with regard to this issue. This interview is particularly noteworthy because it was conducted with a former CEO of an institution dedicated exclusively to asset management. Overall, however, members of the Task Force, based on their personal experience, have a different view but reaffirm that confidentiality remains the most important feature in asset management dispute resolution.

19 **Summary of applicable literature and ICC cases.** There is a lack of consistent and thorough scholarship on the topic of asset management and international arbitration. Of course, there exist voluminous scholarly works in the area of asset management, but they are limited to the aspects of asset management related to banking and financial operations, and do not address the legal issues arising therefrom. Indeed, the legal materials available are scarce and limited to three noteworthy works written by Laurent Levy, Francisco G. Prol and Paul Dickson.[2] Hence, the general legal considerations and conclusions discussed below are drawn from these three works.

20 The survey regarding arbitral awards rendered under the aegis of ICC provided only one example of a dispute in asset management among the sixty cases that were made available for analysis. This single case, however, is not of particular interest in terms of relevant or applicable issues of law. The substantive issues also merely focus on standard relief of damages and specific performance for a breach of contract claim.

21 The ICC case related to a dispute arising from non-compliance with instructions given by the clients, but may only be considered to fall within the scope of asset management if we consider the setting up and maintenance of an escrow account to belong in this category.[3] In this case, a Spanish real estate developer brought arbitration proceedings against a Spanish investment bank. The claimant contended that the respondent failed to comply with its obligation to release and pay to the claimant an amount that was deposited by claimant in the escrow account held by respondent. The tribunal, comprised of three members, decided that the respondent was bound to release and pay to the claimant the amount deposited in such escrow account.

22 The analysis of the interviews held during the fact-finding phase of the Task Force does not seem to clearly point in any particular direction as far as the use of arbitration in asset management is concerned. One cannot say with certainty that either arbitration or litigation is the preferred method for resolving disputes. Furthermore, based on what was reported, experience with arbitration in the context of asset management is virtually non-existent.

23 On the other hand, scholarship on this topic is scarce, and there are few legal commentaries dedicated to arbitration in asset management and private banking disputes. To be more specific, only Laurent Levy has written an article specifically dedicated to this issue (some inferences based on this article will be discussed below). There does not appear to be other works specifically dedicated to arbitration of disputes related to asset management and private banking or discussion of this topic in either case law or arbitral decisions.

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[2] L. Levy, "Arbitration of Asset Management Disputes", in *Arbitration in Banking and Financial Matters*, ASA Special Series 20, at p. 89, G. Kaufmann-Kohler and V. Frossard (eds.), 2003; F.G. Prol, "El Arbitraje Financiero: Una Aproximación desde España", in *Revista de Arbitraje Comercial y de Inversiones*, edition of Centro Internacional de Arbitraje, Mediación y Conciliación (CIAMEN) de Madrid, Vol. VI, 2013 (3); P. Dickson, *The Asset Management Review*, Law Business Research, 6th Ed. (October 2017).

[3] This assumption is yet to be proven and may be accurate only with respect to some financial institutions specially dedicated to asset management, that also provide services related to escrow accounts, which is a type of service that is not always provided.

CONSIDERATIONS WITH REGARD TO THE USE OF ARBITRATION IN ASSET MANAGEMENT DISPUTES

(i) Definition of asset management

24 After having done some research relating to the definition of "asset management" as used in the banking and finance industry in general and in the arbitration context specifically, it can be said that no comprehensive suitable definition exists. Very few authors, scholars and commentators discuss this topic in their works.

25 Notwithstanding the foregoing, using a lexicon which is close to the arbitration environment, Laurent Levy defines asset management as consisting of "custody, administration and management of assets which the client entrusts to the bank [or the other financial institution] which shall receive a compensation."[4] Moreover, L. Levy points out that asset management consists of several components and is conducted in the areas of custody, administration, acquisition and disposal of assets, and management.[5]

26 This list may not be exhaustive (and therefore not entirely accurate). Thus, it may not encompass all possible real world scenarios in the banking and finance industries. Notably, there seems to be some overlap between what Laurent Levy categorises as "administration" and "management" (*stricto sensu*, one would have to add). Moreover, these descriptions are focused on the notion of "assets, which the client entrusts to the bank", and might not reflect all the various features of asset management. Banks and financial institutions are often not entrusted with the assets themselves, and function solely in an advisory capacity with regards to asset management. Thus, the need arises to examine other areas.

27 ISO (International Organization for Standardization) has recently revised its "ISO 55000" for asset management. The ISO standards seem to focus on "physical" assets, but a closer reading of the first definitions may lead to a different conclusion; an asset is an item, thing or entity that has potential or actual value to an organization. Therefore, the definition encompasses all kinds of assets, including financial assets. Thus, the "ISO 55000" definition of "asset management" may be applicable in this context; asset management is the "coordinated activity of an organization to realise value from assets". Furthermore, it may be said that "asset management" is a systematically performed process of the long-term maintenance of assets, with the objective of using the assets to produce the best results.

28 In the finance and banking industry, "asset management" is a process which aims to substantially expand the client's financial portfolio. In order to do so, this process combines research, interviews, and statistical analyses of companies, markets, and trends, including evaluating asset financing options, asset accounting methods, productions operation management, and maintenance discipline in order to maximise a client's financial portfolio value.

29 On the other hand, asset management may be characterised by one of two fundamental features. Sometimes the bank or the financial institution will act solely in an advisory capacity (i.e. providing information, making suggestions, recommending decisions) while on other occasions it will act with the authority of a power-of-attorney with discretionary powers.

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[4] L. Levy, supra note 2.

[5] See also F.G. Prol, supra note 2.

30 Generally speaking, one may refer to this activity as one that is carried out by individuals and companies that either manage investments on behalf of others or advise others as to their investments. Depending on the circumstances and the role played, discretionary powers may or may not be available.

