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INTERNATIONAL ARBITRATION QUARTERLY



Welcome to the June edition of our International Arbitration Quarterly Bulletin.

Our first two articles in this edition focus on issues of enforcement. We begin by examining the pro-enforcement approach of the Hong Kong courts to arbitral awards. In particular, we look at a recent Hong Kong case which emphasises the difficulty in succeeding to establish a public policy ground for refusing enforcement of an award. Next, we look at the issue of state immunity and the response of the English courts to an attempt to use immunity to avoid enforcement of an arbitration award.

New ICC Mediation Rules came into force on 1 January 2014. Our third article reflects on the new rules, whether they are ground-breaking or controversial, and how they help to promote mediation as part of a dispute resolution tool kit alongside arbitration.

Our final article looks at a new set of arbitration rules recently adopted by the French Reinsurance and Insurance Arbitration Centre, CEFAREA.

Should you require any further information or assistance on any of the issues dealt with here, please do not hesitate to contact any of the contributors to this Bulletin, or your usual contacts at HFW.

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hfw **Hong Kong's pro-enforcement stance: a reluctance to countenance bias in the enforcement of arbitral awards?**



The recent Hong Kong case *X Chartering v Y*¹ confirms that Hong Kong is a pro-enforcement jurisdiction and that the bar for invoking public policy as a ground for refusing enforcement is very high.

Background

In 2008, X *Chartering* (X) commenced arbitration proceedings in London against Y for repudiation of a contract of affreightment. X obtained an award from Y and was subsequently granted an order for the enforcement of the award in Hong Kong.

Y applied to set aside the award. Y argued that there had been procedural irregularities which were contrary to public policy. In Y's view, the Hong Kong Court should exercise its residual discretion to refuse enforcement on the grounds that:

- Y had been unable to present its case on the calculation of quantum.
- The arbitrators had made an error of law in their calculation of quantum (and by doing so, the arbitration procedure was not in accordance with English law or the parties' agreement).
- There was a conflict of interest in X's solicitors acting for X. The firm of solicitors acting for X was the legacy of the firm that had previously acted for Y in another matter prior

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to a merger of two firms. Y argued that the fact that X's solicitors had previously obtained confidential information about Y tainted the propriety and fairness of the proceedings, which was contrary to public policy.

Y's application was refused.

The judge held that Y had not been unable to present its case on the calculation of quantum and that by agreeing to resolve a dispute by arbitration rather than through the courts, the parties were deemed to have undertaken the risk that an arbitrator may be wrong. In any event, a previous application to overturn the substantive findings of the tribunal on the same point had been rejected by the supervisory court in England and moreover, to review the tribunal's decision on the quantification of damages was akin to revising the merits of the decision.

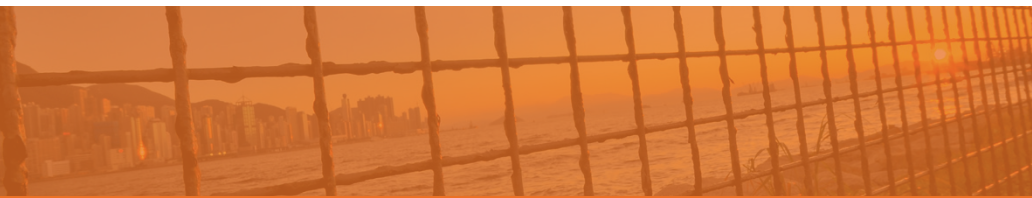
As to the third ground of the perceived conflict of interest, the Court held that there had been no actual conflict of interest to justify it setting aside the

award. It is here that the Court missed an opportunity to clarify the position of the law regarding the threshold of bias required to refuse enforcement.

Bias as a ground for refusing enforcement of arbitral awards in Hong Kong

Hong Kong has long been a pro-enforcement jurisdiction. The Hong Kong courts have repeatedly confirmed that the threshold for refusing to enforce an award on public policy grounds is very high: the award must violate the fundamental concepts of morality and justice in Hong Kong. In fact, when faced with an application to enforce an international arbitration award in Hong Kong, the courts will apply a higher threshold than they would when considering bias in a domestic arbitration or court action. In other words, domestic arbitrators and judges are expected to exercise a higher degree of probity than is expected in relation to arbitrators working overseas.

