

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 **Lovells International arbitration planner**.



See page 2 for details

THE STATUS AND OPERATION OF UNILATERAL ARBITRATION CLAUSES

Dispute resolution clauses are usually neutral, in that the parties agree to refer any disputes to a particular forum. In many cases, the parties agree to refer disputes to the courts in a specified jurisdiction. It is possible, however, for one of the parties to retain the option to refer disputes to arbitration. In this article, **Simon Nesbitt** and **Henry Quinlan** consider the status and operation of so-called "unilateral" arbitration clauses.

WHEN WILL AN ARBITRATION AGREEMENT BIND NON-SIGNATORIES?

"Two's company, three's a crowd" perhaps sums up an aggrieved party's argument against an attempt to extend the arbitration agreement to a non-party. The fact is, however, that there are ways in which a non-signatory to an arbitration agreement may be brought within its scope. **Daniel Busse** provides an overview of the circumstances in which this may arise.

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Arbitration news

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Lovells' International arbitration planner



Lovells are launching an International Arbitration Planner, which aims to be a convenient and comprehensive single source of information on forthcoming major international arbitration conferences, seminars and symposia around the world. A printed edition of the Planner will be produced twice a year and a web-based version is also under preparation. For further information, contact John Reynolds or Saira Singh on +44 (0)20 7296 2000 or email iaplanner@lovells.com.

Seminar on investment treaty protection

Lovells will be holding a seminar entitled [insert title] on [insert scope] at its London office on Thursday 7 July 2005. The speakers will include Antonio Parra, Deputy Secretary-General of the International Centre for the Settlement of Investment Disputes (ICSID). To register, or for further information, please contact Charlotte Sassen on +44 (0)20 7296 2000 or email events@lovells.com.

INTERNATIONAL TREATIES AND INSTITUTIONS

NEW YORK CONVENTION

Afghanistan ratified the New York Convention on 30 November 2004 and the Convention came into force there on 28 February 2005. There are now 135 signatories to the New York Convention.

ICSID

ICSID Convention

Two more states have ratified the ICSID, or Washington, Convention: Yemen and Cambodia. The ICSID Convention entered into force on 20 November 2004 in Yemen and 19 January 2005 in Cambodia. This brings the number of ICSID Convention contracting states to 142.

Limits on Most Favoured Nation treatment

"Treaty-shopping", as opposed to forum-shopping, has become more common in investment treaty arbitration. This is where an investor from one state attempts to use a "Most Favoured Nation" clause in the bilateral investment treaty (BIT) between its home state and the host state to benefit from more generous dispute resolution provisions in BITs between the host state and other states. This tactic bore fruit in *Maffezini v Spain*, where the Argentine investor was allowed to use the MFN clause in the BIT between Argentina and Spain to rely on the dispute resolution provisions in the BIT between Chile and Spain. This meant that the investor could avoid having to exhaust domestic remedies

before referring a dispute to ICSID (as required by the Argentina-Spain BIT).

Recent ICSID decisions appear to show a backlash against the approach in *Maffezini*; several tribunals have held that MFN clauses do not extend to dispute resolution provisions unless expressly stated to do so. The latest such decision came in the *Plama Consortium v Bulgaria* ICSID arbitration. The relevant BIT was that between Cyprus and Bulgaria. That contains a narrow investor-state arbitration clause, which only permits arbitration of disputes concerning the amount of compensation owed to foreign investors. The tribunal rejected the investor's argument that, by virtue of the MFN clause in the Cyprus-Bulgaria BIT, it was entitled to rely on more favourable arbitration provisions in other international investment treaties concluded by Bulgaria, such as the Finland/Bulgaria BIT. It held that an intention to incorporate dispute resolution provisions by virtue of an MFN clause must be expressed "unambiguously". That was not the case here. Fortunately for the investor, however, the tribunal's decision was not fatal to its claim: it upheld jurisdiction under the Energy Charter Treaty.

ENERGY CHARTER TREATY

What is the scope of Article 45 of the Energy Charter Treaty ("ECT")? This interesting question has arisen in relation to an arbitration claim brought by Group Menatap (part of the Yukos group) against the Russian Federation. The claim has been brought under the ECT, alleging expropriation of the Group's majority shareholding in Yukos and seeking \$28.3 billion in damages. The ECT is a multilateral investment treaty which

has been signed and ratified by over 50 states. (See the October 2004 edition of this newsletter for a fuller description of the ECT.) Whilst Russia has signed the treaty, it has not ratified it. The case therefore raises an interesting jurisdictional point: does the Energy Charter Treaty bind Russia, given that it has only signed, but not ratified, it? The answer may lie in Article 45 of the treaty, which provides that the treaty will apply provisionally pending its entry into force. The question is whether Article 45 covers the dispute resolution provisions of the treaty, so that they can be invoked against a state even before the treaty has entered into force in that state. A fascinating debate looks set to unfold. Watch this space.

ICC

2004 statistics

561 Requests for Arbitration were filed with the ICC Court in 2004, a slight fall from the 580 Requests filed in 2003. At least one of the parties was a state or public entity in 11.6% of cases, up 0.6% from the previous year.

