ARBITRATION IN BANKING AND FINANCE

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I.
INTRODUCTION

Although the banking and finance sector represents one of the backbones of the world economy,[1] arbitration has for a long time played a rather limited role in this sector. Instead, there has been a preference for resolving arbitration and finance disputes in state courts of important financial centers, such as New York or London.

Things are, however, changing. Arbitration is increasingly gaining importance in banking and finance.[2] Parties, thus, have to exercise particular care in drafting the arbitration agreement and choosing the right arbitral institution.[3] Arbitrators also face specific challenges: in particular, the need to establish a sufficient degree of legal certainty and dealing with public interest mandatory regulation.[4]

In the end, the success of arbitration in banking and finance will depend on whether it will be responsive to the needs of market participants. While it is impossible to predict the future developments with certainty, this success will to some extent depend on the competitiveness and performance of the State courts traditionally called upon in banking and finance matters. In general, there is no reason why arbitration should not have the potential to extend its market share in banking and finance matters in the same way as arbitration has grown in other industries of major economic relevance (e.g., energy and reinsurance).[5]

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1. According to statistics of the European Union, the total value of financial transactions in 2007 was equal to 70 times the total worldwide GDP. *Opinion of the European Economic and Social Committee on 'Financial Transaction Tax' (Own-Initiative Opinion)*, 2011 O.J. (C44) 81 (referencing Bank of International Settlement statistics).

2. *See* discussion *infra* Part II.

3. *See* discussion *infra* Part III.

4. *See* discussion *infra* Part IV.

5. *See* discussion *infra* Part V.

II.
THE RISE OF ARBITRATION IN THE BANKING AND FINANCE SECTOR

A. *Banking and Finance Disputes*

For the purposes of this paper, the terms "banking" and "finance" are used in a broad sense. The term "banking" includes both commercial banking (i.e., deposit taking and loan making) and investment banking (i.e., the provision of underwriting and advisory services, trading and brokerage, as well as asset management).[6] The term "finance" is defined as "the management of large amounts of money."[7] It includes financing methods such as project finance.[8]

Given this broad definition of banking and finance, there is a wide array of disputes that may arise out of transactions in this sector, but not all of them can be analyzed here. These disputes can neither all be anticipated in this paper, nor can they be analyzed in detail.

In order to narrow the topic, this paper focuses on disputes between commercial entities. It does not deal with consumer contracts. Moreover, this paper deals with commercial arbitration only, as opposed to investment disputes arising out of sovereign debt[9].

B. *Traditional Reluctance Towards Arbitration*

For a long time, banks have been very reluctant to submit their disputes to arbitration. It was the prevailing opinion among bankers that disputes in the banking and finance sector are most frequently "one-shot money disputes," i.e., disputes arising from simple transactions such as loans involving a mere payment obligation.[10] According to bankers, such dis-

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6. For a similar definition, see Giuliano Iannotta, INVESTMENT BANKING 2 (Berlin et al. 2010).

7. OXFORD ENGLISH DICTIONARY, (2012).

8. On arbitration in project finance transactions, see generally Christophe Dugué, *Dispute Resolution in International Project Finance Transactions*, 24 FORDHAM INT'L L. J. 1064 (2000).

9. *Cf.* Inka Hanefeld, *Is There a Need for A Sovereign Debt Tribunal?*, NYU TRANSNATIONAL NOTES (Oct. 8, 2012), http://blogs.law.nyu.edu/transnational.

10. Georges Affaki, *Nouvelles Réflexions sur la Banque et L'arbitrage*, LIBER AMICORUM SERGE LAZAREFF, at 27 (2011).

putes were easy to settle so that there was no need to have recourse to arbitration.[11] Some bankers even considered arbitration to bear the risk that arbitrators might decide *ex aequo et bono* without express authorization to do so.[12]

The limited use of arbitration also resulted from international framework agreements referring to the exclusive jurisdiction of state courts.[13] The 1992 and 2002 versions of the Master Agreement of the International Swaps and Derivatives Association, Inc. (ISDA) are good examples. The vast majority of OTC derivatives—i.e., derivatives which are negotiated "over the counter" outside a regulated exchange—are documented under the ISDA Master Agreement.[14] The model jurisdiction clause contained therein provided that all disputes concerning OTC derivatives had to be settled before state courts in New York or London.[15] Similar jurisdiction clauses in favor of the New York or London state courts can be found in the standard terms of the Loan Market Association.[16]

Finally, reluctance towards arbitration was fostered for a long time by the uncertainty as to whether or not certain financial disputes could be arbitrated.[17] In Germany, for instance, the arbitrability of securities-related disputes is limited by the German Security Trading Act. This follows from Section

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11. *See* William W. Park, *Arbitration in Banking and Finance*, 17 ANN. REV. BANKING L. 213, 216 (1998); Stefano Cirelli, *Arbitration, Financial Markets and Banking Disputes*, 14 AM. REV. INT'L ARB. 243, 268 (2003).

12. Affaki, *supra* note 10, at 28; Georges Affaki, *A Banker's Approach to Arbitration*, ARB. IN BANKING AND FIN. MATTERS, ASA Special Series No. 20, at 63, 68 (2003).

13. Park, *supra* note 11, at 215; Mark Kantor, *OTC Derivatives and Arbitration: Should Counterparties Embrace the Alternative?*, 117 BANKING LAW JOURNAL 408, 409 (2000).

14. Stephen H. Moller et al., *Section 2(a)(iii) of the ISDA Master Agreement and Emerging Swaps Jurisprudence in the Shadow of Lehman Brothers*, 7 J. INT'L BANKING L. AND REG. 313, 314 (2011); Affaki, *supra* note 10, at 40; Kantor, *supra* note 13, at 410 (2000).

15. Marcus C. Boeglin, *The Use of Arbitration Clauses in the Field of Banking and Finance: Current Status and Preliminary Conclusion*, 15 J. INT. ARB. 3, 9(1998).