(ii) The role of asset management in banking and finance

31 Usually, banking and finance institutions (or individuals acting in a professional capacity) are hired by institutional investors like pension funds, corporations, governments and financial intermediaries, as well as high net worth individuals.

32 Therefore, the field of analysis is vast.[6] As an example, and for illustrative purposes only, the website of one of the biggest asset managers in the world reports the existence of assets under supervision (this includes assets under management and other client assets for which that institution does not have full discretion) worth USD 999 billion, with investment solutions including fixed income, money markets, public equity, commodities, hedge funds, private equity and real estate.[7]

33 At the national level – and merely for the purpose of making a distinction – in Portugal the assets managed by the Portuguese asset management industry at the end of 2012 amounted to EUR 94 billion,[8] which is more than the whole Portuguese bailout programme of 2011. Meanwhile, the biggest German private banking institution had EUR 944 billion in assets under management at the end of that same year.

34 More figures can also be cited: according to the annual review of the European Fund and Asset Management Association (EFAMA), the "total of assets under management (AuM) in Europe increased 11% in 2012 and close to 9% in 2013, to reach an estimated EUR 16.8 trillion at end 2013. This growth was driven by net flows and market movements, on the back of improved financial market conditions and renewed investor confidence. This brought the ratio of AuM to aggregate European GDP to 115% of GDP at end 2013."[9] It is also interesting to note that, according to that review, a total of 52% of the AuM were under discretionary mandate, while the other 48% were investment funds. Citing this same review, "by providing credit capital directly via corporate bonds or indirectly via money markets, as well as equity capital in both primary and secondary markets, asset managers are financing the economy". Furthermore, "European asset managers held 23% of the securities other than shares issued by euro area residents at the end of 2012, and 31% of the share and other equity issued by euro area residents".

35 By comparison, and according to that same report, the U.S. represents a total of EUR 21.5 trillion, Japan a total of EUR 3.6 trillion, and Asia a total of EUR 2.9 trillion. In total, worldwide asset management represents EUR 47 trillion under management. It is therefore undeniable that asset management's role within the world of banking and finance is of the utmost relevance and importance. For this very same reason, it is somewhat surprising that so few legal materials have been produced concerning disputes involving issues of asset management.

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6 For a comparative review of the asset management industry see *The Asset Management Review*, supra note 2, featuring a European overview, and surveys on the jurisdictions of Austria, Belgium, Bermuda, Brazil, Canada, Cayman Islands, China, France, Germany, Hong Kong, India, Ireland, Italy, Japan, Luxembourg, Malta, Netherlands, Nigeria, Norway, Portugal, Russia, Saudi Arabia, Singapore, South Africa, Spain, Sweden, Switzerland, the United Kingdom and United States.

7 Goldman Sachs http://assetmanagement.gs.com.

8 *The Asset Management Review*, supra note 2. However, the EFAMA Annual Review points to a total of EUR 66 billion under management.

9 Annual Review of June 2014, available at http://www.efama.org/SitePages/Home.aspx.

(iii) Considerations as to the specific nature of the players

36 This section describes some of the characteristics which may be regarded as specific to the asset management and private banking industries, as distinct from other financial sectors, such as mergers & acquisitions, trade finance, etc.

37 Asset management is generally conducted using business units (or companies), which are quite distinct from other banking activities (e.g. mergers & acquisitions). In addition, it is often recommended or proposed that some "Chinese walls" exist in order to avoid conflicts of interest, typically where merchant banks also engage in advisory capacities, and help to conduct mergers and acquisitions, such as in the case of IPOs' and stock exchange listings. Also, the types of parties involved may vary; in mergers and acquisitions, trade finance, etc., both parties are generally commercial companies (i.e. banks or other companies in the financial sector), on one side, and industrial, commercial companies (listed, large, or SMEs), on the other side. This kind of "B to B" relationship demonstrates both parties' powers and responsibilities in the negotiation, execution and performance of these "banking" or "advisory" transactions.

38 Considering the "B to B" relationship and the (assumed) financial education and/or expertise of parties, their duties and responsibilities are frequently (if not always) determined by general principles of tort or contract law and are freely negotiated in transactional work. This approach is probably common to both civil law and common law environments.

39 Generally, in asset management, the private banker faces one or more individuals (sometimes a family estate), SMEs and/or non-profit organizations which typically have less expertise in financial investments. Given the (relative) imbalance between the parties, the latter party frequently enjoys some level of consumer protection, which is often mandatory.

40 In the European Union, this trend in favour of consumer protection is codified in the markets in financial instruments directives (MiFID). These directives generate wide-ranging obligations for credit institutions (investment firms) and are essentially based upon the distinction between "counter parties", "professional clients" and "retail clients". In general, retail clients enjoy a higher degree of protection. This is particularly the case in such contexts as the "best execution" obligation, the "fair clear and not misleading" marketing communication, the requirement that "appropriate information" must be provided in "comprehensible form to clients or potential clients", the "know your customer" rule, and the adequacy rule.

41 All these obligations generate higher standards of responsibility on the part of investment firms towards their clients – mostly for retail clients.

42 This asset management activity frequently generates a higher degree of advisory and discretionary services. As a result, there is a higher likelihood that this type of activity may wind up being at the heart of legal disputes, which then have distinct criteria that are used in the assessment of liability.

43 Another significant aspect of asset management is that the companies are often located (or maintain their headquarters) in countries with specialised expertise in asset management (e.g. Luxembourg, Switzerland), whereas other aspects of their business (of a more general nature) may be located in different places, such as London, New York or Paris. In other words, this type of activity often has an underlying "cultural" or local dimension.

44 Lastly, an important aspect of the activity relies upon the confidentiality of the relationship between the investment firm and its clients, which is particularly significant where the clients are (high net worth) individuals or families.

45 The players involved are extremely diverse: just as asset and liability management encompasses banks and finance institutions, it also includes the private banking industry, family-run offices and individuals. All these entities work on behalf of their clients.