New ICC arbitration clause for China

The ICC has adapted the wording of its standard arbitration clause for arbitrations with their seat in mainland China. This is to comply with a provision in the 1994 Arbitration Law of the People's Republic of China which requires a valid arbitration agreement to refer to the "arbitration commission" which the parties have selected to conduct their arbitration. It is not clear whether foreign arbitral institutions constitute arbitration commissions within the meaning of the law, but the ICC suggests that parties wishing to refer disputes to

ICC arbitration in Mainland China include reference to the ICC International Court of Arbitration in their arbitration clause.

LCIA

2004 also saw a fall in the number of cases referred to the LCIA: 87, compared to 104 in 2003. However, indications are that 2005 will be a busier year as 30 cases had already been referred by the beginning of April.

UNITED NATIONS COMMISSION ON INTERNATIONAL TRADE LAW (UNCITRAL)

After considerable debate, it appears that Article 17 of the UNCITRAL Model Law on International Commercial Arbitration will be amended to give arbitrators the power to grant interim measures on an *ex parte*, or without notice, basis. The amendments were discussed at the 42nd Session of the Working Group on Arbitration and Conciliation in New York in January 2005. The Working Group has agreed that, whilst tribunals will be given the power to grant applications for interim measures without notice to the other party, their orders will be "preliminary orders", valid for a maximum of 20 days, and will not be enforceable by state courts. The party against whom a preliminary order is made will have to be informed immediately and given an opportunity to present its case to the tribunal as soon as practicable.

The revised draft Article 17 is to be discussed and probably settled at the next scheduled meeting of the Working Group, in Vienna in October. The agreed text would then be put to a meeting of UNCITRAL in June 2006.

DEVELOPMENTS IN NATIONAL LAW

CHINA: New CIETAC Rules

The new CIETAC Arbitration Rules are due to take effect from 1 May 2005. Principal changes include the ability of the parties to appoint an arbitrator from outside the CIETAC panel (but subject to the confirmation of the Chairman of the Commission); the reduction of the time limit for rendering an award to six months from the formation of the tribunal; the ability of the Commission to delegate the power to determine jurisdiction to the tribunal (the Arbitration Law confers such power on the Commission, not the tribunal); and an express confirmation that the tribunal has the power to make rulings and issue orders in respect of procedural matters.

UK: English court may determine challenge to arbitral award in investment treaty arbitration

The English court has, for the first time, had to consider an award made in an investment treaty arbitration and has rejected an attempt to strike out a challenge to the award.

In July 2004 an UNCITRAL arbitral tribunal awarded Occidental Exploration and Production Company ("Occidental") US\$75 million in VAT refunds, plus interest, in an arbitration against the Republic of Ecuador. Occidental satisfied the tribunal that Ecuador had breached its obligations under the bilateral investment treaty (BIT) between the United States and Ecuador. The BIT gave Occidental, as a US investor in Ecuador, a direct right to arbitrate against Ecuador.

As the arbitration had taken place in London, the English Arbitration Act 1996 applied to the conduct of the arbitration. Ecuador applied to the English Commercial Court to challenge the award on the basis that the tribunal lacked jurisdiction, under section 67 of the 1996 Act. However, Occidental argued that the English court had no jurisdiction to determine the challenge because it would involve the interpretation of an international treaty between two foreign states (ie the BIT), which was not permitted under English law by virtue of the doctrine of "non-justiciability". The doctrine establishes a general principle that the English courts may not determine rights arising under a treaty that has not been incorporated into English national law.

The court rejected Occidental's argument, holding that it was entitled to consider the rights arising under the BIT, even though it was not part of English law, as this was necessary in order to determine Ecuador's English law right (under the 1996 Act) to challenge the arbitral tribunal's ruling on jurisdiction.

The court will now go on to hear Ecuador's application to challenge the award. The judgment will be awaited with interest.

UK: European prohibition on anti-suit injunctions does not extend to arbitration-related proceedings

The English Court of Appeal has clarified that the European Court of Justice's recent prohibition on anti-suit injunctions does not apply to court proceedings commenced in breach of a valid arbitration clause. Such proceedings are not covered by the

Brussels Regulation on jurisdiction and the recognition and enforcement of judgments (Council Regulation 44/2001).

As reported in the April 2004 issue of this newsletter, in *Turner v Grovit* and *Gasser v MISAT* (both 2004), the ECJ held that where two sets of proceedings have been commenced in different European jurisdictions, it is for the court "first seised" to determine whether or not it has jurisdiction. The other court must stay the proceedings before it pending such determination. That is the case even if the first set of proceedings was brought in breach of an exclusive jurisdiction clause (*Gasser v MISAT*) or in bad faith (*Turner v Grovit*).

There has been considerable debate as to whether the ECJ's decisions applied to arbitration-related court proceedings, in circumstances where arbitration is excluded from the Brussels Regulation by virtue of article 1(2)(d). Whilst there has not been a decision from the ECJ on this issue since *Turner v Grovit* and *Gasser v MISAT*, the English Court of Appeal considered the scope of the arbitration exception in December 2004 in *Through Transport Mutual Insurance Association (Eurasia) Ltd v New India Assurance Association Co Ltd* [2004] EWCA Civ 1598.