16. Vivane Gillor, Die Bedeutung der Schiedsgerichtsbarkeit für Großbanken, DIS-MAT XIV (2008); Schiedsgerichtsbarkeit in Finanz- und Kapitalmarkt-Transaktionen, p. 55 (62).

17. *See* B. Hanotiau, *Arbitrability of Financial Disputes*, *in* ARBITRATION IN BANKING AND FINANCIAL MATTERS, 20 ASA Special Series 33 (Gabrielle Kaufmann-Kohler & Viviane Frossard eds., 2003).

37 of the German Security Trading Act ("*Wertpapierhandelsgesetz*"), which provides that arbitration agreements on future securities-related disputes are only binding if both parties are merchants or corporate bodies organized under public law.[18] To the extent that disputes are arbitrable, the arbitration agreement must meet strict form requirements.[19]

While a different approach has succeeded in the United States, the U.S. securities market was originally also one of the few fields where the arbitrability of disputes used to be contested.[20] The traditional view was expressed by the Supreme Court in *Wilko v. Swan*.[21] In this 1953 decision, the Supreme Court ruled that claims under the Securities Act of 1933 had to be referred to state courts, as arbitral tribunals would not be able to provide customers with the protection intended by the Securities Act. This mistrust towards arbitration was questioned in 1987 in *Shearson/American Express, Inc. v. McMahon*.[22] Eventually, in 1989 *Wilko v. Swan* was overruled in the decision *Rodriguez de Quijas v. Shearson/American Express, Inc.* Here, the Supreme Court held that "resort to the arbitration process

18. § 37 h WpHG. See also D. Quinke, Die Gleichwertigkeit auf dem Prüfstand: Schiedsverfahren mit Privatanlegern, in: DIS-MAT XIV (2008), Schiedsgerichtsbarkeit in Finanz- und Kapitalmarkt-Transaktionen, p. 76 ff.; K.P. Berger, Schiedsgerichtsbarkeit im modernen Finanzmarktgeschäft – ein Überblick, in: DIS-MAT XIV (2008), Schiedsgerichtsbarkeit in Finanz- und Kapitalmarkt-Transaktionen, p. 29 f. See also T. Niedermaier, Schiedsgerichtsbarkeit und Finanztermingeschäfte – Anlegerschutz durch § 37 h WpHG und andere Instrumente, SchiedsVZ 2012, 177 (177 et seq.).

19. BGH NZG 2010, 550 (551); BGH, decision of 25 January 2011, reference no. XI ZR 106/09; BGH NJW-RR 2011, 548 (549); BGH, decision of 22 March 2011, reference no. XI ZR 22/10.

20. *See* William W. Park, *Arbitrability and American Securities Law: A Tale of Two Cases, in* ARBITRATION IN BANKING AND FINANCIAL MATTERS, 20 ASA Special Series 81 (Gabrielle Kaufmann-Kohler and Viviane Frossard eds., 2003); Bradley J. Bondi, *Facilitating Economic Recovery and Sustainable Growth Through Reform of the Securities Class-Action System: Exploring Arbitration as an Alternative to Litigation*, 33 HARV. J. L. & PUB. POL'Y 607, 622 (2010); Marilyn Blumenberg Cane and Marc J. Greenspon, *Securities Arbitration: Bankrupt, Bothered & Bewildered*, 7 STAN J. L. BUS. & FIN. 131, 134 (2002); Kenneth R. Davis, *The Arbitration Claws: Unconscionability in the Securities Industry*, 78 B.U. L. REV. 255, 265 (1998).

21. 346 U.S. 427, 438 (1953), *overruled by* Rodriguez de Quijas v. Shearson, 490 U.S. 477, 109 (1989).

22. 482 U.S. 220 (1987).

does not inherently undermine any of the substantive rights afforded to petitioners under the Securities Act."[23]

C. *Change of Trend*

Today, the traditional reluctance towards arbitration in the banking and finance industry is less prevalent. Instead, there is an increasing demand to have recourse to arbitration.[24]

Pursuant to statistics of the International Chamber of Commerce (ICC), the number of arbitrations arising from disputes in the fields of finance and insurance has risen from 7.2% to 15% between 2008 and 2010.[25] In a similar vein, statistics of the Financial Industry Regulatory Authority (FINRA) indicate that the number of securities related disputes which are resolved by arbitration have been growing.[26]

The volume of arbitrations in the banking and finance sector, i.e., the amount in dispute of individual cases, has equally grown. One of the largest cases which was brought under the Rules of the International Centre for Dispute Resolution (ICDR) in recent years concerned, for example, a banking and finance transaction between an investor from the Middle East and a U.S. bank; the amount in dispute was US$ 7.5 billion.[27] In the same vein, an arbitration with US$10 billion in dispute is reported to have been initiated against a Dubai investment group in September 2012.[28]

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23. *Rodriguez de Quijas*, 490 U.S. at 484 (1989).

24. *See* ISDA, MEMORANDUM FOR MEMBERS OF THE INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION, INC.:, THE USE OF ARBITRATION UNDER AN ISDA MASTER AGREEMENT, 1 (Jan. 19, 2011) [hereinafter ISDA Mem.], *available at* 0http://www2.isda.org/functional-areas/public-policy/financial-law-reform; Gillor, *supra* note 12; Kantor, *supra* note 13 at 411-12; Cirielli, *supra* note 11, at 244.

25. *See* ICC International Court of Arbitration Bulletin Vol. 20 No. 1 (2009), p. 5 and ICC International Court of Arbitration Bulletin Vol. 22 No. 1 (2011), p. 5.

26. *See* DISPUTE RESOLUTION STATISTICS – FINRA, http://www.finra.org/ArbitrationAndMediation/FINRADisputeResolution/AdditionalResources/Statistics/ (last visited 6/1/13).

27. *See* William D. Cohan, *Citigroup's Amazing Abu Dhabi Adventure*, BLOOMBERG (Dec. 9, 2012), http://www.bloomberg.com/news/2012-12-09/citigroup-s-amazing-abu-dhabi-adventure.html.