(iv) Typical disputes in asset management

46 There is a dearth of scholarship analysing the type of disputes arising out of asset management. Moreover, searches of court database systems containing publicly available decisions do not produce any notable results. As discussed above, Laurent Levy characterises the typical disputes in this context as pertaining to contractual liability.[10] In his discussion, he indicates three main issues that must be assessed when analysing or deciding a dispute concerning asset management: scope of the dispute, negligence and damages. However, there is no precise indication as to what "type" of disputes arise in this field.

47 When analysing the cases where a dispute typically arises in the context of asset management, one should keep in mind the common features of this activity, which involve the setting of goals, the allocation of funds, the setting of a strategy and the monitoring of that strategy. Typically, asset management involves investments or specific advice regarding whether to invest, which are consequently subject to processes of decision making. These processes are, in turn, subject to several factors associated with the prediction of the financial portfolio's performance. This performance may suffer due to changes in those factors but may also be impacted by wrong assessments and decisions (or advice provided in this context) along the way. Consequently, it is fair to assume that typical disputes in asset management involve issues related to misrepresentation, lack of consideration, and mistake. In addition, misappropriation, possible *force majeure/fait du prince*, an unexpected change in circumstances, and a change in regulation(s) may also appear as the subject matter of an asset management dispute. In line with this view, some common issues are described below.

48 First, cases involving the alleged "poor performance" of an asset portfolio may fall under the category of "misrepresentation" when the broker, advisor or the banking institution has provided miscalculated representations concerning the promised potential of investments made under the asset management agreement. Fraud and "Ponzi schemes" may serve as the basis for a dispute when claims for damages suffered are brought by defrauded investors. Laurent Levy's work provides a guideline on this topic.[11] Additionally, the questions it raises will highlight the usefulness and the real need to resort to an expert in the decision-making process.

49 Indeed, when considering issues relating to the "scope" of the contract between the bank and the client, the primary issue is whether the bank acted within the scope of the portfolio management mandate. According to the plain meaning of the agreement, considered together with trade usage and the special instructions of the client, one may ask whether the bank's actions were within the scope of the agreement. Going even further, what if the mandate is restricted to "common bank investment instruments"? And furthermore, what are "common bank investment instruments"? Do they include security lending? Over-the-counter instruments? Financial futures? One may also ask: was the bank authorised to enter into any of these transactions?

[10] L. Levy, supra note 2, at p. 106.

[11] Ibid., at 89.

50 Even more questions may be asked: did the client agree to or give valid instructions for a particular transaction or set of transactions? Was a particular telephone purchase or confirmation order valid? And what if the bank had been making transactions based upon notions of good faith and trust – do issues of formality take precedence over the actual performance of the parties?

51 Secondly, on the issue of negligence, one may begin by asking: was the bank truly negligent? Was a particular investment a reasonable decision? Should the bank have made a completely different investment decision? Was there sufficient monitoring of the assets? Did the bank collect the appropriate information about a particular transaction or set of transactions?

52 Thirdly, on the question of whether there were any Chinese walls in place to prevent conflicts of interest, it is also important to determine if the bank properly presented the accounts to the client.

53 The final set of issues focuses on damages. In this context, it is necessary to determine what the potentially faulty operations consisted of. Subsequently, it is necessary to evaluate the negative and positive impact of those operations on the portfolio of the client as a whole. Ultimately, an assessment must be made as to the effect of the bank operations, and whether it carried them out in a diligent manner or if it had not carried them out at all.

54 As demonstrated above, asking these types of questions helps to illustrate a fundamental advantage of using arbitration in this area: expertise of the decision maker.

(v) Use of arbitration in asset management disputes

55 The Task Force conducted a broad survey of the contractual instruments available on the public websites of the most important banking and financial institutions in the world. To cite just one of many examples, the Lehman Brothers website section dedicated to asset management contains a bundle of drafts for use in the day-to-day business with their clients. However, none of those drafts contains or references an arbitration clause. Instead, they all state that any dispute arising out of those agreements must be submitted to the jurisdiction of the courts (in this particular case, the applicable jurisdiction is the city of Luxembourg). One may easily attribute the lack of an arbitration clause to the fact that these documents are publicly available drafts to be used for consumer purposes. However, it is still fair to conclude from the fact-finding phase of this chapter that the lack of such a provision extends to other areas in asset management, and not only those connected with consumer products.

56 Notwithstanding the foregoing, the fact remains that arbitration is indeed used in the context of resolving asset management disputes. If that is the case, how is it possible that there are so few reports, data and decisions that are publicly available? The answer seems to be premised on one of the advantages attached to arbitration in asset management: arbitration is used primarily for the very reason that it is a confidential process by nature. Banking and other financial institutions do not wish to be publicly connected to any issue involving their interactions with clients. Confidentiality concerns are even more important to them when dealing with claims alleging breach of the client agreement, or those claiming the existence of misleading advice and information regarding investments. Similarly, clients often wish to preserve the privacy of their investments. However, sometimes knowledge of the existence of these disputes causes them to be brought into the public eye.[12]

[12] See, e.g., http://www.forbes.com/sites/nathanvardi/2011/10/03/hedge-fund-manager-of-former-1-billion-fund-quits-after-arbitration-loss./

57 On the other hand, one of the major institutions managing arbitration disputes in the area of finance – FINRA – is reported as having served in 1,963 cases involving breach of fiduciary duty up to November 2014 (varying from 3,162 in 2010 to 1,873 in 2013). This claim is one of the most common in disputes involving asset management.

58 However, once again, there seems to be a lack of precise data and information, which does not necessarily mean that arbitration is not frequently used in the context of dispute resolution, but may indicate that numerical figures in this area are not completely accurate.