1 [2014] HKCFI 494



Although a case has yet to succeed on the ground of bias, bias (together with fraud, corruption and bribery) has received obiter recognition as being sufficiently offensive as a ground to refuse enforcement. However, in the cases where it has been raised, efforts to rely on bias have notoriously failed due to a lack of actual bias having been established.

In a seemingly progressive restatement of the law, two recent cases suggested that apparent bias may be sufficient grounds for refusing enforcement. In *Granton Natural Resources Co. Ltd v Armco Metals International^P* and *Gao Haiyan v Keeneye Holdings Ltd.*³ apparent bias was considered in principle sufficient. However, in both these cases, the question of whether apparent bias existed on the facts was skirted. Instead, deference was made to the judgment of the supervising courts to determine whether there was bias. No inquiry was made by the Hong Kong courts into the bias threshold applied by the supervising court and indeed whether that threshold was sufficient.

In *X Chartering*, the Court addressed the issue of bias by considering whether actual bias existed. The Judge held no actual breach of confidentiality had been established and furthermore doubted the risk of relevant confidential information having been acquired or used by Y. Enforcement was therefore permitted. Unfortunately the Judge refrained from clarifying the role of apparent bias in setting aside an award and the extent to which a supervisory court's finding on the matter should be imported into the decision of the enforcing court.

Hong Kong's public policy favours enforcement

The court's reluctance to clarify and develop the law pertaining to the relevance of apparent bias in refusing enforcement of arbitral awards in *X Chartering* comes as no great surprise. It has long been apparent that the Hong Kong courts lean towards enforcement. Public policy arguments for refusing enforcement have been discouraged. Although bias has been recognised as a ground for refusing enforcement, the Hong Kong courts have been reluctant to articulate its parameters, thereby making it difficult to pursue arguments against enforcement.

By skirting the issue of what level of bias is required to set aside an award, the decision in *X Chartering* appears to take us no further. However, it is significant in that the Hong Kong courts have confirmed the policy towards the enforcement of arbitral awards.

In this sense, *X Chartering* is a decision to be welcomed. Unlike some other jurisdictions where the finality of awards is sometimes disregarded, the sanctity of arbitral awards remains intact in Hong Kong for all but the most egregious decisions. *X Chartering* provides assurance that Hong Kong remains a jurisdiction which, when it comes to enforcement, strives to uphold the parties' contractual agreement to submit their disputes to arbitration.

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hfw Using state immunity to avoid enforcement of arbitral awards: a case study

This article examines what happens when a state-owned entity enters into a commercial contract and agrees to submit any disputes arising out of that contract to arbitration. If the state loses the arbitration, it sometimes claims sovereignty immunity to attempt to block enforcement of the arbitral award. The recent judgment in *Taurus Petroleum Ltd v State Oil Marketing Company of the Ministry of Oil, Republic of Iraq (SOMO)* (18 November 2013), demonstrates that English courts do not look favourably on such defences.

In *Taurus v SOMO*, Taurus contracted with SOMO to purchase a number of crude oil cargoes and to sell LPG cargoes. The contract was subject to UNCITRAL arbitration with the seat in Baghdad, under Iraqi law. In breach of contract, SOMO failed to pay Taurus around US\$8 million in demurrage, war risk premiums, interest and other liabilities and drew upon Taurus' performance bond without any grounds.

HFW represented Taurus in arbitration proceedings against SOMO, obtaining an award for more than US\$8 million, including 90% of Taurus' legal costs. SOMO were fully represented throughout and did not contest the appointment of the sole arbitrator, or raise a defence of sovereign immunity.

HFW then applied to enforce Taurus' award in the English High Court and obtained a third party debt order against Credit Agricole, which had opened a letter of credit in favour of SOMO for another petroleum trader. The order required the funds due to SOMO under the letter of credit to be paid to Taurus instead.

2 [2012] HKEC 1686

3 [2012] 1 HKLRD 627



At this point, SOMO applied to have the order set aside on the basis of, *inter alia*, sovereign immunity. SOMO's evidence was that it was "wholly owned, funded by, and an integral part of the Ministry of Oil of the Republic of Iraq" and that in consequence, SOMO's assets were state assets, covered by sovereign immunity.