28. Alyx Barker & Alison Ross, *Dubai Faces Arbitration with Banks over $ 10 Billion Debt*, 7 GLOBAL ARB. REV. 5 (2012).

The trend towards arbitration is reflected in initiatives such as the recent consultation of ISDA on the use of model arbitration clauses instead of jurisdiction clauses under ISDA Master Agreements.[29] This consultation resulted in the release of model arbitration clauses for use in the ISDA 2002 Master Agreement and the 1992 Master Agreement (Multicurrency – Cross Border). Six different combinations of institutional rules, seat of arbitration and governing law have been suggested.[30]

Other master agreements—for example the Tahawut Master Agreement—have already foreseen the possibility of arbitration.[31] The Tahawut Master Agreement was developed by ISDA and the International Islamic Financial Market (IIFM) to document Sharia-compliant derivative transactions. It thus concerns Islamic banking—a field that has been growing increasingly over the last decade with a total volume of Sharia-compliant assets exceeding $1 trillion.[32]

Finally, the demand for arbitration in the field of banking and finance is mirrored by the creation of specialized arbitral institutions with special rules. The most recent development in this field was the creation of the Panel of Recognized International Market Experts in Finance, P.R.I.M.E. Finance, an arbitral institution with its seat in The Hague, which this paper explores in more detail below.[33]

D. *Reasons for Change of Trend*

The trend towards arbitration in banking and finance has been motivated by several factors including the internationalization of banking and finance transactions,[34] the increased complexity of disputes,[35] the lack of consistency in court deci-

29. ISDA Mem., *supra* note 24, at 5.

30. *Cf.* HERBERT SMITH ARBITRATION NOTES (Apr. 18, 2013), http://hsf-arbitrationnotes.com/2013/04/18/isda-issues-model-arbitration-clauses-for-use-with-master-agreements/.

31. Affaki, *supra* note 10, at 41.

32. M. Sadeghi, *Financial Performance of Shariah-Compliant Investment: Evidence from Malaysian Stock Market*, 20 INT'L RES. J. OF FIN. & ECON. 15 (2008).

33. *See* discussion *infra* Part III.A.2.

34. *See* discussion *infra* Part II.D.1.

35. *See* discussion *infra* Part II.D.2.

sions,[36] a demand for more flexibility and party autonomy,[37] and privacy and confidentiality considerations.[38]

1. *Internationalization of Banking and Finance Transactions*

In today's globalized world, banking and finance transactions possess a greater international dimension than ever before. A large number of financial transactions are made with participants from emerging markets. Here, arbitration can be the only efficient means of dispute settlement.

On the one hand, it is often not a viable option for market participants from capital exporting countries to resolve disputes before state courts where the counterparty has its assets. This has to do with the risk of legal uncertainty in these countries. Pursuant to statistics of Transparency International, corruption is still widespread in large parts of the world, thereby undermining the basic tenets of justice.[39]

On the other hand, it is rarely productive to settle disputes before state courts in financial centers such as New York or London if judgments are unenforceable against the respective counterparty.[40] Within the European Union and Switzerland, this problem is of less acuity due to the Brussels/Lugano regime on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters. Article 33 of the Brussels Regulation provides that a judgment rendered in a Member State shall generally be recognized in other Member States without any special procedure required.[41] Similarly, if a case is brought before New York courts, and provided that the underlying party has its accounts in New York banks, the successful party may easily attach these assets and enforce the New York court decision without greater problems.

However, apart from these scenarios, enforcement of foreign judgments is significantly more difficult than the enforce-

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36. *See* discussion *infra* Part II.D.3.

37. *See* discussion *infra* Part II.D.4.

38. *See* discussion *infra* Part II.D.5.

39. TRANSPARENCY INTERNATIONAL, GLOBAL CORRUPTION REPORT 2007 –EXECUTIVE SUMMARY, *available at* http://archive.transparency.org/publications/gcr/gcr_2007#summary.

40. Cirielli, *supra* note 11, at 250.

41. In relation to Iceland, Norway and Switzerland, this protection is extended by the Lugano Conventions.

ment of foreign arbitral awards.[42] According to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958 (the "New York Convention"), each of the contracting states "shall recognize arbitral awards as binding and enforce them in accordance with the rules of procedure of the territory where the award is relied upon, under the conditions laid down in [its] articles".[43] The recognition of foreign arbitral awards may only be denied on very limited grounds, such as the violation of the public policy of the country where recognition and enforcement is sought.[44]

2. *Increased Complexity*

Disputes in the banking and finance sector have raised increasingly complex, difficult legal questions.[45] Structured financial products like synthesized collateralized debt obligations, for example, often involve a high number of legal relationships which are governed by different individual contracts and framework agreements. Assessing the interaction of these different contracts can be a challenging task. Things are rendered even more complicated because new financial products are being invented on an almost daily basis.[46]

In addition, these disputes often raise difficult factual questions. Project finance serves as a good example. This financing technique involves highly structured loans that are paid out of the cash flows produced by the specific project.[47] The assessment of these cash flows typically requires a thorough knowledge of economic concepts as well as familiarity with market expectations.

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42. *See* ISDA Mem. *supra* note 24; Andrew Pullen & HiChong Ko, *The Rise of Arbitration in Financial Transactions: Key Issues for Users nad Practitioners*, 16 No. 2 IBA ARB. NEWS 36, 36 (2011) (describing how arbitration enforcement is underpinned by international treaty).

43. Convention on the Recognition and Enforcement of Foreign Arbitral Awards art. III, June 10, 1958, 21 U.S.T. 2517, 330 U.N.T.S. 3. [hereinafter New York Convention]; *see also* L. Levy, *Arbitration of Asset Management Disputes, in* ARBITRATION IN BANKING AND FINANCIAL MATTERS 89 (G. Kaufmann-Kohler and V. Frossard, eds., 2003); Allan L. Gropper, *The Arbitration of Cross-Border Insolvencies*, 86 AM. BANKR. L.J. 201, 240 (2012).