In *Through Transport*, the claimant sought an anti-suit injunction from the English High Court to restrain proceedings brought by the defendant in Finland. The claimant argued that the claim should be pursued in arbitration. The question arose as to whether the English court, as the court second seised, should follow the ECJ's decisions in *Turner v Grovit* and *Gasser v MISAT* and stay the

proceedings before it and refuse to grant an anti-suit injunction restraining the Finnish proceedings. The Court of Appeal upheld the judge's decision that New India should pursue its claim in arbitration and that the English proceedings should not be stayed, finding that the arbitration exception in the Brussels Regulation applied to litigation before a national court which was ancillary to arbitration. *Turner v Grovit* and *Gasser v MISAT* therefore did not apply. The court went on to find that there was nothing in the Brussels Regulation to prevent the courts of a contracting state from granting an injunction to restrain a claimant from beginning or continuing proceedings in another contracting state which would be in breach of an arbitration clause. Having said that, in the circumstances of this case (where New India had not acted in bad faith and was not a party to the contract containing the arbitration clause), the Court of Appeal held that this was not a case where an anti-suit injunction should be granted.

The English Commercial Court applied the Court of Appeal's decision but went a step further in *West Tankers Inc v Ras Riunione Adriatica di Sicurita and another* [2005] EWHC 454 (Comm) in March 2005, granting an anti-suit injunction restraining proceedings brought before the Italian courts.

Unless the ECJ revisits the issue of anti-suit injunctions in arbitration-related proceedings, it seems that contracts containing arbitration clauses may offer an advantage over those with clauses referring disputes to European national courts: parties wishing to enforce arbitration clauses know that the English courts will at least consider restraining proceedings

brought in breach of the clause before the courts of another European state.

US: Changing the standard of judicial review for arbitral awards being enforced in the US

Can parties to an arbitration agreement contract to change the standard of judicial review for an arbitral award? The answer will depend on the location of the US federal court in which you attempt to enforce the award. Under the US Federal Arbitration Act, which governs judicial review of domestic and foreign arbitral awards (the latter via adoption of the New York Convention), the US federal courts are afforded a limited scope of judicial review. As such, parties are taking it upon themselves to contractually modify and expand the scope of judicial review of any arbitral award. However, the federal appellate courts in the US are divided on whether parties can do so.

The majority of US federal appellate courts have either ruled or noted in dicta that private parties do not have the power contractually to impose their own standard of review on federal courts. These courts reason that the US Congress, which determines the subject matter jurisdiction of the federal courts, has explicitly adopted a narrow scope of review for arbitral awards in light of the federal presumption favouring arbitration. This is the law in the Ninth US judicial Circuit (encompassing California, Nevada, Arizona, Idaho, Oregon, Washington, Montana, Hawaii and Alaska), the Seventh Circuit (Illinois, Indiana and Wisconsin), the Eighth Circuit (Arkansas, Iowa, Missouri, Nebraska, Minnesota and North and South Dakota), and the Tenth Circuit (Utah,

Colorado, Wyoming, Kansas, New Mexico and Oklahoma). The Tenth Circuit has also noted that, although parties may not contract to *expand* judicial review, they may contract to *eliminate* it as long as their intention is "clear and unequivocal."

However, the courts of appeal for the Third US judicial Circuit (Pennsylvania, New Jersey and Delaware) and Fifth Circuit (Texas, Louisiana and Mississippi) have ruled that arbitration is a creature of contract and, therefore, parties are free to expand judicial review of arbitral awards.

The influential Second Circuit Court of Appeals (encompassing New York, Connecticut and Vermont) has not squarely decided the question yet. While the court has ruled that parties cannot eliminate judicial review, it has yet to address whether they can expand it. Because the federal appellate courts are split, the issue will probably find its way to the US Supreme Court.

While parties to an international arbitration agreement may agree to expand the scope of judicial review of an arbitral award, the arrangement may not be enforced in many parts of the United States federal judicial system.

DENMARK: New Danish Arbitration Act

The Danish government has adopted a draft new Arbitration Act and put forward the draft Act in the Danish Parliament. The draft Act is based on the UNCITRAL Model Law on International Commercial Arbitration and is expected to come into force on 1 July 2005.

SPAIN: The new Spanish Insolvency Act affects arbitration agreements and arbitral proceedings

Arbitration agreements and arbitral proceedings may be seriously affected by the entering into force of the new Spanish Insolvency Act 22/2003, last 1 September 2004, where one of the parties is subject to insolvency proceedings in Spain.

The Act provides that arbitration agreements to which the debtor is a party will be deprived of value and effect during the insolvency proceedings (article 52.1). Thus, the parties to the arbitration agreement will not be able to initiate any arbitration proceedings until the insolvency proceedings have been terminated. During that time, the newly created Commercial Courts (which conduct the insolvency proceedings) will be exclusively competent to hear any disputes that would otherwise fall within the scope of the arbitral agreement. Once insolvency proceedings have been terminated, the arbitration agreement will be valid and binding on the parties.

