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international arbitration

NOVEMBER 2005

This newsletter provides information on issues of current interest and an update on recent developments in international arbitration law and practice. It is written in general terms. The application of the law always depends on the particular facts of the case. If you would like to follow up any of the issues raised, please contact one of the individuals listed below:

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In this issue

ARBITRATION NEWS

Find out what's new in international arbitration, including details of the second edition of the **International Arbitration Planner.**

RECENT DEVELOPMENTS IN INVESTOR-STATE ARBITRATION IN LATIN AMERICA

The use of international arbitration in Latin America has been gathering pace in recent years, a development which is all the more evident in the sphere of investor-State arbitration, with a stark rise in the number of arbitrations brought against Latin American States. In this article, **Alejandro López Ortiz** looks at recent developments in investor-State arbitration in Latin America, including the stance adopted by certain States in the face of the increased number of claims.

CHALLENGES TO ENGLISH ARBITRATION AWARDS UNDER SECTION 68 ARBITRATION ACT 1996

The House of Lords' decision in *Lesotho Highlands Development Authority v Impregilo SpA and others* was awaited with interest by the arbitral community. The judgment of June 2005 clarifies the basis on which arbitral awards may be challenged in the English courts and affirms the underlying policy of the English Arbitration Act 1996, which was to reduce court intervention in the arbitration process to a minimum. **Andrew Foyle** analyses the decision and its ramifications.

CIETAC'S NEW ARBITRATION RULES: WHAT'S IN IT FOR YOU?

The China International Economic and Trade Arbitration Commission (CIETAC) introduced new rules in May 2005. In this article, **Mark Lin** and **Terence Wong** highlight some of the features of the new Rules that are relevant to foreign parties arbitrating, or considering arbitration, in China.

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Arbitration news

EVENTS

Lovells' International Arbitration Planner

The second edition of the International Arbitration Planner, covering events from October 2005 onwards, has been published and sent to over 1600 practitioners and contacts worldwide to date. The first edition of the Planner, which aims to be a convenient and comprehensive source of information on forthcoming international arbitration events, was enthusiastically welcomed by practitioners. The International Arbitration Planner can now be accessed on-line at www.arbitrationevents.com, where new events and suggestions for future editions can be submitted. For further information, contact John Reynolds or Clare Connellan on +44 (0)20 7296 2000 or email info@arbitrationevents.com.

INTERNATIONAL TREATIES AND INSTITUTIONS

NEW YORK CONVENTION

Pakistan ratified the New York Convention on 14 July 2005 and Liberia acceded to the Convention on 16 September 2005. The New York Convention entered into force in Pakistan on 12 October 2005 and will enter into force in Liberia on 15 December 2005. Pakistan's ratification of the New York Convention is subject to a reciprocity reservation that it will apply the Convention only to the recognition and enforcement of awards made in the territory of another contracting State. There are now 137 signatories to the New York Convention.

ICSID

ICSID Convention

Syria signed the ICSID, or Washington, Convention on 25 May 2005, bringing to 155 the number of states who have signed the Convention. Of those, 142 have ratified the Convention.

"Treaty-shopping": the debate goes on

The debate about "treaty-shopping" looks set to continue following a recent decision of an ICSID tribunal (*Gas Natural SDG SA v Argentine Republic*). The issue is whether Most Favoured Nation (MFN) clauses allow investors to avail themselves of more favourable dispute resolution provisions in investment treaties other than that concluded by their own home state and the host state. In a jurisdictional decision of 17 June 2005, a tribunal accepted the Spanish investor's attempt to use the MFN clause in the Spain-Argentina bilateral investment treaty (BIT) to invoke more favourable dispute resolution provisions in the BIT between the US and Argentina. The decision means that the investor could ignore the requirement in the Spain-Argentina BIT to have recourse to local courts for 18 months before turning to arbitration. The tribunal rejected Argentina's argument that the MFN clause extended to substantive investment protections, not to procedural matters. The tribunal effectively affirmed the award in a previous ICSID arbitration, *Maffezzini v Spain*, but went against more recent awards on this subject in *Salini v Jordan* and *Plama v Bulgaria* (the latter case being decided after submissions had been made in *Gas Natural* but several months before the tribunal made its award).

DEVELOPMENTS IN NATIONAL LAW

UK: English courts have supervisory jurisdiction over investor-State arbitration

The Court of Appeal has rejected an attempt by a successful claimant in an investment treaty arbitration to prevent the losing State from challenging the award in the English courts (*Republic of Ecuador v Occidental Exploration and Production Company* [2005] EWCA Civ 1116). The proceedings before the English courts arose out of an arbitration between Ecuador and Occidental. The place of arbitration was London and the arbitration was brought under the terms of the BIT between the United States and Ecuador. Occidental had entered into a contract with a state-owned corporation of

Ecuador, whereby it obtained the exclusive right to carry out hydrocarbon exploration and exploitation in a part of the Ecuadorian Amazon basin. Occidental ultimately invoked the arbitration procedure provided for in the BIT, alleging that Ecuador had breached its treaty obligations under the BIT by introducing resolutions which had the effect of preventing VAT refunds from being paid to Occidental. Ecuador challenged the tribunal's jurisdiction on various grounds. Having found that it had jurisdiction, the tribunal went on to rule that Occidental was entitled to VAT refunds.