44. New York Convention, *supra* note 43 at art. V.

45. Kantor, *supra* note 24 at 409-10; Cirielli, supra note 11, at 255

46. *Id.* at 408-09.

47. Cirielli, *supra* note 11, at 272.

Arbitration can be a particularly suitable means of resolving such disputes because parties can choose their arbitrators. The principle of party autonomy allows parties to ensure that arbitrators with the necessary expertise will be in charge of their dispute.[48]

3. *Inconsistent Court Decisions*

Inconsistent court decisions are a further reason why banks have become more open to arbitration. For example, in the aftermath of Lehman Brothers' (hereinafter "Lehman"), bankruptcy, courts in London and in New York reached different conclusions as to whether Section 2(a)(iii) ISDA Master Agreement is enforceable. Section 2(a)(iii) ISDA Master Agreement stipulates that certain obligations under the ISDA Master Agreement are subject to the condition precedent that no event of default or potential event of default with respect to the other party has occurred and is continuing.

When Lehman became insolvent, Section 2(a)(iii) of the ISDA Master Agreement was invoked by Lehman's counterparties in two highly similar situations in order to justify a suspension of payment obligations under interest swap transactions. In both cases, the administrators of Lehman challenged this suspension on the basis that Section 2(a)(iii) of the ISDA Master Agreement is unenforceable. Despite these similarities, the two courts reached opposite conclusions. The UK Court of Appeal confirmed the enforceability of Section 2(a)(iii) of the ISDA Master Agreement in *Lomas v. Firth Rixson*[49] whereas the New York Bankruptcy Court of the Southern District of New York denied its enforceability in *Metavante*.[50] These different conclusions were not only caused by differences in the applica-

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48. Kantor, *supra* note 24, at 414-15; Levy, *supra* note 43, at 89; Cirielli, *supra* note 11, at 249; John P. Roberts, *Mandatory Arbitration by Financial Institutions*, 50 CONSUMER FIN. L. Q. REP. 365, 366 (1996).

49. [2010] EWHC 3372 (Ch), (Eng.). For more on this decision, see Edward Murray, Lomas v. Firth Rixson*: A Curate's Egg?* 7 CAP. MARKETS L. J. 5 (2011); *see also* Moller, *supra* note 14, at 317-20.

50. *See* In re Lehman Bros. Inc., No. 08-13555 (JMP), Transcript [Dkt. No. 5261]; In re Lehman Bros. Holdings Inc., No. 08-133555 (JMP), 2009 WL 6057286 (Bankr. S.D.N.Y. Sept. 17, 2009); Stephen H. Moller et al., *Section 2(a)(iii) of the ISDA Master Agreement and Emerging Swaps Jurisprudence in the Shadow of Lehman Brothers*, 7 J. INT'L BANKING L. & REG. 313, 316 (2011).

ble insolvency laws, but also by discrepancies in interpreting Section 2(a)(iii) of the ISDA Master Agreement.[51]

Does arbitration offer a panacea against such inconsistent court decisions? Obviously, one could overstate the advantages of arbitration by arguing this. Yet, arbitration appears to have comparative advantages when it comes to the interpretation of international agreements such as the ISDA Master Agreement. There is notably a lower prospect that the decision of an arbitral tribunal consisting of three qualified experts from different jurisdictions will be affected by national particularities.

4. *Demand for More Flexibility and Party Autonomy*

A further attribute that has fostered the rise of arbitration is that it grants parties more flexibility and autonomy. Arbitration allows the parties to design the proceedings in advance in accordance with their needs for special experience of the arbitrators, speed and efficiency.[52]

In certain fields of banking and finance, this aspect has been key in strengthening the role of arbitration. A prominent example is Islamic banking. Here, parties often share an interest in choosing an arbitrator who belongs to a certain religious community.[53] While the ability to choose such an arbitrator was put into question when the U.K. Court of Appeal held in *Jivraj v. Hashwani*,[54] that a requirement for arbitrators to be part of the Ismaili community would violate European Antidiscrimination Regulations, this decision was quashed on appeal by the U.K. Supreme Court.[55] Reportedly, a complaint was filed to the European Commission pursuant to Article 258 of the Treaty on the Functioning of the European Union.[56] Ac-

51. *See* Moller, *supra* note 14, at 323.

52. See, for example, the modified version of the UNCITRAL Arbitration Rules (as revised in 2010) in the P.R.I.M.E. Finance Rules discussed *infra* Part III.A.2.

53. Jasri Jamal et. Al., *Alternative Dispute Resolution in Islamic Finance: Recent Developments in Malaysia*, 3 INT'L J. SOC. SCIS. & HUMANITY STUDIES 185 (2011)

54. Court of Appeal [2010] EWCA Civ 712.

55. *See id.*

56. *See* Craig Tevendale, *Jivraj – It's Back and This Time it's at the European Commission*, KLUWER ARB. BLOG (Sept. 28, 2012), http://kluwerarbitrationblog.com/blog/2012/09/28/jivraj-%E2%80%93-its-back-and-this-time-its-at-the-european-commission/.

cordingly, there is still a possibility that the case will be referred to the Court of Justice of the European Union.

5. *Privacy and Confidentiality*

Finally, the possibility to shield information from the public sphere may also have been a driving factor for the increasing use of arbitration in banking and finance.[57] Especially in times of crises, when financial institutions already struggle to maintain their reputation, there is a premium placed on privacy and confidentiality.

Shielding information from the public sphere in arbitration is possible due to two related but distinct concepts: privacy and confidentiality. Privacy means that hearings are not open to the public. Thus persons other than arbitrators, parties, parties' counsel or witnesses can be excluded from the hearing.[58] Under most institutional rules, the privacy of proceedings is the default rule that applies unless parties have agreed on something else.[59] Confidentiality, on the other hand, concerns the obligation of the participants not to disclose information related to the proceedings to third persons.[60] Such an obligation is not limited to the hearing but may also exist in the pre- and post-arbitration phase.[61] Even though confidentiality obligations are foreseen in some institutional arbitration rules,[62] such provisions are less prevalent in institutional rules than the equivalent rules on privacy. If the parties seek confidentiality, they should include individual agreements on confidentiality.