(vi) Exclusion from arbitration of claims below a certain threshold and asymmetrical arbitration clauses

59 The first question in this section is to ascertain whether arbitration should be considered the most preferable dispute resolution option for claims in all amounts. Theoretically, the answer to this question should be affirmative. When arbitration is possible, it appears that it should be used regardless of the amount involved. However, this is not always feasible in light of the reality of the situation. The use of arbitration will almost always depend on the size of the claim. Arbitrating small claims is not considered an attractive option due to the perception of high costs associated with arbitration. Unless there is a public or quasi-public institutionalised arbitration system in place, arbitration will not be a reliable option for small claims. This is similar to many experiences in the consumer protection setting across the globe. However, it is difficult to determine the proper threshold for arbitrating a claim. This determination is completely dependent on the type of arbitration system chosen, and the costs associated with such a system.

60 It is important to note that it may be possible to conceive a potentially different approach to this issue based on recent developments in this area. Specifically, in France, the Postal Bank had guaranteed financial products, even those worth a small amount. The economic crisis prevented the reimbursement of the guarantee to the subscribers. In the French courts, the litigation against the Postal Bank has covered all amounts. In such instances, a "class arbitration clause" could be a useful legal argument to make arbitration more easily accessible. Admittedly, this is an issue far beyond the scope of this chapter and of the Task Force.

61 Secondly, concerning the issue of asymmetrical arbitration clauses, it seems to be impossible to draw any clear-cut conclusion regarding the use and validity of such clauses, although the majority of the finance institutions would prefer to have the option to insert them into their respective contracts. As is the case with many other issues in banking and finance arbitration, there is no "one size fits all" solution when addressing the question of whether or not to insert asymmetrical arbitration clauses into these agreements.

62 The issue must be considered in light of the idiosyncrasies that exist in each jurisdiction, and it is futile to suggest the insertion of such clauses in jurisdictions that have banned unilateral or asymmetrical arbitration clauses. On the other hand, the special legal framework applicable in the consumer protection context in many jurisdictions has warranted little or no discussion as to the preclusion of the use of asymmetrical arbitration clauses.

63 In any event, it is certainly worth noting that the recent debate regarding unilateral or asymmetrical arbitration clauses was fuelled by the "Rothschild" case, which arose in the context of an asset management agreement entered into by (the now famous) Mrs. X, a Spanish individual, and the Luxembourgish private bank, Edmond de Rothschild Europe, through a French intermediary affiliated with Rothschild. The sole clause in dispute was a forum selection clause, but there were many who raised concerns about a possible extension of the same reasoning to the arbitration agreement.

In brief, in this case the French Supreme Court held the following:

> [B]y reserving the Bank's right to bring an action in Mrs X's place of domicile or 'in any other court of competent jurisdiction', the clause only restricted Mrs X, who was the only party obligated to commence proceedings in Luxembourg; accordingly, the Court of Appeal correctly determined that the clause was potestative in nature, for the sole benefit of the Bank, and therefore was contrary to the objectives and the finality of the prorogation of jurisdiction provided for in Article 23 of the [Brussels] Regulation.[13]

64 Those commentators who were expressing their concerns about the validity of a unilateral arbitration clause in the French jurisdiction were most likely unaware of the fact that in a decision of the Cour d'Angers made on 25 September 1972 subsequently upheld by the Cour de Cassation on 15 May 1974 the validity of an asymmetrical arbitration clause was expressly upheld.[14] The issue remains unsettled in France.

65 When considering this issue in other jurisdictions, it is noteworthy that a recent survey conducted in 40 jurisdictions by Marie Berard and James Dingley of Clifford Chance concluded that the following jurisdictions expressly admit the validity and enforceability of a unilateral arbitration clause: England & Wales, Greece, Hong Kong, Italy, Luxembourg, and Spain. On the other hand, a "red flag" marks the jurisdictions of Bulgaria, Poland, Romania, Russia, and Thailand, in the sense that the validity and enforceability of an asymmetrical arbitration clause is not recognised in these jurisdictions.[15] According to this survey, other jurisdictions such as those in Canada, France, Germany, India, Netherlands, Switzerland or United States (just to name a few) seem to fall into a "no man's land" category, where the conclusion is not clear.

66 As a result of this very interesting survey, one may conclude that there are very few "safe harbours" for the recognition and enforceability of a unilateral arbitration clause.

(vii) Confidentiality of the decision maker

67 Confidentiality is considered to be "the" core feature that arbitration may provide in the asset management industry. Surprisingly, this was not the first conclusion reached as a result of the empirical phase. In fact, one of the most representative interviews was with a former CEO and Chairman of a financial institution located in Luxembourg and its Belgium subsidiary. This interview is particularly relevant because this institution is, among the interviewees, the only one which is exclusively dedicated to asset management and private banking.

68 This financial institution maintains an operational chain of detection and resolution of disputes, at the beginning of which is an internal assessment by the bank's legal department. If the assessment concludes that there is a serious risk of liability on the part of the bank, they prefer to settle the dispute amicably with the client, without any further action. If the bank's liability is unclear, they then proceed to consider the commercial impact of a quick settlement versus litigation. On the other hand, in the "B2C" environment, they tend to refer the dispute to an Ombudsman of the Association of Belgian Banks to attempt to resolve the matter with the client. The "jurisprudence" on the part of the Ombudsman is generally considered to be quite favourable to the banks. If the dispute continues beyond this stage, the bank prefers to submit the case to the domestic courts, rather than to arbitration.

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[13] Free translation of Decision of 26 September 2012 available at http://www.courdecassation.fr/jurisprudence_2/premiere_chambre_civile_568/983_26_24187.html.

[14] CA Angers, 25 Sept. 1972, Gaz. Pal. 1973, Jan-Fév, p. 210, Rev. Arb. 1973, p. 164; Cass. Civ.1, 15 May 1974: Bull. civ. I, no. 143.

[15] See http://uk.practicallaw.com/7-535-3743#.