Ecuador then applied to the English courts to challenge the award under section 67 of the English Arbitration Act 1996, on the ground that the tribunal had exceeded its jurisdiction. Occidental raised an interesting argument to counter Ecuador's application: the English court had no jurisdiction to consider Ecuador's section 67 challenge because of the "doctrine of non-justiciability", by virtue of which English courts cannot interpret an international treaty which has not been incorporated into English law. The thinking behind this doctrine appears to be that it would be wrong to interpret an international law which has nothing to do with the United Kingdom and where not all of the states who are parties to the law are involved (here, the United States was a party to the BIT but was not involved in the proceedings). Occidental argued that the claim, the arbitration and the award all arose out of the BIT.

Occidental's argument was rejected by a High Court judge in April 2005 and the Court of Appeal dismissed Occidental's appeal. It held that where an arbitration arose out of a BIT between states and one of the parties to the arbitration was a state, the courts had jurisdiction to rule on the scope of the arbitration agreement. The BIT expressly provided that each party could refer any investment disputes to international arbitration and intended to give private investors the ability to arbitrate against a state party to the treaty. The agreement to arbitrate gave rise to rights between the parties to it, including the right to have disputes arbitrated within its scope and not to have disputes arbitrated which fell outside its scope. Effect should be given to the consensual agreement to arbitrate contemplated by the BIT, as well as the usual procedural and supervisory remedies provided under English law as the relevant procedural law.

This would appear to be the logical outcome: if the tribunal can decide jurisdictional issues, why should the courts of the place of arbitration not be able to do so?

UK: English court orders parties to arbitration agreement to mediate

In a curious decision in April 2005 an English High Court judge ordered the parties to refer their dispute to mediation, despite the existence of an arbitration clause in their contract. In *C v RHL* (28 April 2005), C sought an anti-suit injunction against RHL, restraining it from proceeding with pending actions before the Arbitration Court of Moscow (a commercial court) and from commencing any further or other proceedings in the courts of any jurisdiction in relation to certain claims connected to a share purchase agreement between the parties. The agreement contained an ICC arbitration clause, with an express choice of London as the place of arbitration. C had commenced arbitration proceedings.

The judge hearing the application decided that it would be in the overall interests of all parties if all of the disputes between C and RHL were referred to mediation before any further substantial costs were incurred. He thought that mediation would provide scope for commercial solutions beyond the power of the court or ICC arbitrators. The parties were given 28 days to appoint a mediator and conclude their mediation, during which time neither party was to commence any further proceedings or do anything in the existing proceedings.

If it were not for the existence of the arbitration clause, this would not perhaps have been a surprising decision: the English courts routinely encourage parties to litigation to attempt to resolve their disputes by alternative dispute resolution (ADR) and have enforced a contractual clause in which the parties had agreed to attempt mediation before having recourse to litigation. However, it seems that there was no multi-tiered dispute resolution clause requiring the parties to mediate as a precursor to arbitration in this case. Furthermore, the judge's decision raises the question whether he would have made the same order if C had been applying to stay English court proceedings (section 9 of the English Arbitration Act 1996 requires the court to stay court proceedings in favour of arbitration where there is a valid arbitration clause). There is no reason to think that his order would have been any different, despite the fact that this would almost certainly be contrary to

the spirit of the 1996 Act which envisages minimum court intervention in arbitration. It will be interesting to see if other judges follow the example of the judge in this case.

UK: House of Lords clarifies basis for challenge to arbitral awards

The House of Lords in *Lesotho Highlands Development Authority v Impregilo SpA and others* has clarified the basis on which English arbitration awards may be challenged in the English courts and has reaffirmed that the policy underlying the Arbitration Act 1996 is to reduce drastically the intervention of the courts in the arbitration process. Specifically, their Lordships clarified the scope of section 68(2)(b) of the 1996 Act, which covers challenges for serious irregularity on the ground that the tribunal exceeded its powers (otherwise than by exceeding its substantive jurisdiction). It is now clear that section 68(2)(b) applies where the tribunal has purported to exercise a power that it did not have under the 1996 Act, but not where the tribunal has merely erroneously exercised a power conferred by the Act. For further details, see the article on page 9 of this newsletter.

FRANCE: French courts can appoint arbitrator in face of risk of denial of justice

The French courts may have jurisdiction to appoint an arbitrator even if France is not the place of arbitration and French law is not applicable to the arbitration. So held the French Cour de Cassation (Supreme Court) in a recent judgment (*Etat d'Israel v National Iranian Oil Company* (Cour de Cassation, 1ère civ., 1er févr. 2005, Juris-Data no. 2005-026746)). The contract between the parties contained an arbitration clause providing for three arbitrators, two to be appointed by the parties and the third, in the absence of agreement between the parties, to be appointed by the President of the ICC Court. NIOC appointed an arbitrator but Israel refused to do the same. NIOC therefore applied to the President of the Paris Tribunal de Grande Instance for the constitution of the arbitral tribunal, in accordance with article 1493(2) of the New Code of Civil Procedure. The Tribunal de Grande Instance rejected the application twice. On the first occasion, it held that there was not a sufficient link with France, as the proceedings were not to take place in France and the parties had not chosen French procedural law. Furthermore, there was no denial of justice as NIOC had not applied to the Israeli courts to appoint an arbitrator. The parties subsequently attempted to agree on the constitution of a tribunal, but in the meantime Iran came to be considered by Israel as an enemy for the purposes of criminal law, such that the Israeli courts no longer had jurisdiction to assist with the appointment of an arbitrator. Rather than applying to the Israeli courts in those circumstances, NIOC made a second application to the Tribunal de Grande Instance. The application was rejected on the ground that NIOC had not exhausted all applications to foreign jurisdictions.

