Recent international arbitration developments

This e-bulletin contains summaries of the following recent developments in international arbitration:

- **UK - House of Lord decision in Fiona Trust upholds Court of Appeal's pro-arbitration stance**
- **UK — Court of Appeal overturns order for security for costs against creditor enforcing New York Convention award**
- **ICC publishes report on techniques for controlling time and cost in arbitration**
- **ICSID Tribunal in Vivendi case broadens scope of fair and equitable treatment, finding Argentina in breach of BIT**
- **Allocation of Costs — Joint Order in Canfor v USA applies 'loser pays' rule in investment treaty arbitration**
- **Hong Kong — the benchmark for refusing enforcement on the basis of fraud**
- **PCA facility to be established in Singapore**

1. **UK - House of Lord decision in Fiona Trust upholds Court of Appeal's pro-arbitration stance**

On 17 October 2007, The House of Lords in *Premium Nafta Products Limited & ors v Fili Shipping Company Limited & ors* delivered an important ruling, strongly supportive of the arbitration process. In determining the appeal from the Court of Appeal's ruling in *Fiona Trust & Holiding Corp & ors v Privalov & ors*, the Lords endorsed the Court of Appeal's liberal approach to the construction of arbitration agreements in international commercial contracts. They also strongly supported the view that an arbitration agreement is "separable" — that apart from in a few limited circumstances, it can only be voided on grounds which relate directly to the arbitration agreement rather than to the contract as a whole.

The case concerned various charter contracts made between companies in the Russian Sovcomflot group. These contained an arbitration clause referring primarily to disputes "arising under" the contract. The Owners of the relevant vessels had purported to rescind the contracts on the basis that they were allegedly procured by bribery. They argued that the arbitration clause was not applicable to this dispute because:

i. the question of whether the contracts were procured by bribery was not a dispute "arising under" the contract; and

ii. the arbitration clause had been rescinded and was therefore no longer in force.

The House of Lords dismissed the Owner's arguments on both grounds.

**Construction**

Lord Hoffman, delivering the leading judgment, held that, as a matter of construction, the question of whether the contracts were procured by bribery or not fell within the arbitration clause. He observed that in some previous authorities a distinction had been drawn between disputes
“arising under” a contract (which had been interpreted narrowly to refer only to disputes regarding the rights and obligations created by the contract) and disputes “arising out of”, “in relation to” or “in connection with” a contract (which had been interpreted to refer to a wider class of disputes). Lord Hoffman suggested that many draftsmen regard these phrases as mutually interchangeable and applauded the Court of Appeal’s opinion that “the time has come to draw a line under the authorities to date and to make a fresh start”. It was held that the courts must seek to give effect to the reasonable commercial expectations of the parties, the starting point being a strong presumption that the parties intend all their disputes to be resolved in the same forum.

Separability

The House of Lords also held that the allegation that the contracts had been procured by bribery did not mean that the Owners could rescind the whole contract, including the arbitration clause. Lord Hoffman emphasised the principle of separability of the arbitration clause as enshrined in section 7 of the Arbitration Act 1996 as a basis for arguing that an arbitration agreement can be invalidated only on a ground which relates to the arbitration agreement directly.

This common sense approach to the construction of arbitration agreements will be welcomed by parties to arbitration agreements, as lengthy (and often costly) proceedings focussing closely on the meaning of particular phrases are not in the best interest of the parties. The presumption that parties intend all their disputes to be resolved in the same forum is also to be welcomed. However, a party who wishes to exclude disputes about the validity of a contract from the arbitration agreement will need to ensure that this is expressed clearly. (Premium Nafta Products Limited (20th Defendant) and others v Fili Shipping Company Limited (14th Claimant) and others, [2007] UKHL 40.)

2. UK – Court of Appeal overturns order for security for costs against creditor enforcing New York Convention award

In Gater Assets Limited v Nak Naftogaz Ukrainiy the Court of Appeal has overturned an order which obliged the successful party to an arbitration to give security for the costs of the losing party when the latter sought to prevent enforcement of the award. The outcome is supportive of the spirit of the New York Convention (the primary mechanism for enforcement of international arbitral awards). It has removed what could be a potentially difficult hurdle to enforcement.