The Act provides that arbitration proceedings already initiated when the insolvency is judicially declared will continue unaffected until the award becomes final (article 52.2).

Arbitral awards (issued before or after the declaration of insolvency) will be binding on the Commercial Judge in the same way as court judgments (article 53.1). However, the trustees may challenge "the arbitral agreements and arbitration proceedings in case of fraud" (articles 53.2 and 86.2). It is not clear what the scope of this action is. Some commentators understand that these articles refer to the action to set

aside the award on the grounds of fraud. However, the wording and context of the articles suggest that it provides for a new action to be brought - most likely before the Commercial Court dealing with the insolvency proceedings - by the trustees to challenge an arbitration agreement entered into for fraudulent purposes (though this provision is unlikely to be used, as any arbitration agreement will be ineffective during the insolvency proceedings); and to challenge arbitral proceedings already initiated where the parties' or the tribunal's actions amount to fraud (for instance, the parties agree on the appointment of an arbitrator who agrees to issue an award which damages other creditors). However, it remains unclear when and how this action must be brought.

International parties to arbitration agreements in which the other party is subject to Spanish insolvency proceedings should be aware of these rules, and bear in mind that an award obtained in arbitration proceedings (whether held in Spain or elsewhere) may not be enforceable. In these circumstances, it may be possible (and more desirable) to disregard the arbitration clause and bring any claims before the Commercial Court dealing with the insolvency proceedings in Spain.

Finally, parties to arbitral proceedings in which the other party is subject to Spanish insolvency proceedings should be aware that the trustees may challenge (before the Spanish Commercial Court) arbitral proceedings taking place abroad, where they consider that those proceedings may result in fraud as against the other creditors.

CHILE: Chile passes new Arbitration Act

On 10 September 2004, Chile passed its new Arbitration Act, which entered into force upon publication on 29 September 2004. The Chilean Act is a precise copy of the UNCITRAL Model Law, with only a couple of minor additions. One of these additions is of particular note: applications to set aside awards are to be given preference over other cases by the competent courts.

The Government of Chile has declared that one of the purposes behind the Act is to promote Chile as a centre for international arbitration, especially for Latin American related disputes, joining Spain and its recent UNCITRAL-based Arbitration Act in pursuing this objective. Chile enjoys an advantageous economic position in the South American continent and its legal and judicial systems are considered transparent and reliable. Furthermore, Chile is a party to the New York Convention of 1958, the Washington Convention of 1965 and the Inter-American Convention on International Arbitration of Panama of 1975 and enjoys a status as a privileged commercial partner to the EU and MERCOSUR.

NORWAY: New Arbitration Act in Norway

A new Arbitration Act, also based on the UNCITRAL Model Law, entered into force in Norway on 1 January 2005.

GERMANY: Single court to hear arbitration-related claims in Hessen

From 2005, all arbitration-related court applications in Hessen will be

heard by one "senate" (chamber). Until now, arbitration applications have been divided between all 30 chambers. In future, the 26th senate will deal exclusively with arbitration matters and will be presided over by the President of the Court of Appeal in Frankfurt.

The status and operation of unilateral arbitration clauses

Simon Nesbitt and Henry Quinlan¹

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The recent decision of the English High Court in *NB Three Shipping Ltd v Harebell Shipping Ltd*² has confirmed the validity of unilateral arbitration clauses under English law. It also contains useful guidance on the proper operation and effect of such clauses where they are intended to be used to enable a party to decide (both as claimant and defending party) whether, and in what circumstances, a claim should be referred to court or to arbitration.

Ordinarily, dispute resolution clauses are neutral in their approach, that is, the parties simply agree that any dispute will be heard in a particular forum. This often reflects the equal bargaining positions of the parties to the agreement at the time of signing and/or the fact that they are utilising a standard clause; it also reflects the fact that, generally, neither party can foresee who will be the likely claimant in a future dispute under the agreement and, as a result, a neutral approach to the drafting of the clause is the safest bet for all.

Unilateral arbitration clauses

Unilateral arbitration clauses adopt a different approach. They generally have the following structure: the parties to the agreement are restricted to bringing proceedings in a particular jurisdiction; however, one party (or in some cases, all of the parties) has an option to elect that the dispute in question must be referred to arbitration.

A typical unilateral arbitration clause might read:

"Notwithstanding clause x above [in which the parties submit to the jurisdiction of a particular court], party A may, at its sole option, refer any Dispute to arbitration, as provided by clause y below [which provides the details of the arbitration, that is, arbitral rules, number of arbitrators, seat of arbitration etc]."³

This type of clause is often adopted where:

- one of the parties is not domiciled in a jurisdiction which readily enforces the judgments of the court to whose jurisdiction the parties have agreed to submit; or
- where one party has a superior bargaining position, in which case there are often other one-sided provisions in the dispute resolution clause.⁴ These clauses can be powerful weapons, used by the dominant party to optimise its position in any given dispute.