69 In Luxembourg, one must take into account the special handling of disputes involving private customers' transactions by the CSSF (Commission de Surveillance du Secteur Financier). Indeed, CSSF Regulation no. 13-02 relating to the out-of-court resolution of complaints has vested the CSSF with a special competence to resolve disputes through a hybrid process, best described as being a cross between mediation and arbitration. It must be noted that the conclusions of the CSSF are not binding on the parties, who are free to accept or refuse to follow them. Yet, the legal and moral authority of the CSSF on the financial sector is such that the parties (financial institutions and clients) frequently rely on its competence and the procedure to settle disputes without having to choose between court proceedings and arbitration. In a nutshell, this financial institution assumes the consequences of the reputational risk attached to the absence of confidentiality that is characteristic of litigation, which is the preferred method as opposed to either the Ombudsman or CSSF. Therefore, for that financial institution, confidentiality is not regarded as a primary concern encouraging the use of arbitration, rather than litigation.

70 As emphasised in the discussion above, and notwithstanding the interview described above, after considering the personal experience of the members of the Task Force and the interviews of both colleagues and clients, confidentiality must be regarded as extremely important, particularly in this context. Indeed, companies working in the finance market area are very eager to maintain the confidentiality of the transactions they engage in, the clients they work with and in particular, the disputes their activity may give rise to.

71 Confidentiality is a matter of paramount importance for all financial entities, but particularly for investment companies. It is also important to remember that the need for confidentiality arises both before and during the course of the arbitration proceeding, but also remains in effect following the conclusion of the proceeding.

72 Confidentiality requirements begin prior to the commencement of the proceeding because the investment companies wish to keep the existence of any disputes with their clients completely hidden from public knowledge (as reputation is a key factor in the asset management market and in the investment business in general). A potential threat to maintaining confidentiality before the proceeding is the existence of third parties' funders who are required to disclose the details of the dispute to their legal advisors in order to decide whether they will finance the costs of the future proceeding.

73 During the proceedings, confidentiality could be affected if the parties are bound by an obligation of discovery (disclosure). Civil law lawyers and executives are extremely threatened by the process of discovery. It is a strange and foreign concept for them, something that contradicts the basic principles of their legal education. Continental European banks (and other financial entities) dislike the idea of participating in proceedings (either litigation or arbitration) where they may be compelled to "disclose" every document related to the case (mainly because some very sensitive materials, which they would prefer to keep confidential, might be disclosed to other parties' (perhaps competitors) legal counsel and experts). Although the IBA made a great effort to achieve standardization when preparing its Rules on the process of taking and collecting evidence in international arbitration, the non-binding nature of its recommendations cannot assure parties reluctant to participate in discovery that they will not be compelled to file documents with the tribunal that they would have preferred to keep confidential.

74 After the proceeding, in the event of the exercise of an annulment action or an appeal against the award, the risk that all the details of the proceeding may be disclosed is considerable. Furthermore, the approach to the issue of whether, in the absence of agreement between the parties, the award will remain confidential varies from country to country. However, standard practice shows that agreement between the parties to disclose the award (or other information regarding the proceeding) is quite unusual.

75 Lastly, in some jurisdictions, where the procedural documents must be kept confidential, the disclosure of the award (even with redacted details, but in a form that will allow third parties to perceive the identity of the parties involved) may involve serious consequences for those who have disclosed its terms and conditions.

76 Thus, one must pay close attention to the issues of confidentiality that currently surround the process of arbitration. It may be argued that confidentiality is no longer what it used to be, and parties wishing to preserve the intimacy of the proceedings may be caught by surprise if no additional preventative measures are taken. Indeed, the confidentiality of the proceedings may be subject to attack on two fronts. On the one hand, the presence of experts, witnesses and representatives of the parties – it is unsettled whether those persons are bound by the confidentiality obligations of the parties' lawyer(s) – may place confidentiality in jeopardy. On the other hand, if there is a push to have the action set aside, or if the appeal against the award is exercised, the involvement of the judicial court (and the subsequent and inevitable publicity of its decision), as well as previously confidential facts underlying the arbitration (along with its development and outcome) will also be subject to publicity not originally contemplated by the parties. Consequently, there is a need to take extra precautions as far as confidentiality is concerned. This means close observation and examination of the contractual provisions, as well as the legal and institutional rules and settings applicable to the arbitration proceeding(s).

77 The literature available on the subject generally concludes that there is no standard of confidentiality in arbitration. It is often automatically assumed that confidentiality is always applicable in arbitration, and is one of its main advantages. But this seems excessive, at least after consideration of the applicable legal instruments and regulations. Indeed, only a few legal systems address the subject. In this context, it is noted that the French law provides that subject to the applicable legal provisions and unless the parties decide otherwise, the arbitral procedure is subject to the principle of confidentiality.[16]

78 Similarly, the Portuguese Law 2011[17] (Article 30(4) PAL) provides that the arbitrators, the parties and the arbitral institutions, as applicable, are obliged to maintain confidentiality regarding all information obtained and documents brought to their attention in the course of the arbitration proceedings, without prejudice to the right of the parties to make public procedural acts necessary to the defence of their rights, and to the duty to communicate or disclose procedural acts to the competent authorities, which may be imposed by law. This rule does not prevent the publication of awards and other decisions made by the arbitral tribunal, with the exclusion of anything which may lead to the identification of the parties, unless any party expresses a preference otherwise.

79 Beyond these scattered legal provisions, it should be noted that neither the UNCITRAL Model Law nor its Rules contain provisions dealing with confidentiality. The recent Belgian Law on arbitration as of 24 June 2013 (which reflects the UNCITRAL Model Law) is also silent on the subject. The Rules of various centres (including ICC) themselves provide a clear example of the lack of uniformity which exists on the subject. The Swiss Rules (article 44.1), LCIA 2014 (article 30), German DIS (Section 43), HKIAC 2013 (article 20), etc. and the Corte Española de Arbitraje provide for some confidentiality protection of the arbitration proceedings.

[16] Free translation of Code de Procédure Civile, Article 1464 para. 4 : "Sous réserve des obligations légales et à moins que les parties n'en disposent autrement, la procédure arbitrale est soumise au principe de confidentialité".