As a result of the arbitration, Gater was assigned the benefit of an arbitral award for US$88 million and sought to enforce this in the English Courts. Naftogaz resisted enforcement on various grounds, including that the award was obtained by fraud. In its first instance application to set aside the enforcement order, Naftogaz successfully sought security for costs from Gater.

The majority in the Court of Appeal held that security for costs should not have been given. Each judge reached the same conclusion though for different reasons. In the view of one of the judges (Rix LJ), the courts should be reluctant as a matter of principle, save in exceptional cases, to order security for costs against an award creditor, even if the power to do so is technically available. In this regard, he was influenced by the fact that security for costs could not be ordered in the same circumstances for a domestic award.

The decision will make it very difficult for future award debtors resisting enforcement proceedings to obtain security for costs. This has the positive effect of closing a particular loophole: formerly an award debtor challenging an award was not eligible for security for costs, whereas an award debtor who waited until the enforcement stage to challenge an award may have been. The decision therefore increases the incentive to
bring any challenges to an award at the appropriate time rather than delaying and using them to resist enforcement. Given the different reasoning of the judges, the precise legal basis for this outcome will require further clarification in future decisions.

3. **ICC publishes report on techniques for controlling time and cost in arbitration**

As arbitration proceedings have become more complex there has been a concern that the time taken and cost of resolving them has increased dramatically. The ICC Commission on Arbitration's recent report "Techniques for Controlling Time and Cost in Arbitration" seeks to address this by setting out various techniques designed to minimise cost and delay during the arbitration process.

These techniques include simplifying arbitration agreements and using time limits for the rendering of an award, holding an early case management conference, using telephone and video conferences and the promotion of settlement by the tribunal. The report also highlights the importance of identifying the issues at an early stage in order to focus submissions and disclosure, and limit the number of witnesses required and the scope of their evidence. The report recommends that consideration be given to detailed written submissions at an early stage to achieve this.

The techniques are not binding on any tribunal, and do not form part of the ICC Rules. They do, however, have the full endorsement of the ICC Court and provide useful guidance. Many of these techniques are already incorporated into the Herbert Smith arbitration practice and are regularly used. We will continue to adopt them wherever possible and appropriate.

The full text of the report is available [here](http://www.herbertsmith.com/NR/rdonlyres/84447ACC-9376-468B-BE87-08EFC55...).

4. **ICSID Tribunal in Vivendi case broadens scope of fair and equitable treatment, finding Argentina in breach of BIT**

In the latest of many ICSID decisions against Argentina in recent months, an ICSID tribunal recently rendered a final decision in the long-running proceedings between Vivendi and Argentina. Its findings offer much needed clarity for investors (and guidelines for future tribunals) on some common BIT provisions.

The dispute arose when various actions taken by the provincial government of the Argentine province of Tucuman in the 1990's impacted upon the water concession operated by Vivendi's subsidiary. The measures taken included:

i. unilaterally imposing tariff reductions;
ii. politicising decisions of the regulatory agency;
iii. applying unjustified fines relating to water quality; and
iv. stirring up local feeling against the "foreign investor" by advising customers not to pay their bills.

In finding that Argentina had breached the Bilateral Investment Treaty (BIT) between Argentina and France, the tribunal rejected Argentina's argument that the fair and equitable treatment protection provided for under the BIT should be restricted to a "minimum standard of treatment under international law". Rather, it held that instead of applying a particular standard to the question of fair and equitable treatment, a tribunal should decide if in all the circumstances the conduct in issue is fair and equitable. It also commented that claims of unfair and inequitable treatment are not limited to claims for denial of justice. In addition, the Tribunal provided a useful insight into expropriation by a State, holding that regulatory measures can amount to expropriation, even where there is no bad faith involved. It added that the effect of a measure, rather than the state's intent, is the critical factor to determine whether a measure is expropriatory.
Although Vivendi was successful in its claim, the Tribunal limited the damages awarded to the actual value of its investment (following the Chorzow Factory case). It rejected Vivendi’s lost profits claim as Vivendi had failed to establish with a sufficient degree of certainty that the concession would have been profitable, although it did indicate that a history of demonstrated profitability would have led it to make a far higher award. (Compania de Aguas del Aconquija & Vivendi v. Argentina Award, ICSID Case No. ARB/97/3, 20 August 2007.)