Unilateral arbitration clauses commonly appear in two different forms:

1. In agreements such as tenancy agreements or construction contracts, where, in relation to certain specified disputes, only one party may need the right to refer disputes to arbitration.
2. In financing agreements, particularly international derivatives and loan transactions,

and other agreements where one party has a strong negotiating position such as charterparties, in which the clause is included as an option which operates to "trump" another method of dispute resolution, ordinarily court proceedings.

In relation to the latter category, it is increasingly common for these clauses to be used in such agreements, where the negotiating power of the lender, and the one-sided nature of the obligations in the underlying agreement, are reflected in the one-sided nature of the clause.

It is the proper operation of the latter type of clause, on which there has been little guidance given, which is most interesting to companies which enter into contracts with an international element. The judge in *NB Three Shipping* considered the effect and application of this more complex type of clause.

The Case

The dispute resolution provision considered by the High Court formed part of a charterparty, and contained (among a number of other provisions) the following clauses:

"47.02 The courts of England shall have jurisdiction to settle any disputes which may arise out of or in connection with this Charterparty but the Owner shall

1 Simon Nesbitt is a partner and Henry Quinlan a senior associate in Lovells' International Arbitration group. They are based in the London office.

2 [2004] All ER (D) 152 (Oct).

3 This clause is provided by way of illustration only, and should not be used or relied upon. Each agreement needs to be considered separately when drafting an appropriate dispute resolution clause.

4 Providing, for example, in a loan agreement, that the lender may bring proceedings in any court of competent jurisdiction; that the borrower irrevocably submits to the jurisdiction chosen by the lender; and that the borrower must maintain an agent for service of process in a particular jurisdiction.

have the option of bringing any dispute hereunder to arbitration.

47.10 Any dispute arising from the provisions of this Charterparty or its performance which cannot be resolved by mutual agreement which the Owner determines to resolve by arbitration shall be referred to arbitration in London ...".

Other clauses in this section of the charterparty demonstrated that it had been drafted very favourably towards the owners of the vessels.

The charterers, NB Three Shipping, commenced proceedings in the High Court in relation to certain alleged breaches of the charterparty. The owners, Harebell Shipping, promptly wrote to the charterers expressing surprise, given the option which they possessed to refer claims to arbitration, that the charterers had not consulted with them prior to commencing proceedings, and stating that they were entitled to a reasonable time in which to consider whether to exercise that option.

A few days later, the owners sent a further letter to the charterers confirming that they were exercising their option to refer the dispute (and some claims of their own) to arbitration. They duly appointed an arbitrator pursuant to the arbitration clause in the charterparty and applied for a stay of the court proceedings pursuant to section 9(1) of the Arbitration Act 1996.

The unilateral clause

Morison J, in his judgment, had the following to say of unilateral clauses (at paragraph 12):

"The arbitration stream [clause 47.10] satisfies the requirements of an arbitration agreement since a one sided choice of arbitration is sufficient."

In disposing of this issue (which appears not to have been contested by the charterers) so swiftly, Morison J confirmed that unilateral arbitration clauses are generally valid and enforceable and that there exists a general principle that parties are at liberty to agree the manner in which they will dispose of any disputes which arise between them.⁵

The operation of the option

In relation to this issue, the charterers argued that the owners could only exercise their option as the claiming party in a dispute, and that the option was inoperable in circumstances where the charterers commenced court proceedings. The charterers relied on the use of the word "bringing", rather than "referring", in the phrase "but the Owner shall have the option of bringing any dispute hereunder to arbitration", in support of this contention.

Morison J first set out the way in which he believed that such a clause should operate in practice:

"In the normal course of events, where a dispute arose the parties would seek to resolve by agreement whether the dispute was to be arbitrated or litigated,

but with a reservation of a right to Owners to decide to ... have that dispute referred to arbitration Thus it would have been in the contemplation of the parties that the issue of arbitration or not would be decided before proceedings were commenced in the courts by charterers."

He then went on to dismiss the charterers' contention that the option could only operate where the owners were the claiming party:

"I cannot accept that argument because it seems to me to contradict the commercial sense of the clause as a whole. Clause 47 is designed to give "better" rights to Owners than to Charterers It seems to me that clause 47.02 gives Owners the right to stop or stay a court action brought against them, at their option.... Whilst I can see the force of the submission as to the words "bringing any disputes" and the absence of the word "refer"; it is, in my view putting too much weight on what is a point of semantics. The sense of the whole of clause 47 is clear, I think."

He also concluded that the fact that the charterers had chosen not to operate the clause in accordance with the approach which the parties had contemplated, by commencing proceedings without reference to the owners, had no effect on the operation of the clause:

"If Charterers seek to bypass the Owners' determination to have disputes resolved by arbitration

⁵ The judge was referred to five cases, including *Lobb Partnership Limited v Aintree Racecourse Company Limited* [2000] 1 BLR 65 and *Pittalis v Sherefettin* [1986] QB 868, [1986] 2 WLR 1003, [1986] All ER 227 (CA).

as contemplated by Clause 47.10, then Owners' option of bringing the disputes to arbitration remains, continuing Owners' control over the issue of arbitration or court. Charterers can obtain no advantage from "jumping the starting gun."

He considered that this interpretation of the clause was "consistent with what is, largely, a one-sided clause."