The Paris Court of Appeal allowed NIOC's appeal, on the ground that NIOC was denied access to justice in Israel and therefore required the intervention of the French courts. Israel applied to the Cour de Cassation to set aside the Court of Appeal's judgment on the grounds that it was procedurally defective and that the French courts did not have jurisdiction under the denial of justice theory.

The Cour de Cassation rejected the appeal. It held that refusing access to a judge, or an arbitrator, constituted a denial of justice. In this case, due to the tensions between Israel and Iran, NIOC was unable to apply to the Israeli or Iranian courts for the appointment of an arbitrator. This was a denial of justice which would give the French courts jurisdiction provided there was a sufficient link with France. Whilst the reference in the arbitration clause to the President of the ICC Court was a tenuous link with France, it showed that the parties had chosen France as the competent forum in case of difficulties arising during the arbitral procedure, thus justifying the jurisdiction of the French courts.

SPAIN: The Spanish Arbitration Club is launched

A group of Spanish arbitration lawyers has created the "Club Español de Arbitraje" (Spanish Arbitration Club), with the purpose of encouraging the use of arbitration in Spain, promoting Spain as the seat of arbitrations relating to Latin America and improving the practice of arbitration. The Club has announced that one of its first objectives is to organise a conference in Madrid on Arbitration in Latin America.

Lovells is represented in the Spanish Arbitration Club through Madrid-based partner José Luis Huerta.

POLAND: Changes to Polish law on arbitration

Poland has joined the club of countries whose arbitration law is based on the UNCITRAL Model Law on International Commercial Arbitration of 1985. The new Part V of the Code of Civil Procedure which contains the new law came into force on 16 October 2005.

The new law applies in cases where the place of arbitration is in the territory of Poland and does not differentiate between domestic and international arbitration. The law contains standard requirements as to the form of the arbitration agreement. Other features of the new law include: power of the arbitral tribunal to grant interim measures of protection; right of the parties to apply to the state court to grant such measures or take evidence, even in cases where the place of arbitration is outside Poland or is not indicated; rules governing the composition of the arbitral tribunal, the conduct of the arbitral proceedings and the making of awards; provisions covering challenges to awards and recognition and enforcement of arbitral awards (Polish law provides for enforcement of arbitral awards as well as settlements concluded before the arbitral tribunal). Another feature worth noting is a provision that unilateral arbitration clauses, for example where only one of the parties has the right to choose between arbitration and litigation, are invalid. Another interesting feature of the Polish law is that an award can be set aside if the award has been made as a result of a crime or on the basis of a forged or falsified document.

An English translation of the new law, prepared by Lovells' Warsaw office, can be found on-line in our International Arbitration Guide at www.lovells.com/arbitration.

AUSTRIA: New Austrian Arbitration Act

A new Austrian Arbitration Act is expected to come into force on 1 January 2006. The new law is based on the UNCITRAL Model Law on International Commercial Arbitration but contains several key differences. For example, Article 16(1) of the Model Law, which covers the concept of the separability of an arbitration clause, will not be included in the Austrian law. It will be for the courts to rule on this issue based on general legal principles. The new law will not allow an even number of arbitrators; if the parties agree on two arbitrators, those arbitrators will have to appoint a third person as their chairman. Finally, the new law provides for the appointment of arbitrators in a multi-party situation, to the effect that if the parties on one side of the arbitration (whether as claimants or respondents) cannot agree on an arbitrator, the court will appoint all of the arbitrators.

ITALY: Mandatory arbitration with no right of appeal declared unconstitutional

The Italian Constitutional Court has recently held that a statutory provision providing for mandatory arbitration without a right of appeal against the award was unconstitutional (Decision n° 211/2005 - 8 June 2005). The offending provision was Article 13 of Royal Decree n° 1345/1930, which governs the construction and management of waterworks of Monferrato, which the court held violated both Article 24 of the Italian Constitution, which states that everybody has the right to take action to see his or her rights recognised, and Article 25, governing the designation of the "natural judge" for each case.

The Constitutional Court reasoned that it was acceptable for the right to challenge arbitral awards to be excluded if parties had the choice whether or not to refer disputes to arbitration; the constitutional right protected by Article 24 was preserved by the very fact that the parties had exercised their choice of whether to litigate or arbitrate. However, the situation was different where parties had no choice but to arbitrate.

The court's decision means that Article 13 of the Royal Decree can no longer be relied upon to exclude the parties' right to appeal against an arbitral award. The decision has retroactive effect, so even awards which pre-date the decision may be challenged, subject to statutory time limits. It is also consistent with previous decisions declaring other provisions obliging the parties to arbitrate and excluding the right to appeal to be unconstitutional.

Recent developments in investor-State arbitration in Latin America

Alejandro López Ortiz[1]

Several decades ago, Latin America was one of the world's most reluctant users of international arbitration. The Calvo Doctrine, adopted by various Latin American States, perceived arbitration to be an illegitimate interference with their sovereignty and required disputes, even those involving foreign parties, to be resolved by domestic courts. Only very gradually did these countries come to accept international arbitration, for example by signing international conventions such as the 1958 New York Convention or by adopting arbitration statutes that lifted some of the traditional restrictions on arbitration (such as the involvement of foreign parties and foreign arbitrators or interference of domestic courts).