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57. Levy, *supra* note 43, at 110; Kantor, *supra* note 24 at 415; Roberts, *supra* note 39, at 365.

58. I.M. SMEUREANU, CONFIDENTIALITY IN INTERNATIONAL COMMERCIAL ARBITRATION 3 (Springer Heidelberg Dordrecht 2011).

59. *Id.*

60. *See, e.g.*, London Court of International Arbitration Rules art. 19(4) [hereinafter *LCIA Rules*] (discussing confidentiality requirements); International Chamber of Commerce Statutes, app. II art. 1(3) [hereinafter *ICC Rules*] (same).

61. SMEUREANU, *supra* note 58, at 5.

62. *See, e.g., LCIA Rules, supra* note 60 at art. 30.1 (discussing confidentiality requirements); Swiss Rules of Int'l Arb. art. 44 [hereinafter *Swiss Rules*] (same); World Intell. Prop. Org. Rules arts. 52, 73-76 [hereinafter *WIPO Rules*] (same).

III.
PRACTICAL CONSIDERATIONS

Parties who wish to resolve disputes in banking and finance by means of arbitration should observe various practical considerations. Two considerations that merit special attention are the choice of an adequate arbitration institution[63] and the drafting of the arbitration agreement.[64]

A. *Choice of an Adequate Arbitral Institution*

International practice shows a strong tendency towards institutional arbitration.[65] Not every institution, however, offers the same advantages and parties should be cautious when making their choice. Some arbitral institutions with a general mandate for dispute resolution have issued special rules for disputes in the banking and finance sector. In addition, there are specialized institutions with an exclusive mandate for dispute resolution in the banking and finance sector.

1. *Arbitral Institutions Which Have Issued Special Rules for Disputes in the Banking and Finance Sector*

Some arbitral institutions such as the American Arbitration Association (AAA), and the China International Economic and Trade Arbitration Commission (CIETAC) have issued special rules for arbitration in the banking and finance sector.

a. AAA Arbitration Rules for Commercial Financial Disputes[66]

The AAA Arbitration Rules for Commercial Financial Disputes are a set of rules governing disputes "involving any commercial financial arrangement, product or other matter or

63. *See* discussion *infra* Part III.A.

64. *See* discussion *infra* Part III.B.

65. For information on the use of institutional arbitration before various arbitral institutions, see *Arbitration Institutions/Statistics*, QUEEN MARY SCH. OF INT'L ARB. (Feb. 26, 2013), *available at* http://www.arbitrationonline.org/research/ArbitrationInstitStat/index.html.

66. *Commercial Finance Rules*, AM. ARB. ASS'N, *available at* http://www.adr.org/aaa/faces/aoe/commercial/financialservices/commercialfinance [hereinafter *AAA Rules*].

conduct relating thereto."[67] Considering the time constraints of many financial disputes, the rules set forth various mechanisms to expedite the proceedings. Thus, Article 1 of the AAA Arbitration Rules for Commercial Financial Disputes stipulates that "parties shall make every effort in good faith to conclude the arbitration within 120 days of its commencement."[68] In order to facilitate such a smooth arbitration within a short period of time, the AAA Arbitration Rules for Commercial Financial Disputes provide various time limits, e.g., concerning the parties' submissions, the appointment of arbitrators or the rendering of the award after the hearing.[69] In addition, the AAA Arbitration Rules for Commercial Financial Disputes provide for the possibility of expedited proceedings that are applied in cases where no disclosed claim and counterclaim exceeds US$75,000 or upon agreement of the parties.[70]

b. CIETAC Arbitration Rules for Commercial Financial Disputes[71]

CIETAC is another arbitral institution that has issued special rules for disputes arising from or in connection with financial transactions. Similar to the P.R.I.M.E. Finance Rules, the CIETAC Arbitration Rules for Commercial Financial Disputes also stipulate that arbitrators shall in principle be drawn from a list of arbitrators provided by CIETAC.[72] Importantly, however, the parties are not bound by this list.

The CIETAC Arbitration Rules for Commercial Financial Disputes also contain mechanisms to expedite the proceedings. The rules stipulate strict deadlines for the parties' submissions and envisage that the award be rendered within 45 days after the constitution of the arbitral tribunal.[73]

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67. *Id.* at art. 1.

68. *Id.*

69. *Id.* at arts, 6, 11, 13-15, 39.

70. *Id.* at art. 9

71. CIETAC, Financial Disputes Arbitration Rules, *available at*: http://www.cietac.org/index/rules/47607aa1ab746c7f001.cms (last accessed June 1, 2013).

72. Arbitration Rules for Commercial Financial Disputes (promulgated by China Int'l Econ. & Trade Arbitration Comm'n, Feb. 3, 2012, effective May 1, 2012), art. 6, *available at* http://www.cietac.org/index.cms.

73. *Id.* at art. 22.

2. *Special Institutions*

Examples of special institutions with an exclusive mandate for the settlement of disputes in the financial and banking sector include the London City Dispute Panel,[74] Diriban (for interbank settlement)[75] or Euroarbitration.[76]

The most recent example of a special institution with an exclusive mandate for the settlement of disputes in the financial and banking sector is P.R.I.M.E. Finance, whose rules are a modified version of the UNCITRAL Arbitration Rules.

In response to the possibility of high complexity of cases, Articles 8 and 9 of the P.R.I.M.E. Finance Rules require that arbitrators be selected from P.R.I.M.E. Finance's list of approved arbitrators. This list encompasses a number of highly distinguished dispute resolution experts who have won the confidence of P.R.I.M.E. Finance. Apart from a list of arbitrators, P.R.I.M.E. Finance has also issued a list of approved financial experts. Pursuant to Article 29 of the P.R.I.M.E. Finance Rules, the arbitral tribunal may appoint such experts after consultation with the parties to report on specific issues to be determined by the arbitral tribunal. Unlike the list of arbitrators, the list of financial experts is not binding.