Morison J also pointed out that such an interpretation did not have the effect that the party without the option would be forced to pursue proceedings in the knowledge that the party with the option could exercise it at any time if it felt that the proceedings were not running in its favour. He explained:

"It seems to me that the option granted ... is not open-ended. It would cease to be available if Owners took a step in the action or they otherwise led Charterers to believe on reasonable grounds that the option to stay would not be exercised. It would have been better had the precise circumstances in which the option could be exercised or lost were spelt out with greater clarity, but this failure does not, in my judgment render the clause unenforceable."

The decision in *NB Three Shipping* therefore clarifies the following points:

- unilateral arbitration clauses are valid under English law;
- if sufficiently clearly worded, unilateral (and, arguably, bi- or multilateral) options to refer disputes to arbitration can be exercised by the party to which the option has been granted both as claimant and as defendant; and
- the procedure for dealing with such options is for the party without the option (or, in the case of a shared option, any claiming party) to correspond with the party with the benefit of the option to attempt to agree the forum for the dispute in question. Failure to do this may result in costs consequences if the other party subsequently exercises its option and removes the dispute to another forum.

The position in other jurisdictions⁶

The issue of unilateral clauses has not come before many national courts. When it has, courts have generally upheld such clauses, as can be seen from this brief overview of other jurisdictions:

- **Italy**
The Italian courts have consistently upheld unilateral arbitration clauses and supported the principle that the parties should be free to agree how to determine their disputes.
- **France**
In the only reported French authority on unilateral arbitration clauses the Cour d'Appel confirmed that unilateral arbitration clauses were not contrary to French public policy or to the terms of any international treaties to which France was signatory. Commentators generally consider this case to have been correctly decided and that there is no

reason under French law why such clauses should not be upheld.

- **Germany**

There is nothing in German law which prohibits optional or unilateral arbitration clauses. However, as an agreement to which rules of contract apply, an arbitration clause may not contravene the German *ordre public*.

The German courts have drawn a distinction between arbitration clauses contained in standard form contracts and those which are contained in negotiated contracts.

If an arbitration clause is contained in a standard form contract it must also comply with the requirements for standard terms, namely that it will be null and void if it puts an unfair burden on one party which is contrary to the principle of good faith. On this basis, the Bundesgerichtshof has held a unilateral arbitration clause contained in a standard form contract to be unfair on the ground that it permitted one party to choose between arbitration or court proceedings regardless of whether that party was claimant or defendant. Although the facts of this case were similar to those of the *NB Three Shipping Case*, this was a standard form contract. It is still possible that the German courts would enforce such a clause if it appeared in a negotiated contract by applying reasoning similar to that of the English High Court.

⁶ This section is a summary only of the position in some other jurisdictions.

- **Australia**

In *PMT Partners Pty Ltd v Australian National Parks & Wildlife Service* the High Court of Australia upheld an arbitration agreement which provided that the contractor could (subject to taking certain steps) give written notice to the principal requiring that the dispute between them be referred to arbitration.

This decision, and the issue of unilateral arbitration clauses, was further considered by the Supreme Court of Queensland in *Mulgrave v Hagglund*, in which the court considered that such a clause would be valid as it was enough for the parties to agree that, in the event of certain things happening, even if only at the option of the parties or one of them, their dispute would be referred to arbitration.

Conclusion

There can be few objections to the general validity of unilateral arbitration clauses. The principle of party autonomy is the driving force behind international arbitration and, provided it is tolerably clear that the parties did intend that the arbitration clause should operate unilaterally, courts should be reluctant to interfere with the parties' agreement. There are also no persuasive public policy reasons why such clauses should not be upheld in commercial agreements.

One argument which has been raised in the past (and has also been raised in the German courts) is that such clauses are inefficient, and lead to wasted time and costs, in that one party might commence proceedings, only to have its proceedings "trumped"

by the exercise of the option by the dominant party.

However, this argument is unconvincing for three reasons. First, the parties have agreed the clause and intended that it should be operated according to its provisions.

Second, as Morison J has clarified in *NB Three Shipping*, such clauses are intended to operate on the basis that the party without the option will, if it wishes to bring a claim, consult the party with the option before commencing proceedings. This approach not only has the effect that commencing proceedings prior to consultation will be at the claiming party's risk, but it also means that such clauses should, if properly acted upon, operate to remove any element of surprise in the commencement of proceedings against the party with the option. Indeed, any pre-emptive action by the party without the option may ultimately result in their being penalised in costs.

Third, the party without the option has the safeguard that, where the party with the option takes a step in the proceedings commenced in one forum, it will be taken to have submitted to the jurisdiction of that forum and thereafter be taken to have waived its right to exercise the option and refer the dispute in question to another forum.

One practical issue, however, which was not resolved by the decision in *NB Three Shipping* is the strategy which a party with such an option should adopt in the event of a dispute. Caution should be exercised in any discussions with the counterparty as to the forum for a dispute. Though Morison J has pointed out that taking a step in proceedings will amount to a

waiver of the option, any indications given, or indeed inaction, in discussions prior to the commencement of proceedings might also be taken to be a waiver of the option. For example, failure to consult with the party bringing the claim, unreasonably delaying such discussions or failing to indicate which forum the claim should be brought in, might entitle the claiming party to commence proceedings and assert that the option is no longer operable.