The opening up of Latin American countries to international commerce during the 1990s accelerated this process. All Latin American States have now ratified the New York Convention[2] and a significant number of them have passed new arbitration statutes based on or identical to the UNCITRAL Model Law on International Commercial Arbitration[3]. International arbitration has become common practice in Latin America, as evidenced by the Statistical Report of the International Chamber of Commerce for 2003[4], which showed 12.1% of the cases registered with the ICC in 2003 involved Latin American or Caribbean parties.

This process is even more evident in investor-State arbitration. During the 1990s, many Latin American countries ratified the Convention on the Settlement of Investment Disputes between States and Nationals of other States (the Washington, or ICSID, Convention) and a significant number of Bilateral Investment Treaties (BITs) in order to offer guarantees to attract foreign investment to their economies, within a general process of privatisation of public services[5]. Similarly, Mexico became a party to the NAFTA Treaty. These instruments protected investors' rights and gave investors access to arbitration for the resolution of investment-related disputes, usually under the auspices of the International Centre for Settlement of Investment Disputes (ICSID, an entity within the World Bank Group). Thus investors could avoid the jurisdiction of the domestic courts of the host State.

Since the late 1990s and as a consequence of the privatisation process, the number of ICSID arbitration cases against Latin American States has risen from none between 1972 and 1995 to 75 between 1996 and 2005[6].

ARGENTINA

During the 1990s Argentina ratified the ICSID Convention and signed a network of more than 40 BITs with various countries. This new legal framework encouraged foreign companies to obtain concessions on utilities such as water, gas, oil or electricity and other sectors such as information services and insurance.

In 1997, a claim was filed against Argentina as a result of the termination of a water distribution concession. The tribunal in that arbitration made an award, which was subsequently annulled and a new tribunal is to issue a further award shortly. Other claims were submitted to ICSID between 1997 and 1999, but they were all settled.

The severe monetary crisis between 2001 and 2002 forced the Argentinean Government to take economic measures such as the abolition of dollar/peso parity, the conversion of agreed tariffs for utilities from dollars to pesos and the freezing of official tariffs. Between 2001 and 2005, 36 arbitration claims against Argentina were registered at ICSID. This represents almost 34% of the arbitration claims registered by ICSID in that period. The value of those claims amounted to over \$38 billion and Argentina's Attorney-General estimates that many more claims could still be brought, potentially raising the total amount claimed to over \$80 billion.

Argentina has reacted to these claims with a threefold strategy: first, by developing a strong legal defence,

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2 The only Caribbean countries that have not ratified the New York Convention are the Bahamas, Guyana, Saint Kitts and Nevis and Saint Lucia.

3 The last country to pass its new Arbitration Act was Chile, on 10 September 2004 (see Lovells International Arbitration Newsletter of May 2005). In Argentina, there are various drafts to modify its old arbitration laws contained in its Civil Procedural code and introduce the UNCITRAL Model Law; however, the legislative process is under way.

4 ICC Bulletin vol. 15/no. 1 - Spring 2004.

5 Conversely, Brazil has chosen not to ratify any of the BITs signed.

6 Between 1972 and 1995, 33 arbitration claims where registered by ICSID; none of them were against Latin American States and only 3 against Caribbean States (3 claims in 1974 against Jamaica). Between 1996 and 2005, 152 arbitration claims have been registered; 75 of them against Latin American States (49.3%) and only 3 against Caribbean States.

which involves both challenging the jurisdiction of the arbitral tribunals and objecting to the merits of the claims; second, by pushing investors to renegotiate concession contracts, in exchange for withdrawing their claims; and third, by anticipating that it will appeal any award and resist its enforcement domestically and abroad.

Recent developments have shown that Argentina's legal defence is being rejected by arbitral tribunals. In 2004, Argentina's objections on jurisdiction were rejected for the first time by the arbitral tribunal hearing a claim by the US gas transporter CMS. This decision has been followed by all of the arbitral tribunals which have decided on Argentina's jurisdictional objections to date. However, the most important landmark has been the recent award on the merits by the CMS tribunal. On 12 May 2005, the tribunal decided that Argentina had to pay CMS over $133 million. Although the tribunal rejected CMS' contention that the measures adopted by Argentina amounted to expropriation of its investment, it found that Argentina had failed to afford CMS fair and equitable treatment (as required by the applicable BIT) and had breached the "umbrella clause" by infringing certain commitments assumed vis-à-vis CMS. The importance of this award resides not only in the level of damages granted, but also in its effect as a precedent for the remaining cases.

Argentina has announced that it will resist the enforcement of this award. In the first instance, it has submitted an application for annulment of the award. One of the arguments that Argentina might interestingly raise is the lack of neutrality of an ICSID tribunal, due to the World Bank's alleged interests in the case as a lender of CMS. Although it is unlikely to succeed, this application will have the effect of seriously delaying enforcement. At the same time, Argentina has announced that it may apply for any award to be reviewed by its domestic courts on the ground of unconstitutionality (on the basis that such awards are contrary to Argentina's public policy and are an attack on Argentina's sovereignty). It has also indicated that it will adopt legal measures to prevent the effect of BITs and ICSID jurisdiction on Argentina, in a return to the Calvo Doctrine. Although such measures should not have any effect beyond Argentina's borders, they would obstruct the enforcement of any award, since they would force investors to find sufficient assets abroad that were not subject to diplomatic immunity.