[17] The Portuguese Voluntary Arbitration Law, Law 63/2011 (the PAL) was published in the Portuguese Official Gazette on 14 December 2011 and entered into force on 14 March 2012. It revoked the former Portuguese arbitration law (*Law No. 31/86 of 29 August 1986,* amended by Decree-Law No. 38/2003 of 8 March 2003).

80 But this opinion is much less prevalent in other instances. For example, with regard to ICC practice, Derains and Schwartz noted in 2005 that after extensive consideration of the matter, ICC decided not to propose a general confidentiality provision and thus to leave the determination up to the parties, the arbitrators and, as necessary, the local courts. Preferably, it was to be addressed in the Terms of Reference. This was reflected in Article 20(7) of the old Rules stating simply that "the Arbitral Tribunal may take measures for protecting trade secrets and confidential information".[18]

81 In a later revision of the Rules, which led to the 2012 version, this Rule was further developed and Article 22.3 now specifies that "upon the request of any party, the arbitral tribunal may make orders concerning the confidentiality of the arbitration proceedings or of any other matters in connection with the arbitration and may take measures for protecting trade secrets and confidential information." In addition, article 26.3 states that "Save with the approval of the Arbitral Tribunal and the parties, persons not involved in the proceedings shall not be admitted." In other words, this issue must be decided in its entirety on a case-by-case basis.

82 The new Arbitration Rules of 1 January 2013 of the Belgian Centre for Arbitration and Mediation (CEPANI) specify, in Article 25, that "Unless it has been agreed otherwise by the parties or there is an obligation to disclose, the arbitration proceedings shall be confidential". This goes one step further than the 2005 Rules, which (like the above-cited ICC rule) only contained a provision stating that the hearings are not public and that, save with the approval of the arbitral tribunal and the parties, persons not involved in the proceedings are not admitted. This particular provision was not reproduced in the most recent CEPANI Rules, on the assumption that Article 25 is an all-embracing provision on confidentially and its limits (as may be imposed by rules of public policy, at least in Belgium).

83 To conclude, the boundaries of confidentiality are debated and confidentiality often remains a determination made by the parties, within the limits of party autonomy. In practice, it is seldom provided for or discussed, even in the Terms of Reference. In any event, confidentiality is one of the main advantages of arbitration, and is what participants often seek when resolving their disputes.

(viii) Expertise of the decision maker

84 The aforementioned considerations concerning the specificity of issues arising in the context of disputes in asset management serve to demonstrate the need to resort to experts in these matters. There are particular and specific concepts, definitions and classifications which are useful – and even necessary – when dealing with disputes in asset management (for instance, on the determination of a "common bank investment instrument").

85 The alternative approach – resort to national courts for litigation – may be an optimal solution in jurisdictions where the court judges are trained and specialised in issues relating to these matters. That may be the case in France, Switzerland, United Kingdom, United States and other sophisticated venues.

[18] See Y. Derains and E.A. Schwartz, *A Guide to the ICC Rules of Arbitration*, 2nd Ed., Kluwer Law International, 2005, pp. 284 et seq.

86 The world of asset management is certainly not limited to these jurisdictions. In many other jurisdictions (for instance, Germany and Portugal), the protection given to consumers is strengthened. This means that a forum jurisdiction clause inserted into a standard contract form - that the bank may have resorted to in order to set forth its legal relationship with its client - may turn out to be considered invalid and unenforceable. However, by contrast, an arbitration clause inserted into such agreements may afford more protection; again, in the case of the Portuguese jurisdiction, the superior courts have been consistently upholding the validity of arbitration clauses inserted into standard contract forms related to "swaps".

87 Consequently, an arbitration clause may be viewed as "killing two birds with one stone"; by mitigating the risk of diverting a forum jurisdiction clause to an "undesired" jurisdiction, it will simultaneously allow the parties to appoint experts to decide their case, or at least to participate in the process of their appointment.

88 In this respect, there is a recent paper published by the University of Cologne which is very helpful in understanding the importance of the expertise. Expertise of the decision maker in the asset management industry should therefore be emphasised. An excerpt from the paper is provided below.

> Examples from recent practice, both in the area of commercial and investment arbitration, show that there is nowadays no reason for banks and other financial institutions to avoid arbitration in favour of state court jurisdiction as a matter of principle. In many instances arbitration has proved to be a superior method of dispute resolution. It is obvious that one of the many advantages of arbitration is the ability of the parties to select an arbitrator with specialized legal know-how and market expertise. In few other areas is this classical advantage of arbitration as evident as in the field of national and international banking and capital markets law. It seems hardly possible to explain to most domestic judges the market understanding and functioning of terms like "backstop facility", "convertible preferred equity certificates", "collateralized debt obligation," "MAC-clause", "parallel debt", "senior facilities agreement", "*pari passu* clause," "gun jumping" or "contractual subordination" within a reasonable period of time.[19]

CONCLUSIONS

89 At first glance, arbitration in asset management and private banking is not the preferred method for resolving disputes. However, one of the major concerns related to disputes arising in this context is confidentiality - regarding both the proceedings and the existence of the dispute itself. This would constitute a major argument in favour of the use of arbitration because it is well established that arbitration is the method better adapted to maintaining the confidentiality of every element related to a dispute: the type of dispute, the "players" involved in the dispute, the allegations brought in the dispute, the amounts involved and, last but not least, the existence of the dispute itself.

90 This feature may also provide an explanation for the scarcity of materials gathered during the fact-finding phase. However, there seems to be a slight tendency by the players in this industry to prefer the use of "alternative" methods of resolving disputes (such as the Ombudsman, negotiation and the like) rather than actually initiating arbitration proceedings. This attitude seems to stem from a lack of concern with maintaining the privacy of disputes in the area of asset management.

[19] See http://arbitrationinfinance.com/basics_ID2.