SOMO asserted that:

- The true beneficiary of the letter of credit was the state of Iraq, because SOMO was selling Iraqi oil pursuant to Iraqi law and the purchase price had to be paid to the Central Bank of Iraq.
- The debts due under the letters of credit constituted "property of the state" within the meaning of section 13(2)(b) *State Immunity Act 1978* and accordingly they were immune from execution.
- Even if SOMO was not part of the Iraqi state, its sale of Iraq's petroleum reserves could only be performed in the exercise of sovereign authority where the state itself would be immune and thus SOMO's property is immune from execution pursuant to section 14(2) *Sovereign Immunities Act 1978*.
- The Central Bank of Iraq had a legal interest in the debts due under the letter of credit so as to trigger protection afforded by section 14(4) *Sovereign Immunities Act 1978*.

The Court rejected all of SOMO's sovereign immunity arguments for the following reasons:

- SOMO was an entity separate from the state of Iraq formed "for commercial or industrial purposes, with its own management and budget" and its separate corporate status should be respected.



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- "SOMO was not acting as the agent for the Government of Iraq in entering into the sale contract and procuring the letters of credit. Albeit that it was a public company carrying on these activities for the over-all benefit of the people of Iraq, it was acting as aforesaid as a principal in its own right".
- "the question is not whether the acts of SOMO in selling oil ... and procuring the opening of the credits were authorised by the state, but whether these acts were of a sovereign character. ... these acts were manifestly of a commercial character of the sort that any private

citizen can perform and were not done in the exercise of sovereign authority... It follows that SOMO's argument for state immunity based on s. 14 (2) of the Sovereign Immunities Act fails."

The general approach of arbitral tribunals and courts to issues of immunity can be summarised as follows:

- Is the state immune from jurisdiction *ratione personae* - is the relevant act that of the state, or a separate non-state entity?
- Is the state immune from jurisdiction *ratione materiae* - is the nature of the act sovereign, or private and commercial?
- Does the state exercise its sovereign powers through the property which is the subject of the enforcement action, or is the property used solely for commercial purposes?

Immunity enables a state to avoid payment of a debt. The historical argument in favour of this is that states should not be permitted to enforce against the strategic (sovereign) assets of other states because this could negatively affect comity between nations.¹

However, this argument has been eroded over time and by the demands of international commerce. A defendant state can avoid enforcement against its strategic assets by paying sums due under an award made against it. Replacing sovereign immunity with sovereign commercial responsibility encourages a more accountable and confident international trading community. It is important for traders to know that they can enforce claims against state-owned traders.

¹ *The Schooner Exchange v McFaddon* 11 US 7 (Cranch) 116 (1819).



These arguments are even more pertinent in an international arbitration context. It is now well established that a state or state entity is bound by an agreement to submit a commercial dispute to arbitration.² This implies that, in the context of commercial transactions, states are also bound by the jurisdiction of the supervisory courts in the country where the arbitration has its seat.³ If a state, knowing that it is acting as a private company, agrees to be bound by the jurisdiction of a specific forum and knows that its assets may be subject to enforcement, it should not be able to evade enforcement.⁴

In an interesting and ongoing development, SOMO continues to assert its right to title over all of the crude oil of Iraq, including in the semi-autonomous region of Kurdistan. As in *Taurus v SOMO*, SOMO argues that under Article 111 of the Iraqi Constitution: “Oil and gas are the ownership of all the people of Iraq in all the regions and governates”.

The Kurdish Regional Government of Iraq claims autonomy from the Iraqi state and title over oil in Iraqi Kurdistan.

Until 23 May 2014, around 1.5 million barrels of Kurdistan oil were sitting unsold at the Turkish port of Ceyhan, stored in tanks. In a treaty between Turkey and Iraq, Turkey committed to “the sole sovereign authority for

the exportation of Iraqi hydrocarbon resources” vesting power in “the Iraqi Federal Ministry of Oil and Oil Marketing Co (SOMO)”.