P.R.I.M.E. Finance Rules implement several mechanisms to accommodate time constraints. If the parties cannot await the constitution of the arbitral tribunal because they are in need of an urgent measure, they may, for example, file an application for emergency proceedings.[77] The appointment of an Emergency Arbitrator shall be made within 72 hours.[78] An Emergency Arbitrator then must render an order within 15 days after transmission of the case.[79] As an alternative to emergency proceedings, the parties may file an application for urgent provisional measures in referee arbitral proceedings per

74. S. Cirielli, *Arbitration, Financial Markets and Banking Disputes*, 14 AM. REV. INT'L ARB. (2003), 243 (254); G. Affaki, *A Banker's Approach to Arbitration, in* G. KAUFMANN-KOHLER & V. FROSSARD, ARBITRATION IN BANKING AND FINANCIAL MATTERS, ASA Special Series No. 20 (2003), 63 (67).

75. Affaki, *supra* note 10, at 42; Affaki, *A Banker's Approach to Aarbitration, supra* note 12, at 66.

76. *See* A. Hirsch, Presentation of *Euroarbitration, in* EUROPEAN CENTER FOR FINANCIAL DISPUTE RESOLUTION, in 55 ASA Special Series No. 20 (2003).

77. P.R.I.M.E. FINANCE ARBITRATION RULES, art. 26a (2012).

78. *Id.* art. 4, Annex C.

79. *Id.* art. 9, Annex C.

the Dutch Code of Civil Procedure.[80] Recourse to these proceedings is, however, only available if the place of arbitration is in the Netherlands and if the parties have agreed on the application of the Referee Arbitration Rules.[81]

Parties under time constraints may also agree on expedited proceedings[82] or file an application for interim measures[83].

3. *Selection Criteria*

While the two recurrent aspects—a highly complex subject matter and time constraints—are a challenge for an efficient resolution of disputes in the banking and finance sector, this does not necessarily mean that parties should limit their selection to one of the above-mentioned dedicated arbitral institutions or procedures. Likewise, ordinary arbitration procedures that are administered by arbitral institutions with a broader mandate still offer alternative solutions. An application for an emergency arbitrator is, for example, also possible under the current Rules of Arbitration of the International Chamber of Commerce (ICC) in force as of January 1, 2012.[84] To the extent that institutional rules do not provide special mechanisms in response to time constraints or the high complexity of proceedings, they typically leave parties enough flexibility to find their own solutions. Even in the absence of a list of arbitrators and experts, parties remain free to select their own well-qualified arbitrators who can then decide to hear experts on complex financial questions.[85]

The choice of rules and arbitral institutions therefore ultimately depends on whether the parties prefer an active involvement of the arbitral institution or whether they wish to retain ultimate autonomy for themselves and the arbitrators. Whatever the final decision, the expertise, experience and quality of the arbitrators will be key for the quality of the proceedings.

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80. *Id.* art. 26b
81. *Id.*
82. *Id.* art. 2a.
83. *Id.* art. 26.
84. *See* ICC ARB. R., art. 29 (2012); ICC IRB. R., appendix V (2012).
85. ICC Arb. R, art. 25.

B. *Drafting the Arbitration Agreement*

Having selected an adequate arbitral institution for their banking and finance dispute, parties need to exercise particular care in drafting the arbitration agreement.

1. *Model Arbitration Clauses / Additional Elements*

The model clauses recommended by the pertinent arbitral institutions are a good starting point for drafting the arbitration agreement.[86] Parties are also commonly advised to determine important issues such as the place of arbitration, the language of proceedings or the applicable substantive law already in the their arbitration agreement.[87]

Other additional elements of arbitration clauses should, by contrast, be considered with particular care. Unilateral optional arbitration agreements are a good example. These agreements grant one of the parties—typically the bank—the right to choose between arbitration and litigation.[88] It is not settled whether, and if so, to what extent, unilateral optional arbitration clauses are enforceable.

In Germany, the German Federal Court of Justice held that a unilateral optional arbitration clause embedded in the general terms and conditions of a contract is void, unless the respondent can be forced to exercise his optional right before the initiation of the proceedings.[89] In another case that concerned an individually negotiated optional arbitration agreement, the German Federal Court of Justice considered a uni-

86. For example, the model arbitration clauses of P.R.I.M.E. Finance are available at http://www.primefinancedisputes.org/images/pdf/Model_clause.pdf (last accessed Aug. 27, 2012).

87. IBA Guidelines on Drafting International Arbitration Agreement, *available at* http://www.ibanet.org/ (*last visited* July 18, 2012).

88. V. Gillor, Die Bedeutung der Schiedsgerichtsbarkeit für Großbanken, in: DIS-MAT XIV (2008), Schiedsgerichtsbarkeit in Finanz- und Kapitalmarkt-Transaktionen, p. 55 (62).

89. Bundesgerichtshof [BGH] [Federal Court of Justice] 1999, Neue Juristische Wochenschrift [NJW], 282, 2008 (Ger.). *See also* K.P. Berger, Schiedsgerichtsbarkeit im modernen Finanzmarktgeschäft – ein Überblick, in DIS-MAT XIV (2008), Schiedsgerichtsbarkeit in Finanz- und Kapitalmarkt-Transaktionen, p. 3 819.

lateral optional arbitration clause to be void as it significantly limited the rights of one of the parties.[90]

Courts in other jurisdictions have taken similar approaches.[91] For example, the Presidium of the Supreme Arbitrazh Court of the Russian Federation issued a decree on June 19, 2012 stating that unilateral option clauses would violate the principle that the parties to a dispute have equal procedural rights.[92]

To be on the safe side, parties should investigate whether such unilateral optional arbitration clauses are valid under (a) the law at the seat of the arbitration, (b) the law governing the arbitration agreement, if different, and (c) the law at the place where enforcement is likely to be sought.