These developments have had an effect on negotiations with investors. Some long-term investors are more interested in paving their way for the future than in recovering all of their past investments and are aware that, although they would almost certainly secure legal victories, they would face difficulties in enforcement. Thus, they have preferred to reach agreements with the Argentinean Government, including partial tariff increases and future renegotiation of the terms of their concession contracts. Thus, Gas Natural and Pioneer Natural Resources have announced the withdrawal of their claims; Endesa (the main shareholder of Enersis) and Telefónica (which claims $2.8 billion, the biggest single claim against Argentina) have reached preliminary agreements including the suspension of proceedings; and CGE seems to be following this path too. Other investors (for example, EDF, which has sold its investment), however, prefer to take their chances of obtaining an award in their favour, trusting that Argentina will not dare resist enforcement (other than seeking the annulment of any award), in fear of the serious international economic and political consequences that could ensue and which could result in a loss of credibility in the eyes of private investors, international organisations and other States.

OTHER COUNTRIES

Argentina is not the only front of investor-State arbitration in Latin America. Recent events in Bolivia, which culminated in the resignation of the President and the passing of legislation creating a new tax on the exploitation and commercialisation of oil and gas, have given rise to claims by foreign investors who arrived in the country when the sector was privatised during the 1990s. Some investors have already notified their claims to the Bolivian Government and, unless the disputes are settled within the next few months, arbitration proceedings will follow. The Government, having learnt some lessons from Argentina, has shown a willingness to negotiate with investors.

Similarly, Venezuela recently announced that all existing agreements between foreign investors and the state oil company will be terminated by the end of 2005. New investments will have to be operated through joint ventures controlled by the State. Income tax and royalties on oil exploitation have been increased significantly and in some cases tax increases will apply retroactively to investors' profits over the past five years. Furthermore, Venezuela is failing to comply with certain payment

provisions contained in concession agreements. As a consequence, foreign investors are considering whether to bring arbitration claims against the State, even though high oil prices and the Government's warning that any investor bringing an arbitration claim against the State would be excluded from future bids are both strong incentives to accept the Government's actions. Another contentious issue for the future is a legal provision requiring any new oil investment agreement to contain a clause whose confusing wording seems to exclude any arbitration abroad. Venezuela is not a newcomer to investor-State arbitration: ICSID arbitration cases have been brought in the past against Venezuela in other sectors, two of which are still pending.

Ecuador recently announced its plan to revise oil investment contracts to increase the participation of the State in production. These measures, if implemented, might infringe investors' BIT rights and provoke a number of claims for arbitration before ICSID.

CONCLUSIONS

During the last few years, the importance of Latin America in international arbitration has increased considerably. The economic and monetary crisis in Argentina has taught the international community that commitments to arbitrate contained in BITs are fully enforceable and provide strong protection for investors. Developing States should have learned that whilst BITs are a powerful tool in attracting investors, it is neither easy nor cheap to modify substantially the conditions offered to foreign investors protected those BITs. Some States have already stopped signing and ratifying BITs and the Uruguayan Senate has proposed that a common position on BITs be determined by Mercosur.

Argentina is caught in a very difficult situation and it remains to be seen how long it will be able to pursue its plan of resisting enforcement and challenging the whole system of investment treaty protection, as well as how effective this approach will prove in negotiations with investors.

Any developments will certainly be observed very closely by the Bolivian, Venezuelan and, eventually, Ecuadorian Governments, as well as by others in many parts of the world.

Alejandro López Ortiz

Challenges to English arbitration awards under Section 68 of the Arbitration Act 1996

Andrew Foyle[1]

INTRODUCTION

The decision of the House of Lords in *Lesotho Highlands Development Authority v Impregilo SpA and others* [2005] UKHL 43 is an important decision for those who choose to arbitrate their disputes in England and Wales and will be of interest to the wider international arbitral community. The decision clarifies the basis on which English arbitration awards may be challenged in the English courts. It provides a very strong affirmation of the underlying policy of the Arbitration Act 1996 (the 1996 Act), which was to reduce court intervention in arbitration to a minimum. The decision should allay any concerns that the English courts are becoming too interventionist in their approach to challenges to arbitration awards.

BACKGROUND

The dispute arose out of a contract (the FIDIC 4th edition, with additions and amendments) to construct a dam in Lesotho. The contract was governed by the law of Lesotho. The contractor consisted of a consortium of seven companies from various different countries. The contract provided that the currency of account would be the Lesotho Maloti and, for the purposes of payment, conversion between the Maloti and certain specific currencies stated in the contract was to be made at the rates of exchange to be determined in accordance with the rates set out in the contract. These rates were not to be subject to any variation as a result of changes in the rates of exchange between the Maloti and the foreign currencies.

The contract was made on 15 February 1991 and the works completed on 26 February 1998. During the course of the works the contractor made various claims for reimbursement of increased costs and for upwards adjustments to prices and rates. These claims were rejected by the employer and the engineer and were ultimately referred to ICC arbitration in London. The tribunal issued a partial award in January 2002.

The tribunal found that various sums expressed in Maloti were due to the claimants on various dates. Because the value of the Maloti had fallen heavily between the date when the payment should have been made and the date of the award, the tribunal made its award in hard currencies, converted from Maloti at a rate prescribed in the contract which predated the Maloti's collapse. The complaint of the employer was not that the award was expressed in the wrong currencies but against the rate at which the Maloti had been converted into those hard currencies by the tribunal.