On 23 May, a vessel began loading the previously embargoed Kurdistan oil. On the same day and in response, the Iraqi Ministry of Oil applied to the ICC to commence arbitration proceedings against the Turkish government and Botas Petroleum Pipeline Corporation (Turkey’s state oil pipeline company), for breach of the terms of the Iraq-Turkey pipeline treaty.

It will be interesting to see whether SOMO will continue to argue sovereign immunity on the one hand, while asserting its commercial rights through the courts on the other.

In conclusion, national courts seem likely to continue to look unfavourably on the use of sovereign immunity to avoid payment of sums due under an award, especially where the state has submitted to arbitration and/or engaged in a commercial relationship with a private party.

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hfw Reflections on the new ICC Mediation Rules

New ICC Mediation Rules (the new Rules) came into force on 1 January 2014, making mediation the default form of alternative dispute resolution (ADR) for the ICC. The new Rules are the successor to the ICC Amicable Dispute Resolution Rules, which had been in force since 1 July 2001.

Although there is no universally accepted definition of ADR, it is used in this article to describe dispute resolution methods, other than court proceedings and arbitration, most of which are characterised by being non-adjudicative. Mediation in particular is a voluntary, flexible and confidential dispute resolution procedure in which a neutral third party (the mediator) facilitates a structured negotiation between the parties with a view to achieving a settlement. A mediator has no authority to make an award in favour of either party (any settlement will only be binding when the parties agree its terms) and this is one of the key ways in which mediation differs from litigation and arbitration.

The introduction of the new Rules could be seen as a narrowing of the ICC’s ADR focus, given that the old rules were not confined to mediation, but also encompassed other forms of ADR, such as conciliation and neutral evaluation (both of which involve the parties inviting a third party to give a non-binding view on the case). However, these forms of ADR are still available under the new Rules, albeit that the ICC’s emphasis is now upon mediation as the default ADR tool. In fact, this emphasis simply reflects what has already been happening in practice: approximately 90% of ICC ADR procedures held under the old rules took the form of mediation.

2 V. Heiskanen, *State as a Private: The Participation of States in International Commercial Arbitration*, *Transnational Dispute Management*, 2010, Vol.7, issue 1; Hakeem Seriki and Mark Beeley, *State immunity and arbitration: Svenska Petroleum Exploration AB v Government of the Republic of Lithuania and AB Geonafta*, *Int. A.L.R.* 2006, 9(2), 37-39; *Ciemens Judt*, in *State immunities: ratione personae or ratione materiae*, *I.B.L.J.* 1989, 8, 999-1010

3 *Supra* at 4.

4 As concluded by V. Heiskanen, this effectively means that “when participating in international commercial arbitration the State is stripped of its sovereign rank and effectively acts as a private – perhaps in all senses of this term”.



The introduction of the new Rules constitutes explicit recognition by the ICC of the predominance of mediation as an ADR method.

The new Rules are not prescriptive in terms of the detail of how mediations should be conducted. They deliberately provide flexibility, leaving procedural matters for determination by the mediator in each case, in accordance with the ADR needs of the particular parties. The mediator is required to discuss with the parties how the mediation will be conducted and to set this out in written form. The new Rules provide that the parties are free to withdraw from the procedure if they do not agree with the approach that the mediator proposes. In this way, the parties' control of the mediation process is reinforced.

Although the new Rules do not impose a set mediation procedure, they nonetheless envisage a hands-on role in the process for the ICC International Centre for ADR. Unless the parties have agreed otherwise, the Centre will be responsible for selecting a mediator, who is likely to come from the network of suitably qualified individuals developed by the Centre through its mediations to date (the Centre does not have an official panel of mediators). The Centre will also have a role in helping the parties reach agreement as to how the mediation will take place, by helping them decide upon practical matters such as venue and timing. The intention is to keep such matters outside the scope of the mediator's role, leaving him or her to focus impartially on the core task at hand. The rules also provide for the Centre to have a role in persuading a party to engage with a mediation in circumstances where one party has proposed it, but there is no pre-existing agreement to mediate.

Importantly, the new Rules have been drafted to work in conjunction with the existing ICC Arbitration Rules, thereby providing for a joined-up dispute resolution system.