91 Indeed, concerns related to maintaining the confidentiality of the dispute ought to lead the players in this arena to choose arbitration. This is particularly true in asset management disputes between investment firms, with a professional client or an eligible counterparty. On the other hand, costs related to arbitration seem to scare off some institutions dedicated to asset management and private banking.

92 Finally, there are some institutions that expressed serious concerns regarding the use of arbitration in this industry due to considerations related to consumer protection, especially with regard to the relationship between banking/financial institutions and private individuals.

93 The general perception regarding the use of arbitration in asset management and private banking generally shares the concerns which were expressed in the banking and finance sectors. In this regard, there is no specific response that is within the scope of this chapter, but some remarks may be made to highlight the relevance of arbitration in this field, and to provide a new and different perspective on this issue.

94 There is undoubtedly a misconception as far as the use of arbitration in these sectors is concerned. Arbitration is seen by some as costly, not particularly speedy and, in some cases, is viewed as having unpredictable results, due to the absence of the *stare decisis* concept.

95 In response to such concerns, and reflecting the opinion of some interviewees, arbitration may not only preserve one of the fundamental principles of the institutions and clients involved in a dispute – the confidentiality of the proceedings, including the confidentiality of the existence of the dispute itself – but it also presents the advantage of allowing a decision to be made by experts in the field. This is usually done at a reasonable cost, while also complying with fairly speedy timelines, with no appeal derailing the soundness of the final decision, and – above all – producing a decision which is binding and enforceable in almost every jurisdiction. Moreover, the statement that arbitration is more expensive than litigation is unfounded.

96 Therefore, the importance of two fundamental characteristics of arbitration mentioned above should be underscored. The first is the confidentiality of the proceedings and of the dispute in the context of asset management and private banking. The second relates to the type of disputes that typically arise in this context. It is not just a matter of repayment of credits; such disputes are primarily intertwined with intricate issues arising from the principles of private contract law (such as misrepresentation or fraudulent inducement). This latter observation leads to the conclusion that the expertise of the decision maker is crucial to a proper resolution of the case. When there is also the added consideration of the possibility that the parties may enjoy selecting or at least participating in the selection process of the decision maker, there is no doubt that the best means to resolve asset management disputes is through arbitration.

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VII. Trade finance

Commodities	The International Cotton Association claims that the majority of the world's cotton is traded under the ICA Bylaws & Rules. These Rules provide parties with the option of settling disputes under ICA arbitration; over 400 such arbitrations were conducted during 2011.	www.ica-ltd.org/media/layout/documents/rulebooks/rulebook_english_jun2014.PDF
	GAFTA (the Grain and Feed Trade Association) is an international trade association which supports and represents the interests of traders in agricultural commodities. It has 1,400 members in 86 countries. GAFTA provides, inter alia, standard forms of contract for agricultural trade which provide for arbitration under English law by GAFTA–qualified arbitrators. GAFTA's arbitration rules, which are divided into Standard Rules and Simple Dispute Rules, are specifically designed with commodities trading in mind.	www.gafta.com/Arbitration
	FOSFA (the Federation of Oils, Seeds and Fats Associations) is a professional international body which issues contracts and provides arbitration services concerned with the world trade in oilseeds, oils and fats. It has over 1,000 members in 84 countries. 85% of the global trade in oils and fats is traded under FOSFA contracts, which all include a dispute procedure using arbitrators experienced within the trade.	www.fosfa.org/arbitration/
Letters of Credit	*"The documentation required in a letter of credit depends on the level of complexity of the transaction and the degree of security that the two parties wish to have on the transaction: security of payment, security and transparency regarding the description of the goods, security regarding the clearance of customs, transportation process and delivery on time, and other kinds of risks related to the transactions. Document compliance has to be verified – one important feature of the acceptance/endorsement process for letters of credit, in particular by the bank of the exporter. While the amount of documentation varies according to the nature of the transaction, the legal clauses of basic letters of credit are subject to regular standardization by the banking commission of the International Chamber of Commerce, which also provides for arbitration services in the case of such contingencies. The existence of a strong and well identified collateral, and detailed documentation, concur to make documented letters of credit one of the safest forms of lending as such documentation and collateral are internationally*	Excerpt from Auboin M., International Regulation and Treatment of Trade Finance: What Are the Issues?, World Trade Organisation, Feb. 2010

	recognized by commercial laws around the world and subject to arbitration in case of default or other problems affecting the transaction."	
SWIFT's new Bank Payment Obligation (BPO) The ICC have produced their own guide to BPOs: http://store.iccwbo.org/Content/uploaded/pdf/ICC-Guide-to-the-Uniform-Rules-for-Bank-Payment-Obligations.pdf	*"Now numbering 88 banks in 105 locations, development of the TSU (Trade Services Utility) continues. In early January, SWIFT approached banks with the concept of the Bank Payment Obligation (BPO) initiative and asked for volunteer institutions that are committed to issuing BPO transactions in either one of two time frames, either by April or August. The dates are significant as SWIFT is keen to receive feedback to present at the ICC banking commission meetings scheduled this year in Beijing and Orlando."* *"The goal is to obtain an endorsement of the BPO as a new credit instrument facilitating the settlement of cross-border trade. Initially, SWIFT and two banks will present their experience of the BPO at the Beijing meeting at the end of April. The Orlando meeting will include further banks providing feedback. The ICC rarely gives an endorsement in this way but the feeling is positive. Seventeen banks (see next page) have committed to the project and there are others waiting in the wings. It's a diverse group both in size and geography."* *"In layman's terms, the BPO works by having the obligor bank or banks, typically the buyer's bank, state when they set up a TSU transaction that they will have to pay a certain amount by a certain date if one of two conditions are met by the TSU. The first condition would be a match at the time of shipping, the second is if the buyer waives a mismatch and the other obligor banks accept that."* *"The execution of the obligation does not take place within the TSU – analogous to the letter of credit – if doc exam finds the documents are clean, SWIFT does not enforce payment, the banks do, and if payment is not made they would go to arbitration. The same is true of the TSU even though everything is automated. Yes, the system could have been built with an automatic debit system, but the rationale against that was that banks didn't want to have that type of enforcement – they felt that the workflow they do with LCs was similar and adequate, and secondly the settlement may not take place over the SWIFT network, but through a local payment system."*	Excerpts from Chris Conn, SWIFT, Trade Finance, Apr. 2010