In reaching this decision, the tribunal relied on section 48(4) of the 1996 Act. This provides, in effect, that unless otherwise agreed by the parties, the tribunal may order the payment of a sum of money in any currency. The tribunal referred to the fact that the terms of reference expressly provided that the dispute would be settled in accordance with the provisions of the 1996 Act. The employer contended that the matter of currencies was dealt with under the contract so that the parties had "otherwise agreed" that section 48(4) would not apply.

The tribunal also awarded simple interest on the amounts found due from the dates on which the payments should have been made to the date of the award. The tribunal awarded this pre-award interest pursuant to section 49(3) of the 1996 Act. This section also applies unless otherwise agreed by the parties. The employer argued that the effect of the provisions of the contract relating to interest constituted a contrary agreement, so that the tribunal did not have power to award interest pursuant to section 49. The tribunal held that the relevant contract provisions only applied to payments following certification by the engineer and were irrelevant to the tribunal's power to award interest on sums which had not been certified.

CHALLENGES TO AN ENGLISH AWARD UNDER THE ARBITRATION ACT

Under the 1996 Act challenges to an award made in England and Wales may be brought under section 67 (on grounds of lack of substantive jurisdiction) or under section 68 (on grounds of "serious irregularity" affecting the tribunal, the proceedings or the award). Section 68 defines "serious irregularity" as meaning an irregularity of one of the specified kinds listed in sub-section (2) "which the court considers has caused or will cause substantial injustice to the applicant". The specified grounds include (at sub-section (b)) "the tribunal exceeding its powers (otherwise than by exceeding its substantive jurisdiction: see section 67)".

The 1996 Act also permits (in section 69) appeals on points of English law. However, the right to appeal may be

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excluded by agreement and requires the leave of the court. The ICC Rules exclude the right of appeal on points of law, so no such appeal would have been possible in the *Lesotho* case.

THE COURT OF APPEAL DECISION

The Court of Appeal upheld a challenge to the award on the ground that the tribunal did not have the power to make an award in a currency other than that provided for in the contract. The Court of Appeal decided that the tribunal had incorrectly concluded that it had the power and discretion under section 48(4) of the 1996 Act to determine the currency of the award. It held that the tribunal had exceeded its powers and therefore contravened section 68(2)(b) of the 1996 Act. Similar issues arose in relation to the tribunal's award of interest. That part of the award was also challenged successfully.

The Court of Appeal's decision caused some concern that "excess of power" arguments (based on section 68(2)(b)) could be used to challenge arbitration awards in circumstances never intended by the legislation. Even if the tribunal was wrong, in law, to conclude that the currency of the award was a matter of procedure governed by section 48(4) of the 1996 Act, to treat that decision as an excess of power under section 68 would undermine the stated purpose of the 1996 Act, by allowing the court to intervene in circumstances that were not envisaged by the Act. Would every error of law by a tribunal be considered an excess of power and, if not, where should the line be drawn?

THE DECISION OF THE HOUSE OF LORDS

The potentially damaging impact of the Court of Appeal's decision on arbitration in England and Wales was highlighted by the comments of Lord Steyn who gave the leading speech in the House of Lords' decision which allowed the contractor's appeal and upheld the tribunal's award. He commented that the appeal "raises issues regarding the jurisdiction of arbitrators under the Arbitration Act 1996 which are of great importance for the effective functioning of the statute". He also said that "If the view of the Court of Appeal had been upheld, a very serious defect in the machinery of the 1996 Act would have been revealed" and that the decision "would have opened up many opportunities for challenging awards on the basis that the tribunal exceeded its powers in ruling on the currency of the award".

The basic issue considered by the House was how section 68(2)(b) and section 69, so far as the latter excludes a right of appeal on a question of law, are to operate. "Specifically, can an alleged error of arbitrators in interpreting the underlying or principal contract be an excess of power under section 68(2)(b), so as to give the court the power to intervene, rather than an error of law, which can only be challenged under section 69 if the right of appeal has not been excluded?"

The House clarified how section 68(2)(b) should be applied. The sub-section does not permit a challenge on the ground that the tribunal arrived at a wrong conclusion as a matter of law or fact. It is not apt to cover a mere error of law. To purport to exercise a power that the tribunal did not have under the Act would be an excess of power. However, the erroneous exercise of a power conferred by the Act would not be an excess of power within the ambit of section 68(2)(b).

The House decided, by a majority, that the tribunal had committed an error of law in rendering its award in a currency other than that provided for in the contract. Although Lord Steyn dissented (he considered that the tribunal's decision was correct), he said that on the assumption that the tribunal did commit an error of law, that error of law was (at its highest) no more than an erroneous exercise of a power available under section 48(4) and was therefore not an excess of power under section 68(2)(b).

In essence, the approach of the majority of the House of Lords was that if the parties have not excluded the powers of the tribunal under section 48(4) by an agreement in writing, the manner in which the tribunal exercises its power will not be an excess of power under section 68(2)(b). This approach and reasoning would be relevant to other sections of the 1996 Act which confer powers on the tribunal, unless otherwise agreed by the parties.

Lord Phillips did not follow the broader approach to the interpretation of section 68(2)(b) of the majority of the House. In his opinion, the tribunal did not have the discretionary power under section 48(4) and would therefore be guilty of a serious irregularity under section 68(2) if this had resulted in "substantial injustice" to the respondent.