2. *Multi-Contract / Multi-Party Arbitration*

In banking and finance disputes it is always important to anticipate the possibility of multi-contract and multi-party arbitrations when drafting the arbitration agreement.[93]

This is because disputes in the banking and finance sector can easily involve multiple parties and multiple contracts. One might only think of a simple loan agreement with an additional security, such as a guarantee. Here, disputes can arise both under the loan agreement and under the contract governing the guarantee.[94] Even more complex multi-party and multi-contract situations may occur in project finance transactions.[95] Conducting separate proceedings in such situations

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90. Bundesgerichtshof [BGH] [Federal Court of Justice] Jan. 26, 1989, Neue Juristische Wochenschrift [NJW] 1477, 1989 (Ger.).

91. Pullen & Ko, *supra* note 42, at 37. *See also* V. Gillor, Die Bedeutung der Schiedsgerichtsbarkeit für Großbanken, in: DIS-MAT XIV (2008), Schiedsgerichtsbarkeit in Finanz- und Kapitalmarkt-Transaktionen, p. 55 (63).

92. *See* T. Aitkulov, *The Supreme Arbitrazh Court of the Russian Federation Rules on the Validity of Dispute Resolution Clauses with a Unilateral Option*, KLUWER ARB. BLOG (Sept. 11, 2012), *available at* http://kluwerarbitrationblog.com/blog/2012/09/11/the-supreme-arbitrazh-court-of-the-russian-federation-rules-on-the-validity-of-dispute-resolution-clauses-with-a-unilateral-option/ (last visited Sept. 28, 2012).

93. *See* Park, *supra* note 11, at 216 (1998).

94. *See* Pullen & Ko, *supra* note 42, at 37.

95. Mark Kantor, *OTC Derivatives and Arbitration: Should Counterparties Embrace the Alternative?*, 117 BANKING L.J. 408, 413 (2000). *See also* V. Gillor, Die Bedeutung der Schiedsgerichtsbarkeit für Großbanken, in: DIS-MAT XIV

would be highly inefficient and lead to inconsistent decisions.[96]

Parties may counter these problems by using compatible arbitration clauses, creating the basis for a consolidation or joinder of various proceedings.[97] Compatibility can be established by using identical (or at least complementary) wording in the arbitration clauses with respect to the arbitral institution, the place of arbitration, and number of arbitrators. Besides, it is advisable that there are no deviations as to the applicable substantive law or the language of arbitration.[98]

Finally, the parties should explicitly grant the arbitators powers of joinder or consolidation.[99] Other procedural consequences arising from the multiplicity of parties such as special rules for the appointment of arbitrators should be addressed, as well.[100] For example, parties might select an arbitral institution whose rules already address the issue, consequences and handling of multiparty scenarios. The ICC Rules of Arbitration[101] are a prominent example and have proven to be a point of reference for other institutional rules. Parties will, therefore, often have to rely on their own drafting skills when concluding the arbitration agreement.[102]

IV.
CHALLENGES

The future success of arbitration in the banking and finance sector will depend on whether arbitration will be responsive to the needs of market participants. While it is impos-

(2008), Schiedsgerichtsbarkeit in Finanz- und Kapitalmarkt-Transaktionen, p. 55 (64).

96. Affaki, *A Banker's Approach to Arbitration*, *supra* note 12, at 73.

97. *Cf.* INT'L BAR ASS'N, IBA GUIDELINES FOR DRAFTING INTERNATIONAL ARBITRATION CLAUSES, 39 (Oct. 7, 2010) (Multi-Contract Guideline 1).

98. *Id.*

99. *Cf. id.* (Multiparty Guideline 1 and 2). *See also* Pullen & Ko, *supra* note 42, at 37.

100. *Cf.* INT'L BAR ASS'N, *supra* note 97 (Multiparty Guideline 1 and 2).

101. *See* INTERNATIONAL CHAMBER OF COMMERCE, ARBITRATION AND ADR RULES, 17-19 (2012) (Arts. 7-10, 12).

102. Things get even more intricate when the number of parties involved in the arbitration gets that high that a mass claims procedure would be desirable. While institutions like AAA or JAMS have issued special rules for class arbitrations in the US, similar rules have not yet been devised for arbitrations in Europe.

sible to predict the future developments with certainty, there are already two major challenges that are beginning to crystallize. First, dispute resolution in the banking and finance sector must, at least to some extent, contribute to clarifying the legal framework and provide for legal certainty. Second, arbitrators will have to respond to the fact that the regulatory framework for banking and finance transactions is subject to increasing regulation and may raise public policy concerns.

A. *First Challenge: Establishing Legal Certainty*

Legal certainty has an economic value.[103] If market participants cannot be sure whether a certain financial product will withstand scrutiny by an arbitral tribunal, this will affect the price ex ante. Parties will discount the price they are willing to pay for the financial product in light of the legal uncertainty.

Is the quality of justice rendered by the arbitrators sufficient to establish a requisite degree of legal certainty in banking and finance matters? Or is there a need for more transparency and publicity in banking and finance arbitration?

The P.R.I.M.E. Finance Rules, for example, support the idea of transparency and publicity in banking and finance arbitration. Art. 34 para. 4 of the P.R.I.M.E. Finance Rules, provides that:

> An award may be made public with the consent of all parties or where and to the extent disclosure is required of a party or of P.R.I.M.E. Finance by legal duty, to protect or pursue a legal right or in relation to legal proceedings before a court or other competent authority. P.R.I.M.E. Finance may include in its publications excerpts of the arbitral award or an order in anonymised form. P.R.I.M.E. Finance may publish an award or an order in its entirety, in anonymised form, under the condition that no party objects to such publication within one month after receipt of the award.

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103. *See The Use of Arbitration Under an ISDA Master Agreement*, Memorandum for Members of the International Swaps and Derivatives Association, Inc. (Jan. 19, 2011), *available at* http://www2.isda.org/functional-areas/public-policy/financial-law-reform, p. 6. *See also* Pullen & Ko, *supra* note 42, at 39.