5. Allocation of Costs – Joint Order in Canfor v USA applies ‘loser pays’ rule in investment treaty arbitration

As a result of the wide discretion given to tribunals under both the ICSID and the UNCITRAL rules, there are no precise principles governing the allocation of costs incurred during investment treaty arbitrations. Consequently, the position adopted by tribunals has varied from the traditional position of equal allocation of arbitration costs, to the more recent "costs follow the event" principle, whereby the full award of costs is made against the unsuccessful party. However, the recently issued Joint Order in Canfor v USA has provided perhaps the strongest confirmation yet that a trend is developing for investment arbitration tribunals to see the "costs follow the event" principle as the primary factor in deciding on the allocation of costs.

The Joint Order concerned three Canadian entities – Canfor Corporation, Terminal Forest Products Limited and Tembec – whose individual NAFTA claims made, pursuant to the UNCITRAL rules, against the United States had been consolidated. Immediately before the preliminary hearing, Tembec unilaterally withdrew its claim, asking the Tribunal to terminate the proceedings as related to it.

When costs were later decided, Tembec argued that costs should be borne by the respective parties. The US, however, argued that Tembec should bear the US Government’s share of the procedural costs as a matter of principle, stating that "Tembec abandoned its claim on the eve of the jurisdictional hearing" and should therefore be viewed as the unsuccessful party.

In its ruling, the Tribunal elected to apply the "costs follow the event" principle, which it argued should be the general principle of application governing allocation of costs, even in circumstances where the relevant rules do not expressly address the issue. It went further to rule that an "unsuccessful party" (as referred to in Article 40(1) of the UNCITRAL Rules) includes a party that unilaterally withdraws its claim. Parties considering withdrawing from a claim should therefore think carefully about the potential cost consequences of doing so. (Canfor Corporation v United States Of America, Tembec et al. v United States Of America and Terminal Forest Products Ltd. v United States Of America, 19 July 2007.)

6. Hong Kong – the benchmark for refusing enforcement on the basis of fraud

In another instalment in the long running Karaha Bodas v Pertamina arbitration, the Hong Kong Court of Appeal recently dismissed Pertamina’s appeal against a first instance decision granting Karaha Bodas leave to enforce a final arbitration award made in Geneva in Hong Kong. Pertamina’s appeal was based on a number of grounds, but the primary focus was on its allegation that enforcement of the award would be contrary to public policy because it was tainted by bad faith or fraud.

In dismissing the appeal in its entirety (so upholding Karaha Bodas’s right to enforce the award), the Court of Appeal took the opportunity to address the question of the benchmark which must be met by a party seeking to resist enforcement on the basis of an allegation of fraud. Pertamina initially contended that if it was able to establish a prima facie case of
fraud, the allegation should be the subject of a full trial. The Court of Appeal disagreed and observed that such a low benchmark would require the Hong Kong courts to become embroiled in unnecessary satellite litigation concerning a final arbitral award. Rather, it held that any allegation of fraud should be fully identified and be shown to have a "real prospect of success" before the court should pay any heed to it, and that any case which could not responsibly be asserted by counsel to meet this benchmark should not even be raised before a Hong Kong court. (Karaha Bodas Company LLC v Pertamina CACV121/2003 (judgment handed down on 9 October 2007).)

7. **PCA facility to be established in Singapore**

On 10 September 2007, the PCA Secretary General signed an agreement with the Singaporean government to establish a PCA facility in Singapore. This means that PCA arbitrations for the region will no longer have to be heard in The Hague. It will help Singapore in its attempts to promote the country as Asia's leading mediation and arbitration hub.

The PCA's Secretary General Tjaco van den Hout said the creation of facilities in Asia was a natural move as approximately 20 per cent of the court's hearings last year were from the region. Recent published examples of PCA cases including an Asian element include a boundary dispute between Malaysia and Singapore and an investment dispute between Telekom Malaysia and the Government of Ghana. Both disputes were initiated in 2003. The news follows the PCA's announcement in April this year that it had agreed to launch an arbitration court in Pretoria, South Africa to focus on pan-African arbitrations. The PCA, which provides services for the resolution of disputes involving combinations of states, state entities, intergovernmental organizations and private parties, has also set up a court in Costa Rica for Latin American disputes.

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