What would be sufficient to constitute an excess of power (otherwise than by

the tribunal exceeding its substantive jurisdiction), so as to be capable of amounting a "serious irregularity" under section 68(2)(b)? One example suggested by Lord Steyn was where the tribunal purported to exercise a power under section 37 to appoint an expert to report to it, when the parties had agreed in writing that the tribunal did not have that power. Another example was one where an arbitration agreement expressly permitted only the award of simple interest and the arbitrators nevertheless awarded compound interest.

The House was unanimous that the tribunal had been entitled to grant pre-award interest pursuant to section 49(3) of the 1996 Act. Even if the tribunal had been wrong to do so, the pre-condition of substantial injustice had not been established by the appellant. Also, the error would have been an error of law, which would not have been an excess of power within the meaning of section 68(2)(b).

THE WIDER IMPORTANCE OF THE HOUSE OF LORDS' DECISION

The decision of the House is important not just because of the clarification that has been given as to how section 68(2)(b) should be applied but also for the general comments made by Lord Steyn on the ethos and purpose of the 1996 Act and the approach the courts should adopt to challenges to arbitral awards. His comments should influence not only the way in which lower courts deal with future challenges under section 68 of the Act, but their application of the Act more generally.

In relation to section 68, Lord Steyn emphasised that a major purpose of the Act was to reduce drastically the extent of intervention of courts in the arbitral process. Nowhere in section 68 is there any hint that a failure by the tribunal to arrive at the "correct decision" could afford a challenge under section 68. The erroneous exercise of an available power cannot by itself amount to an excess of power.

The requirements of "serious irregularity" and "substantial injustice" were also stressed. Lord Steyn commented that a high threshold must be satisfied to meet the requirement of a "serious irregularity". Furthermore, he emphasised that the additional requirement that the irregularity caused or will cause "substantial injustice" is an important pre-condition. The burden is squarely on the applicant to invoke the exceptional remedy, under section 68, to establish the pre-condition of substantial injustice. Substantial injustice cannot be assumed.

The requirement of "substantial injustice" was also highlighted by Lord Phillips, in his dissenting opinion on the currency of the award. He doubted whether the error would have caused the respondents to incur substantial injustice. Had he been in a majority in concluding that the arbitrators had exceeded their powers under section 68 it would have been necessary to give further consideration to the question of whether this had caused substantial injustice to the respondents, by considering the evidence of how the exchange rates had moved during the relevant period.

Lord Steyn summarised how the 1996 Act should be interpreted by the courts, stressing that it should not be interpreted in the light of the pre-existing case law. He endorsed the comments of Thomas J (now Thomas LJ) in S*eabridge Shipping AB v AC Orssleff's EFtF's A/S*[2] to the effect that reference to pre-1996 Act cases should only generally be necessary in cases where the Act does not cover a point, for example, in relation to confidentiality. International users of London arbitration should be able to rely on the clear "user-friendly language" of the Act and should not have to be put to the trouble or expense of having regard to the pre-1996 Act law on issues where the provisions of the Act set out the law.

CONCLUDING COMMENTS

These comments and the outcome of the *Lesotho* case will be welcomed by those who choose England and Wales as a place for arbitration. It should ensure that the courts fulfil the objective of the 1996 Act to keep judicial interference to a minimum.
It will also be interesting to see to what extent this decision has an impact beyond the application of section 68. For example, would the decision of the English Commercial Court in *Peterson Farms Inc. v C&M Farming Limited*[3] have been different if it had been decided after *Lesotho*?

The *Peterson* case was an application to set aside an arbitrator's award under section 67 of the 1996 Act (lack of substantive jurisdiction) to the extent that the award had allowed claims of companies from the claimant corporate group who were not named parties to

2 [1999] 2 Lloyd's Rep 685, 690

3 [2004] EWHC 121 (Comm), 4 February 2004

the arbitration agreement. The English Commercial Court allowed a challenge to the award on the grounds that the tribunal had erred in not applying the law of Arkansas to the interpretation of the arbitration agreement.

In both the *Lesotho* (first instance and Court of Appeal) and *Peterson* cases the English courts allowed challenges to awards essentially on the basis that the tribunal reached an erroneous legal conclusion. If the *Peterson* challenge had been based on section 68 it would certainly now fail. But a challenge under section 67 is different. All modern arbitration laws permit the parties to request the local courts to decide whether a tribunal has jurisdiction. Under section 67, there is no requirement to establish a serious irregularity causing substantial injustice. Also, a section 67 case involves a rehearing rather than a review of the tribunal's decision.

Logically, the outcome of the *Peterson* case should be no different today. But perhaps, in the light of the general comments made by Lord Steyn on the ethos and purpose of the 1996 Act, the English court will adopt a more sympathetic approach to its analysis of a tribunal's reasoning, even in section 67 cases, resulting in more awards on jurisdiction being upheld by the courts.

Andrew Foyle

A version of this article appeared in the September 2005 edition of the International Bar Association's Arbitration Newsletter.

CIETAC's new arbitration rules: What's in it for you?

Mark Lin and Terence Wong[1]

INTRODUCTION

On 1 May 2005, a new set of Arbitration Rules of the China International Economic and Trade Arbitration Commission ("CIETAC") came into effect (the "2005 Rules").

Under the PRC's Arbitration Law, arbitration must be conducted under the auspices of recognised arbitration institutions. What this means in effect is that China does not recognise ad hoc arbitration. According to the latest statistics, there are 176 arbitration institutions in China. Amongst those institutions, CIETAC is the most well known in terms of handling disputes which involve foreign parties doing business in China. In 2004, CIETAC handled 850 cases. The total amount in dispute exceeded US$1 billion. This makes CIETAC one of the busiest arbitration institutions in the world.