The new Rules are supplemented by Mediation Guidance Notes, which discuss certain commonly encountered features of mediation such as the interplay between private and joint sessions and the use of case summaries, as well as providing guidance on matters such as effective preparation, the need for attendance by a person with settlement authority and, at a more fundamental level, the differences between mediation and arbitration.

Importantly, the new Rules have been drafted to work in conjunction with the existing ICC Arbitration Rules, thereby providing for a joined-up dispute resolution system. In fact, the Mediation Guidance Notes actively encourage arbitrators to consider the use of "mediation windows", whereby proceedings are paused or stayed in order to allow time for a mediation to take place. Traditionally, arbitration panels and parties alike have been somewhat slow to make use of mediation but the use of such designated windows may help to change this.

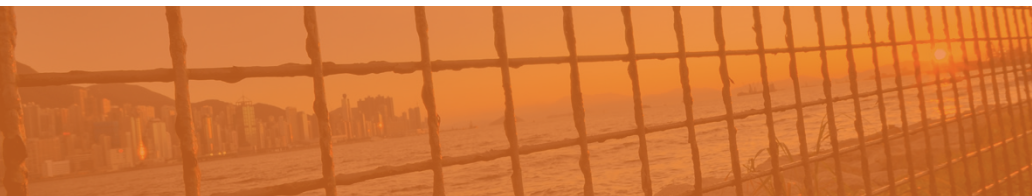
The parties to a mediation are likely to want to keep both their participation and the details of their negotiations confidential - and confidentiality may help to make a settlement more likely, giving the parties freedom to negotiate in the knowledge that what is said will not reach a wider audience.

Confidentiality was provided for under the old rules but interestingly, the new Rules alter its extent. Whereas previously it was the case that all ADR proceedings conducted under ICC rules were confidential, including their outcome, the new Rules, whilst still providing for proceedings to be private and confidential, explicitly exclude from the scope of this confidentiality the fact that such proceedings are taking place, have taken place or will take place.

The new Rules are accompanied by a set of standard mediation clauses, which parties can incorporate into their contracts to provide for ICC mediation in the event of a dispute. The clauses provide a range of alternative options, from an option to use the new Rules to an obligation to mediate in parallel with arbitration proceedings. Of course, it is equally open to parties to include a bespoke clause providing for ICC mediation in such other terms as they see fit or to adopt ICC mediation on an ad hoc basis, with no prior contractual agreement.

Whilst it is unlikely that the new Rules will be considered especially ground-breaking or controversial, they nonetheless represent a welcome effort on the part of the ICC to update its ADR procedures, putting mediation at the forefront, in line with current practice. It is also encouraging to see mediation being promoted as part of a dispute resolution toolkit alongside arbitration, as these methods have too often been employed on a mutually exclusive basis, with the result that opportunities for efficient settlement may have been missed.

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hfw The new CEFAREA rules

The French Reinsurance and Insurance Arbitration Centre (Centre Français d'Arbitrage de Réassurance et d'Assurance, CEFAREA) has recently adopted a new set of arbitration rules. These incorporate changes as a result of the recent reform of French arbitration law, as well as deliberately opting for “amiable composition”.

CEFAREA was created to promote arbitration or mediation as a means of resolving disputes between the various players in the insurance market (i.e. insurers, reinsurers, brokers, insured etc.). It endeavours to offer arbitration and mediation rules tailored to this sector. It has been working in partnership with the Paris Mediation and Arbitration Centre (*Centre de Médiation et d'Arbitrage de Paris*, the CMAP) since 2006.

The new rules are unusual because they provide that arbitrators should act as “amiabes compositeurs” (ruling in accordance with principles of fairness rather than strictly applying the law), unless otherwise agreed by the parties (CEFAREA arbitration rule 23.1). This is a reversal of the normal position under French law, under which arbitrators render a decision in accordance with the rules of law, unless the parties instruct them to act as “amiabes compositeurs” (Article 1478 of the French Civil Procedure Code).

This new approach has given rise to concerns, some of which are legitimate, as the parties probably lose in legal certainty what they may gain in equity. However, it should be noted that the “amiable compositeur” rules do not give arbitrators unfettered discretion.