This provision aims to strikes a balance between the interest in shielding sensitive information from the public on the one hand[104] and the need to develop an established body of case law on the other.[105] Furthermore, it reflects the demands of market participants. ISDA, for example, has also suggested publishing arbitral awards where the names of the parties and other confidential information are deleted.[106] Likewise, in 2010 the American Bar Association recommended publishing awards unless expressly prohibited by the parties.[107]

B. *Second Challenge: Dealing with Mandatory Rules*

A second challenge in banking and finance arbitration will be to anticipate and account for the mandatory rules in the substantive law on banking and finance that are likely to develop.

Mandatory rules have been defined as those rules that "arise outside the contract, apply regardless of what the parties agree to, and are typically designed to protect public interests that the state will not allow the parties to waive".[108]

Such mandatory provisions could, for example, flow from the European Markets in Financial Instruments Directive

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104. Levy, *supra* note 43, at 110; Kantor, *supra* note 85, at 408; Roberts, *supra* note 39, at 365.

105. *See also* Klaus Peter Berger, *Herausforderungen für die (deutsche) Schiedsgerichtsbarkeit*, SchiedsVZ, at 289 (2009).

106. *The Use of Arbitration Under the ISDA Master Agreement: Feedback to Members and Policy Options*, Memorandum for Members of the International Swaps and Derivatives Association, Inc. (Nov. 10, 2011), *available at* http://www2.isda.org/functional-areas/public-policy/financial-law-reform (Apr. 18, 2012).

107. Am. Bar Ass'n, Preliminary Report and Exposure Draft of Supplementary Arbitration Rules for Commercial Finance Transactions, (Section of Business Law, Task Force on Alternative Dispute Resolution in Commercial Finance Transactions and Section of Dispute Resolution, Arbitration Committee, Subcommittee on ADR in Commercial Finance Transactions, 1 Apr. 1, 2010) at 18, *available at* http://apps.americanbar.org/buslaw/newsletter/0093/materials/pp3a.pdf (Apr. 17, 2012).

108. Donald F. Donovan & Alexander K.A. Greenawalt, *Mitsubishi After Twenty Years: Mandatory Rules before Courts and International Arbitrators*, *in* L.A. MISTELIS & J.D.M. LEW, PERVASIVE PROBLEMS IN INTERNATIONAL ARBITRATION (ALPHEN AAN DEN RIJN, 2006), p.1 at 13.

(MIFID),[109] the German Banking Act,[110] or the U.S. Dodd-Frank Wall Street Reform and Consumer Protection Act of July 21, 2010.[111] It is beyond the scope of this paper to analyze these legal regimes in detail with regard to their provisions' mandatory character. At first glance, these laws may contain several provisions designed to protect important public interest which have to be honored in arbitration proceedings regardless of whether the parties plead these provisions or not.

There have been calls for even stricter regulation and supervision of the various actors in the banking and finance sector. Accordingly, one can expect that the number of mandatory rules will increase.

Does this mean that disputes governed, among others, by mandatory rules should be reserved for resolution before state courts? While this has been suggested by some scholars,[112] the overall trend points in the opposite direction.[113] Many energy disputes, for instance, are submitted to arbitration, irrespective of whether they are governed by mandatory EU antitrust law or not.

Nevertheless, arbitral tribunals will have to apply mandatory provisions *ex officio*.[114] In doing so, they will face several problems: First, the question arises as to which mandatory rules should be applied. To date, it is unsettled whether apart from the chosen law, arbitrators may also have to apply a given third country's mandatory provisions.[115] Sec-

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109. Directive 2004/39/EC (*OJ 2004 L 145, p. 1*) (amending Council Directive 85/611/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC).

110. German Banking Act (*Kreditwesengesetz*, KWG) (amended on June 26, 2012).

111. Dodd-Frank Wall Street Reform and Consumer Protection Act Pub. L. No. 11-203, H.R. 4173.

112. Robert H. Smit, *Mandatory Law in Arbitration, in* MANDATORY RULES IN INTERNATIONAL ARBITRATION 207, 226 (Bermann & Mistelis, eds., New York, 2011).

113. *See* Alexander K.A. Greenawalt, *Does International Arbitration Need a Mandatory Rules Method?, in* MANDATORY RULES IN INTERNATIONAL ARBITRATION, *supra* note 112. *See also* Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 631 (1985).

114. Norbert Horn, *Zwingendes Recht in der internationalen Schiedsgerichtsbarkeit*, 209 SchiedsVZ 212 (2008).

115. Laurence Shore, *Applying Mandatory Rules of Law in Int'l Commercial Arbitration, in* MANDATORY RULES IN INTERNATIONAL ARBITRATION, *supra* note

ond, there is no boilerplate methodology to identify mandatory provisions.[116] While some rules are mandatory, it is unclear whether other rules are optional. It will be interesting to see how arbitral tribunals will respond to these challenges in banking and finance arbitration.

V.
CONCLUSION

Arbitration seems poised to grow in importance in the banking and finance sector just as it has in other sectors of economic importance. The success of arbitration in this field will depend in part on whether parties make reasonable progress in drafting workable arbitration agreements and choosing the right arbitral institutions. Ultimately, however, the future of banking and finance arbitration will depend upon the expertise and commitment of the arbitrators and the competitiveness of state courts. As long as state courts are responsive to the needs of the market participants, the banking and finance industries are unlikely to rely on arbitration for dispute resolution. Nevertheless, in certain settings,[117] arbitration is already becoming a preferable method of dispute resolution in the banking and finance industries.

112, at 131. George A. Bermann, *The Origin and Operation of Mandatory Rules, in* MANDATORY RULES IN INTERNATIONAL ARBITRATION, *supra* note 112, at 1.

116. George A. Bermann, *The Origin and Operation of Mandatory Rules, in* MANDATORY RULES IN INTERNATIONAL ARBITRATION, *supra* note 112, at 1.

117. *See* discussion *supra* Part II.D.1-5.