A common criticism of the practice and procedure of CIETAC arbitration in the past was that the practice and procedure were unsophisticated and could not meet the needs or expectations of parties involved in complex or "big ticket" commercial disputes. Hence the increasing pressure for CIETAC to update its arbitration rules, which had last been promulgated in 2000 (the "2000 Rules").

This article will highlight some of the features of the 2005 Rules which are more relevant to foreign parties arbitrating, or contemplating arbitrating, in China. Cases accepted by CIETAC before 1 May 2005 will continue to be governed by the Rules applicable at the time of acceptance.

Seat of Arbitration (仲裁地)

Under Article 31 of the 2005 Rules, the parties may by agreement in writing specify the "*seat of the arbitration*" and the arbitral award shall be deemed as being made at the seat of arbitration. The seat of arbitration is not restricted to China. The seat of arbitration governs the procedural law and is to be distinguished from the "*place of arbitration*" (开庭地点) which only relates to the physical location of the place where the hearing is being held. By specifying a seat say in London, the foreign party may now enjoy the benefit of the more developed English law and judicial system which are in turn very supportive of arbitration.

The arbitral award in that case would be deemed to be made in London and enforcement of that award in China would be enforcement of an international award under the New York Convention, which is slightly more difficult for a local PRC Court to refuse to enforce than a domestic award.

The above interpretation of Article 31 has been confirmed by officials from CIETAC involved in the drafting of the 2005 Rules as well as by other learned authors. Nonetheless, the official English version of Article 31 of the 2005 Rules is still translated as "*Place of Arbitration*", rather than "*Seat of Arbitration*". We hope that the English version will soon be amended to avoid unnecessary confusion.

CHOOSING AND AMENDING THE 2005 RULES

Article 4 of the 2005 Rules allows the parties to modify the 2005 Rules by agreement. The Rules even go so far as to allow application of other arbitration rules.

Accordingly, even though the arbitration is being administered by CIETAC, foreign parties may choose to adopt arbitration rules which they are more familiar with, such as the Arbitration Rules promulgated by the United Nations Commission on International Trade Law ("UNCITRAL"), the Hong Kong International Arbitration Centre ("HKIAC") Domestic Arbitration Rules, etc.

There is, however, a proviso. If the parties' choice of the arbitration rules is inoperative or in conflict with a mandatory provision of the law of the seat of the arbitration, the parties' choice shall not prevail.

If the seat of the arbitration is in China, it remains to be seen whether, and if so, to what extent, parties may choose arbitration rules promulgated by arbitration institutions such as the International Chamber of Commerce.

CHOICE OF ARBITRATORS

Under the 2000 Rules parties must appoint arbitrators from the Panel of arbitrators maintained by CIETAC. According to the latest statistics, CIETAC has 1025 arbitrators on its main and specialist lists. Of these, 232 come from Hong Kong, Macau, Taiwan and abroad. Although the Panel is relatively large, there are circumstances where parties may wish to appoint arbitrators from outside the Panel.

Arguably one of the most celebrated improvements to the Rules, parties may now, under Article 21 of the 2005 Rules, by agreement appoint arbitrators who are not on CIETAC's Panel, after the appointment has been confirmed by

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CIETAC's Chairman "*in accordance with the law*".

The new arrangement will give parties greater freedom of choice of arbitrators from around the world. Given the importance of the arbitrators, the above arrangement is a positive move for CIETAC.

However, it is necessary to have the parties' agreement in order to appoint an arbitrator from outside the Panel. Unless there is already an agreement before the dispute has arisen, it may not be easy for warring parties to reach an agreement on this issue. Further, the appointment must be confirmed by CIETAC's Chairman, and the understanding is that the non-panelist must meet the criteria applicable to admission of those already on the Panel.

Another improvement in relation to the formation of the three arbitrator tribunal is that each party is now expressly entitled to nominate one to three candidates for the presiding arbitrator. Where there is only one common candidate, such candidate will become the presiding arbitrator.

INQUISITORIAL AND ADVERSARIAL

Article 29 of the 2005 Rules provides that the arbitrators may adopt an inquisitorial or adversarial approach when examining the case.

For parties who come from the Common Law tradition, there is generally an inclination to opt for the tried and tested approach rather than the inquisitorial approach adopted by Civil Law countries like China.

Accordingly, the amendment is a positive step to cater for different needs.

CONDUCT OF HEARING

Lawyers who are familiar with CIETAC arbitrations used to complain about the lack of power or unwillingness of the tribunal to make procedural orders to regulate the proceedings, and it often came as a shock to parties from outside China that the next procedural step after the filing of the defence was the substantive hearing itself (which is what one commonly encounters in PRC litigation)!

CIETAC has recognised this apparent limitation in its old rules. Under the 2005 Rules, it is expressly stated that the tribunal may issue procedural directions and lists of questions, hold pre-hearing meetings and produce terms of reference.

Apart from the above specific areas, the 2005 Rules have in numerous other areas updated the 2000 Rules and have brought CIETAC arbitrations more in line with international practice (such as shortening the time limit for rendering awards from nine to six months), which should help preserve CIETAC's position as the leading arbitration institution in China.

Mark Lin and Terence Wong

If you have any queries in relation to this newsletter, would like to add colleagues to the mailing list, amend details or arrange deletions, or would like to receive an electronic copy of this newsletter in future, please contact Saira Singh at saira.singh@lovells.com.

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