“Amiable composition” is a form of waiver by the parties of their strict contractual or legal rights. It implies a willingness by the parties to cooperate in good faith, which is ideal in an industry in which the players wish to maintain good commercial relations despite tensions that result from circumstances in which the parties have competing interests.

Powers

The “amiable compositeur” has the power to disregard certain rules of law or to limit, moderate or modify any effects that may be inequitable. The rules of law which can be set aside are the “subjective rights” of the parties, that is to say those rights which they may choose to waive. The reference to “equity” in this context does not correspond to the English equitable rules, but merely to the notion of balance or fairness.

By way of example, an arbitrator acting as “amiable compositeur” may moderate the application of a penalty clause without being constrained by the provisions of Article 1152 of the French Civil Code. He can find debtors to be jointly liable even when this has not been expressly stipulated, and choose the fairest compensation. The arbitrator may also alter the rules of evidence – although the courts are still reluctant to acknowledge this.

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Duties and limits

Although the parties confer power on the “amiable compositeur”, he is also under a duty. He must use the exceptional powers conferred on him to adjudicate “*ex aequo et bono*” – fairly and justly. In addition, he does not have complete and unfettered freedom as regards the rules of law.

He cannot, in principle¹, ignore public policy rules, whether internal or international. Public policy rules, of which there are many in insurance law, cannot be ignored as they pertain to a fundamental public policy to safeguard the general interest. Arbitrators must abide by them in all circumstances.

Furthermore, the CEFAREA rules provide additional safeguards by requiring at rule 23.3 that “*at all times, the arbitral tribunal must comply with the terms of the contract and take into account industry practices*”.

Case law has acknowledged the moderating power of an arbitrator acting as “amiable compositeur” as regards contractual clauses, subject to the condition that he be motivated by “equitable” considerations². The obligation to comply with the terms of the contract should nevertheless restrain the arbitrator’s power – he cannot modify the economic outcome of the contract, due to the risk of undermining it³.

The arbitrator’s obligation to take into account industry practice should also guide him towards rendering decisions which are compliant with CEFAREA.

¹ *It is only when rights which are protected by law have been acquired, that the amiable compositeur is able to use his power to set aside certain public policy protective rules.*

² (*Cass. Civ. 2eme, 18 Octobre 2001*)

³ (*CA Paris, Unijet, 6 mai 1988, Rev. Arb. 1989 p.83, note Loquin*)



“Amiable composition” remains arbitration

It is important to note that an arbitrator acting as “amiable compositeur” does not become a mediator or conciliator, but remains an arbitrator. He must use his “judicial” power to render a decision which disposes of the substantive issues and must accordingly respect the specified arbitral procedure. His decision must, moreover, be reasoned (rule 26).

There are several consequences which emanate from the judicial nature of an arbitration by “amiable composition”. Firstly, the procedure retains the advantages of arbitration, such as speed, confidentiality, and the arbitrator’s expertise tailored to the dispute. Secondly, the claimants benefit from using established and well-recognised arbitral procedures, with awards recognised and enforceable at home and in other jurisdictions. Moreover, extensive case law imposes a duty on the “amiable compositeur” to comply with normal rules of natural justice⁴.

Finally, whether arbitration is by “amiable composition” or according to the ordinary rules of law, the options for judicial review remain the same.

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4 (see in particular Cass. Civ. 2ème 28 février 1990, Rev. Arb. 1991, p. 646 on Article 9 of the French Civil Procedure Code)

The “amiable compositeur’s” decision is final and binding. Only a claim for annulment, which is restricted to certain serious grievances, is available to parties seeking to challenge it – and in international arbitrations, the parties may expressly agree to waive this challenge (rule 27).

Conclusion

In a relatively restrained market, the CEFAREA rules offer an interesting alternative for arbitrating disputes. When parties wish to preserve their future commercial relationship and favour an outcome which will be balanced rather than dictated by the strict terms of the contract or legal principles, arbitration by “amiable composition” may be the solution. It is nevertheless prudent carefully to weigh the risks and possible consequences of such a decision.

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Conferences and events

LCIA European Users’ Council Symposium

Tyline Hall, Hampshire
12-14 September