The Alternative Dispute Resolution for Commodity Trading, Shipping and Trade Finance ("ACT")	The ACT is the creation of the Geneva Chamber of Commerce and Industry (CCIG), together and the Geneva Trading & Shipping Association (GTSA). It was created to offer tailor-made dispute resolution for those active in the fields of commodity trading, shipping and trade finance. It based on the Swiss Rules of International Arbitration (the Swiss Rules) and on the Swiss Rules of Commercial Mediation (the Swiss Rules of Mediation). Both the CGIG and GTSA were well-placed to create such a specialist ADR centre. At present, about 30 per cent of cases filed with the CCIG relate to commodity trading, shipping or trade finance, and the GTSA is at present the largest international trading hub for the finance of commodity trading. In particular, ACT provides an optional list of recognised arbitrators and mediators specialised in the commodity business and from various countries with various legal systems. This is designed to increase the efficiency of the proceedings and thereby reduce costs. The suggested arbitrators and mediators are selected by an independent selecting committee composed of commodity traders and dispute resolution practitioners appointed by GTSA and the CCIG.	An overview of the ACT is available at http://globalarbitrationreview.com/reviews/58/sections/203/chapters/2298/switzerland/ The GCTA's website also contains information on the custom arbitration clauses offered, including a tool allowing users to create a "customised arbitration clause".
Political Risk / Credit Risk Insurance	*"To an investor, any regulatory action that causes significant economic harm to its investment seems like an expropriation that should be covered by political risk insurance expropriation coverage. However, expropriation coverage is not designed to protect against the effects of most regulatory actions. The reason is basic: when a political risk insurer pays an expropriation claim to an insured investor, the insurer needs to be in a position to make a claim back against the host government for its action.* *A host government, however, is only liable for the consequences of its actions if those actions are unjust (or "wrongful", as lawyers tend to say), as opposed to legitimate. Legitimate regulatory actions do not give rise to a right of recovery against the government. If they did, no government could afford to make changes to a regulatory regime. But what actions are "legitimate" is a complex question. The host government's internal law regarding takings has long been rejected as a standard for legitimacy, in large part because the same government that takes the regulatory action in question can change the internal law (or the interpretation of it) as to the legitimacy of that action."*	PRI Newsletter: Vol. IV (1), Political Risk Coverage of Regulatory Takings: A New Approach, 2008

Political Risk / Credit Risk Insurance (contd.)	*"Accordingly, a body of international law, not dependent on the law or interpretation of any one country, has developed as the standard for expropriation claims against a host government. In turn, most political risk insurance policies over the years have required that for there to be an expropriation, the government's actions must be in violation of this standard of international law.* *Traditional international law regarding takings is complex, but generally has required that, to be legitimate, a taking must be (i) for a public purpose, (ii) non-discriminatory, and (iii) accompanied by just compensation.* *In recent years roughly twenty regulatory takings cases have been brought before international arbitral tribunals. In an attempt to find a consensus as to the key elements of what constitutes a regulatory taking, we reviewed eight of the leading international opinions and decisions involving alleged regulatory takings from the past seven years. Most of these were NAFTA and BIT cases, which collectively have developed new theories of regulatory takings under international law.* *Not surprisingly, the arbitrators in these eight cases took a variety of different and sometimes inconsistent approaches. Each case hinged on two or three (or more) factors, but the tribunals generally did not state which factor was determinative in rendering an award, and did not comment on relative weighting of factors. Looking at recent arbitration cases to try to determine key elements of a workable standard for political risk insurance, we were able to ascertain some broad principles and common factors."*	PRI Newsletter: Vol. IV (1), Political Risk Coverage of Regulatory Takings: A New Approach, 2008 (contd)
	"Arbitration is the mode commonly stipulated for the settlement of disputes between PRI policyholders and insurers. It is thought to be faster and cheaper than the courts, and is likely to be definitive. Still, it can be a long and costly process so it should not be undertaken lightly. The insurer similarly has to consider its costs and the uncertainly of the outcome – especially before an arbitral panel, which is not bound by precedent, not likely to have its decision subject to review, and often prone to compromise. Hence the threat of dispute resolution may inspire insurers to consider a settlement."	Excerpt from Making a PRI Claim: Readiness Is All, Robert Wray PPLC, Sept. 2008

Political Risk / Credit Risk Insurance (contd.)	*"All insurance contracts issued by OPIC (and USAID before it) have provided for resolution of disputes by arbitration under American Arbitration Association (AAA) rules. Coverage and compensation disputes in the context of insurance claims account for all but two of the arbitrations in OPIC's experience, although the arbitration clause extends to "any controversy or claim arising out of or relating to this contract.* *Each case did cause OPIC to review its contracts and reconsider the use of arbitration as a means of resolving disputes. The drawbacks to arbitration include the lack of a right to appeal based on error of law and the difficulty of disposing meritless claims through the equivalent of motions to dismiss. On the positive side, two major advantages over litigation are the opportunity to select decision makers who are knowledgeable about the subject matter of the dispute and the autonomy of the parties to work with the arbitrators within the rules to present the case effectively and efficiently. Also, the case will proceed upon a timetable mutually agreed by the arbitrator and the parties, not one disrupted and dictated by a court calendar."*	Excerpt from Claims Arbitrations, Robert Wray PPLC, Sept. 2008, interview with Robert O'Sullivan, OPIC's Associate General Counsel, Insurance Claims

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XII. International Financial Institutions and bilateral development

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