In light of *NB Three Shipping*, therefore, financial institutions should review the current standard form unilateral clauses which they use (or, if they have not developed one, draft such a clause to use as a precedent) to ensure that the way in which they are intended to operate (and particularly whether they can be operated by a party both as claimant and defendant) is sufficiently clear, and that the language used adequately demonstrates that the intention of the clause is to grant them the unilateral power to "trump" any proceedings brought by the counterparty. They should also consider how best to operate the clause in the event that a claim is made, to ensure that full advantage can be gained from what, properly used, can be a powerful weapon not only to control the forum in which a claim can be brought, but also to limit the counterparty's ability to pursue its claim effectively.

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When will an arbitration agreement bind non-signatories?

Daniel Busse¹

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The problem

Groups of companies generally try to allocate the risk arising out of a major project or transaction to a particular group company. Sometimes separate project companies are set up. In almost every case great care will be taken as to which group entity signs the relevant contract(s). Frequently, however, various other companies belonging to that group are involved in the performance of the obligations under the contract. If a dispute arises, the other contracting party will often attempt to hold these other companies liable in addition to the signatory, particularly where the other group companies are more solvent.

If the relevant contract contains an arbitration clause, the other contracting party may request the arbitral tribunal to assume jurisdiction over the non-signatory group companies. Tribunals have done this in a number of cases, but in others they have not. Sometimes a particular national law was applied, but in some other cases the decision was based on general considerations such as trade usage or the assumed intention of the parties. The view taken in the state courts of different jurisdictions (if confronted with a challenge to the award) is as inconsistent as the approach taken by international arbitration practice.

There have been a number of decisions on this issue in the last year. This article considers what parties should expect from national courts and arbitral tribunals in light of these recent developments.

Typical situations

The extension of an arbitration agreement to a non-signatory has often been suggested in the following situations:

- parent-subsidiary situations
- situations in which an attempt is made to extend the scope of an arbitration clause from the general contractor to the subcontractor, or, vice versa, an attempt by the subcontractor to include the principal in the proceedings
- joint venture situations. One of the shareholders of the joint venture entity might try to commence arbitration proceedings not only against the other shareholder but also against the joint venture entity
- in M&A transactions. The buyer might attempt to hold the target company liable (perhaps for alleged misrepresentations) in addition to the seller, and try to include the target in the arbitration proceedings;
- where the non-signatory is a third party beneficiary. The argument is frequently made that the non-signatory is bound by the arbitration clause included in the contract which confers the benefit on him.

There are also cases in which the signatory is alleged to be a "Marionette" company and it is argued that the "real" party should be the respondent in the arbitration proceedings, or at least be a co-respondent.

Dow Chemical and the group of companies doctrine

Some 20 years ago, the tribunal in an ICC arbitration issued an (interim) award in the case of *Dow Chemical v Isover Saint Gobain*. Isover was the claimant in the arbitration proceedings; the names of the parties appear in reverse order due to the ensuing proceedings before French state courts, in which the Dow Chemical group companies applied to have the award set aside. Isover sought to include not only the two signatory companies as respondents, but also the ultimate parent and a subsidiary, which were both involved in the performance of the contracts. Isover was successful, both before the arbitral tribunal and in the French national courts.

What was new in this case was not the fact that the effect of the arbitration clause was extended, but the basis on which this result was reached. The tribunal rejected the respondent's argument that, as the contracts were governed by French law, the scope of the arbitration clause should also be determined by reference to French law. It held that the ICC rules gave the tribunal power to determine its own jurisdiction without reference to any national law. The autonomous nature of the arbitration agreement meant that it could be governed by its own specific sources of law. The tribunal asked whether the extension of the scope of the arbitration clause had been in the mutual intention of the parties, and answered that question in the affirmative. To arrive at this answer, the tribunal asked whether the various group companies were in fact "one economic reality" and whether the non-signatories were involved in

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the execution, performance or termination of the contract.

The approach by arbitral tribunals after *Dow Chemical*

The position taken by the arbitral tribunal in *Dow Chemical* was adopted by tribunals in a number of other arbitrations. One of these was the tribunal in the *Peterson Farms* case, which gave rise to a much debated judgment by the English Commercial Court (*Peterson Farms Inc v C & M Farming Limited* (2004), reported in the October 2004 issue of this newsletter), in which the court held that the group of companies doctrine formed no part of English law.

It cannot, therefore, be said that the group of companies doctrine and, more importantly, the overall approach of applying general considerations rather than the law of a specific jurisdiction has become an accepted part of international arbitration practice. Indeed, this is not so even with respect to ICC arbitration (despite the fact that both *Dow Chemical* and *Peterson Farms* were ICC cases); it is even less so in ad hoc arbitrations or proceedings under the rules of different arbitral organisations. There are awards in which a tribunal has applied the law of a particular jurisdiction; there are also others which go so far as to refer to the *lex mercatoria* to justify the result reached. Although the facts of the cases differ in a number of ways, the two groups of cases cannot be distinguished so as to allow one to predict with any accuracy what to expect if a given set of facts arises.

