ISDA Arbitration – the Final Lap?

Over the past few years there has been increased interest in providing for the resolution of disputes relating to financial contracts by arbitration. On 31 May 2013, ISDA’s consultation on its model arbitration clauses for use with Master Agreements closed. Lawyer Monthly speaks to James Stacey about the ISDA consultation and what we can expect next.

WHAT IS THE BACKGROUND TO THE ISDA CONSULTATION?

In January 2011, ISDA issued its Memorandum, The use of arbitration under an ISDA Master Agreement, which sought to gauge members’ interest in providing for arbitration in relation to derivatives transactions documented under the ISDA 1992 and 2002 Master Agreements (the Master Agreements). The response was enthusiastic. ISDA followed up with a draft Supplement to the User’s Guide to the 1992 and 2002 ISDA Master Agreements: Arbitration Clauses which includes six model clauses providing for various combinations of governing laws, arbitral rules and seats of arbitration. Consultation on the model clauses closed on 31 May 2013 and ISDA’s Financial Law Reform Committee meets later this month to discuss the feedback received.

WHY THE INCREASED INTEREST IN ARBITRATION?

The main driver has been the increase in cross-border transactions involving parties based in emerging jurisdictions. For a number of reasons – principally relating to enforceability – the traditional and default choices offered in the Master Agreements, ie jurisdiction of the English or New York courts, are less attractive to parties to these transactions.

If a party has substantial assets within the EU, it will be relatively straightforward for the successful litigant to enforce the judgment of an English court under the Brussels Regulation. However, if a party’s assets are outside the EU, the ease of enforcement against assets in any particular country depends upon reciprocal arrangements and these can be patchy. In the absence of reciprocal arrangements, the successful litigant is dependent on the local law in the country of enforcement: at best, this means additional procedural hurdles; at worst, the possibility of the foreign judgment being effectively, or actually, unenforceable.

By contrast, the 1958 New York Convention provides – subject to limited grounds of refusal – a regime for the enforcement and recognition of arbitral awards within its contracting states (currently just under 150). Although the reality of enforcement in certain emerging jurisdictions does not necessarily match the ideal, the Convention typically provides an easier route for enforcement of an arbitral award than where no reciprocal arrangements exist for enforcing a court judgment.
WHAT IS ISDA CURRENTLY PROPOSING?

At present, the model clauses offer a choice of four seats: London, New York, Singapore or Hong Kong. Parties electing the latter two seats will have their arbitration agreement governed respectively by Singapore or Hong Kong law and subject to SIAC or HKIAC arbitration rules (although the Master Agreement's choice of governing law is limited to London or New York law). Parties electing a London or New York seat can elect for their arbitration to be governed by either ICC, LCIA (if a London seat) or AAA (if a New York seat) rules.

CAN WE EXPECT ANY CHANGES AS A RESULT OF THE CONSULTATION PROCESS?

Two omissions from ISDA's current version of the model arbitration clauses have attracted particular comment.

First, the ISDA model clauses do not currently provide for PRIME Finance arbitration rules. PRIME was launched in January 2012 with a remit to focus on complex financial disputes and to provide finance experts to sit as arbitrators. PRIME's rules are based on a modified version of the 2010 UNCITRAL rules: for example, the parties can agree an expedited timetable and there is provision for an 'emergency arbitration'. Following the consultation, it will be interesting to see whether PRIME's rules are included – although PRIME have, in any event, published their own draft model arbitration clauses for use with the Master Agreements (these provide for an English seat and governing law or a New York seat and governing law).

Second, the ISDA model clauses do not provide for an optional arbitration clause which would give one or both parties – but typically the finance party – the option of litigation or arbitration. However, as ISDA noted in 2011, “There are doubts…about the validity of optional clauses in China, Russia, Spain, Poland and the UAE, and in many countries there is simply no clear authority on the issue” – the latter include many emerging jurisdictions. Given these uncertainties, the absence of an optional arbitration clause would seem a sensible omission.

WHAT NEXT?

Once ISDA has published the model arbitration clauses, the trend for providing for arbitration in Master Agreements is likely to gain further traction and pace. However, the private nature of arbitrations threatens to limit the body of jurisprudence which would be publicly available. Accordingly, a key challenge will be to create a comprehensive and disclosable body of arbitral awards, something which ISDA has not expressly addressed in the current version of the model clauses.

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