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Arbitration of International Financial Disputes

Audley Sheppard (Clifford Chance LLP) · Thursday, March 19th, 2009 · American Society of International Law (ASIL)

Banks and financial institutions traditionally have favoured litigation over arbitration as the means of resolving international disputes. The reasons often given include: (i) financial disputes typically involve straightforward payment claims and do not involve complex legal questions or fact finding, with the latter more suited for arbitration; (ii) arbitration does not provide for the possibility of default judgments or summary judgments, and as a result arbitration is not as efficient and cost effective as court proceedings; (iii) disputes about the tribunal's jurisdiction may lead to unnecessary delays; (iv) arbitrators tend to render more equitable decisions than judges; (v) the flexibility of the arbitral process creates legal uncertainty; (vi) banks appreciate control of decisions by higher courts on appeal; (vii) arbitration can permit unnecessarily extensive document production (particularly compared with civil law courts); (viii) arbitration is problematic in multi-party disputes; (ix) arbitral confidentiality means that proceedings cause less embarrassment to the debtor; and (x) awards have limited precedential value.

Major banks traditionally have had sufficient bargaining power in international transactions to insist upon the governing law of their choice (very often New York law or English law) and upon the jurisdiction of their choice (very often New York courts or English courts). Such governing laws are considered bank-friendly, in that they uphold the sanctity of contract and permit very few defenses to non-performance by debtors. And such courts have intelligent, hard-working, commercially-minded and fair judges, who have built up an understanding of sophisticated financial instruments.

However, banks were advised that it could be difficult to enforce a New York judgment outside the U.S. or an English judgment outside the European Community, and that enforcement of arbitral awards might be relatively more successful pursuant to the New York Convention. As transactions increased with counterparties in South America, Russia and the CIS, Middle East and Asia, that did not have assets in the U.S. or the E.C., banks were persuaded that it was preferable to include arbitration clauses in such agreements.

Even then, banks very often preferred to keep their options open. In London, it has become common-place in international loan agreements to provide that disputes be referred to the English courts, with an option – exercisable by the bank once the dispute arises – to refer the dispute to arbitration instead. Such option has been held to be valid by the New York and English courts. *See, e.g., Sablosky v. Edward S. Gordon Co.*, 535 N.E.2d 643 (N.Y. 1989) in New York and *Law Debenture Trust Corp. plc v. Elektrim Finance BV* [2005] EWHC 1412 (Ch.) in England. However, prescribing arbitration only as an alternative to litigation may make the agrement to

arbitrate, or any resulting award, unenforceable in some jurisdictions, *e.g.*, Russia.

On 18th March 2009, I attended a roundtable discussion in Cologne on "Arbitration in Banking & Finance", organized by Jens Bredow (of the DIS German Institute of Arbitration) and Professor Klaus-Peter Berger (of the University of Cologne Banking Law Institute), together with Peter Werner (Policy Director, International Swaps and Derivatives Association, ISDA). The informal group of discussants came from banks, law firms, arbitral institutions and universities.

The group confirmed the widespread antipathy towards arbitration held by many banks and financial institutions and considered the reasons for that. Some of the criticisms of arbitration were considered to be unjustified. However, the group emphasized that the debate should not be "arbitration versus litigation", because not all courts are equal, nor are all arbitral procedures and costs the same (*i.e.*, litigation in country X may be preferable to ABC arbitration, but ABC arbitration may be preferable to litigation in country Y). The relative pros and cons of arbitration vary depending upon the type of transaction and the counterparty (and the whereabouts of its assets). Arbitration is more widely favoured in transactions with counterparties in emerging markets. There was a perception that there were few international arbitrators who had a real understanding of financial instruments, such as SWAPs. It was agreed that there needed to be greater dialogue between bankers and their inhouse counsel and the arbitral community.

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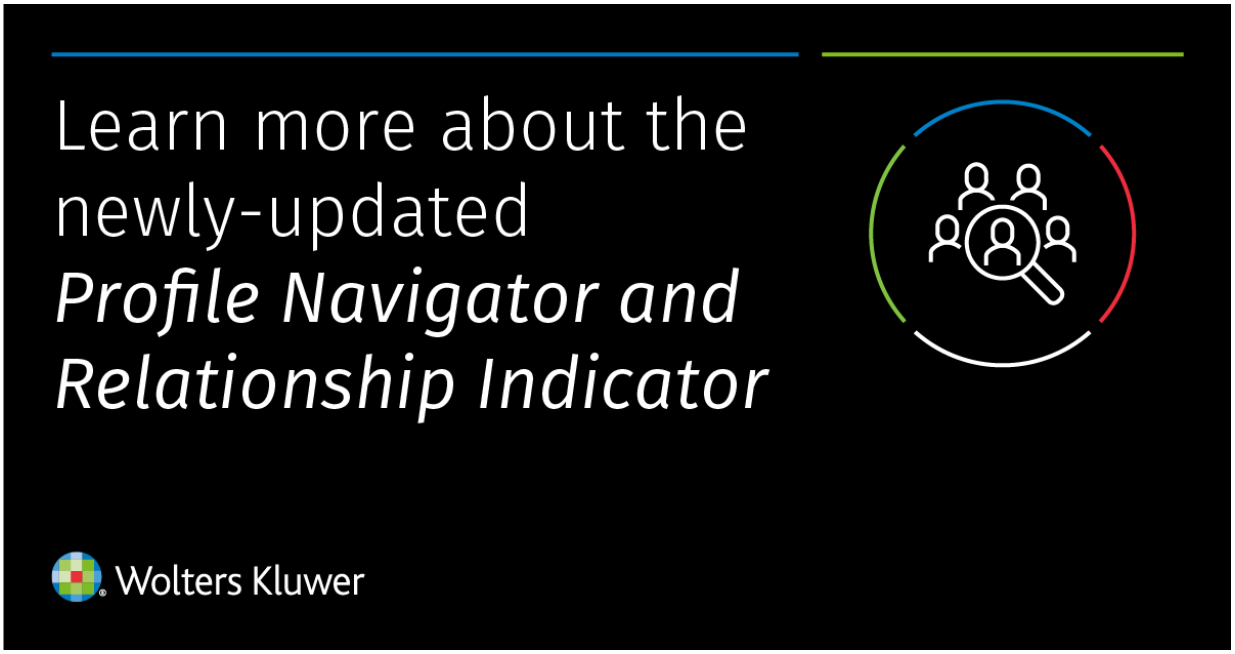

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