It is difficult to ascertain the proportion of awards in which the *Dow Chemical*

approach has been adopted. This is due to the fact that arbitral awards are not often published. One might expect awards which follow the *Dow Chemical* approach to be more likely to be published than those which meticulously follow the relevant choice of law rule, identify the relevant law and apply it. This is because *Dow Chemical* cases could be considered "exceptional" and thus worthy of publication. Roughly speaking, it appears that tribunals with predominantly French (or native French-speaking Swiss) arbitrators appear to have more sympathy for the *Dow Chemical* approach, but the sample is too small to allow for a reliable assessment.

Do state courts require the application of a particular law?

It would be easier (if desirable in a particular case) to argue against the *Dow Chemical* approach if national courts, faced with a challenge against an award, were to insist on the application of a particular law and, consequently, set aside an award extending the effect of the arbitration clause (or resist a request for its enforcement). However, the approach of national courts in different jurisdictions is as inconsistent as that of arbitral tribunals.

As mentioned above, the English Commercial Court held that the group of companies doctrine formed no part of English law and criticised the approach taken by the tribunal in adopting it. The tribunal had started from the premise that, whilst the underlying contract was subject to Arkansas law, the arbitration agreement was autonomous and separate from the contract and

contained no express choice of law. It therefore purported to determine the scope of the arbitration agreement "in accordance with the common intent of the parties". The court found that this approach was "seriously flawed in law": the "law" the tribunal derived from its approach was not the proper law of the contract or the law of the place of arbitration but, in effect, the group of companies doctrine itself. The court held that the correct approach would have been to identify the law applicable to the arbitration agreement, by reference to Arkansas law (as the proper law of the contract), and then apply that law to the question whether the third party was bound by the clause. Using that approach, the court rejected the argument that the arbitration agreement should be extended to the non-signatory by virtue of the group of companies doctrine, as the group of companies doctrine was not recognised under Arkansas law (which for the purposes of the application was agreed to be the same as English law).

As also previously mentioned, the French courts took the opposite view in *Dow Chemical* and, although it is not completely clear, this still appears to be the law in France.

Despite the difference between French and English law, there appears to be no divide between common law and civil law countries. It can be assumed that the German courts would not endorse an approach based on the common intent of the parties (thus concurring with the English Commercial Court), although there are no decisions to this effect. In contrast, the highest Swiss court, in a decision handed down and published exclusively in French, upheld a decision following *Dow Chemical*

just last year, surprising many commentators. In most countries, the situation is simply unclear at present.

The law in some jurisdictions

If the *Dow Chemical* approach is not applied, the question arises whether national laws permit the extension of arbitration agreements to include non-signatories. On a comparison of a number of jurisdictions, it appears that, as with many legal concepts, the result is similar, albeit on the basis of differing legal concepts.

For example, it appears to be more or less accepted that a third party beneficiary can and must resort to arbitration if the contract conferring the benefit contains an arbitration clause. In England, this is contained in section 8 of the Contracts (Rights of Third Parties) Act 1999 (interpreted rather broadly in a recent English decision in the context of an arbitration clause that was clearly aimed at a two-party situation). There is also case law in Germany and the US to the same effect. Similarly, agency is a broadly accepted concept on which the extension of the effect of an arbitration clause can be based. Furthermore, piercing the corporate veil has been possible in arbitrations, for example, in France and the US where the signatory acted fraudulently. Based on an analysis of substantive law it can be assumed that it would also be possible to pierce the corporate veil in England and Spain.

Of course, despite the examples listed above, the law is not the same in all countries, and not even in all major arbitration jurisdictions. There are differences as regards the application of constructive agency concepts (in Germany: *Duldungsvollmacht* and *Anscheinsvollmacht*) on the extension of the scope of an arbitration agreement to a third party. Another example is the Spanish approach to handling disputes in the same forum (be it a state court or an arbitral tribunal) if only one of the potential creditors has agreed to arbitration, hence either ignoring the arbitration clause (if the forum is the state court) or binding the non-signatory to that clause (if the forum is arbitration). Also, the extent to which a non-signatory will be deemed to have acceded to a contract containing an arbitration clause differs from jurisdiction to jurisdiction, in particular if the third party has, in a separate document, signed a guarantee for an obligation arising out of a contract governed by an arbitration clause.

Summary

The question is whether a third party must submit to, or can be included in, arbitration proceedings even though it is not a signatory to the contract containing the arbitration clause. There is no clear answer to this question, either in arbitration practice or in national laws or jurisprudence. In particular, there is disagreement as to whether one should apply general principles, such as looking at the assumed intention of the parties, or

the law of a particular jurisdiction to answer the question. However, cautious drafting of the arbitration clause (including a choice of law clause) and careful selection of the arbitrators can help to achieve the desired result. If the law of a particular jurisdiction is decisive, it is of course important to examine that law closely in order to include the third party in the proceedings or defend the third party against any attempt to have the arbitral tribunal assume jurisdiction over them.

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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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