Dispute Resolution in International Financial Transactions and Project Finance

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Options for Dispute Resolution in International Financial Transactions and Project Finance

1. Direct Negotiations

Often, disputes in complex transactions which are already the subject of court proceedings are ultimately resolved through negotiations between the principals and their attorneys. Thus, the role of direct negotiations as an option for dispute resolution in international financial transactions and project finance should not be ignored.

Even as a first step, it is useful to consider this option before resorting to any kind of Alternative Dispute Resolution ("ADR"), in order to save the expenses of ADR. Even if it does not result in the complete settlement of all issues, it can narrow the issues.

2. Mediation (or "Mediated Negotiations")

Definition. Mediation — a meeting between the disputing parties, their representatives/lawyers and a Mediator, who is selected by the parties jointly or by a third party (such as a chamber of commerce or a professional mediation group) and who helps the disputants explore issues, needs and settlement options. The result is non-binding. The goal of mediation is SETTLEMENT, not one party "winning."

Role of the Mediator

The Mediator:

(1) talks to each party separately to hear each party's point of view regarding the dispute and to obtain facts from each party;

(2) attempts to reduce hostility between the parties and help them to engage in a meaningful dialogue on the issues;

(3) by viewing the dispute objectively, can assist the parties in exploring alternatives in an informal setting that is less emotionally-charged than litigation or even arbitration;

(4) helps to narrow the issues and communicate to each party the other's viewpoint on those issues;

(5) tries to deflate the most extreme demands of the parties and bring each to a point of reasonableness;

(6) offers suggestions and points out issues that the parties may have overlooked or, having had poor communication due to their disagreements before the mediation, that they may not have discussed fully;

(7) identifies what is important and what is expendable for each party; and

(8) structures a settlement to resolve current problems and address the parties' future needs.

Evidentiary Rules and Procedure

Mediation has no explicit procedural, evidentiary or discovery rules and is very informal. Generally, the Mediator decides how to conduct the proceedings and how much evidence he needs to hear in order to lead the parties in productive discussions — generally he will examine everything the parties want to submit (with the understanding that he is not making a decision or judgment on the evidence but instead is trying to help the parties reach a settlement) and frequently, this information is provided to the Mediator before the Mediation begins. Typically, the parties share the costs of Mediation and pay their own legal fees.

Advantages of Mediation for International Financial and Project Finance Transactions

(1) The informal nature of Mediation means that the parties completely control the timing of the meetings, so the Mediation can be set up very quickly, which is highly desirable in project finance transactions where time is of the essence.

(2) It is conducive to the parties maintaining an ongoing and friendly relationship.

(3) Creative solutions or accommodations can be made to suit the parties' special needs.

(4) It is less expensive than arbitration and nearly always less expensive than litigation.

(5) It is completely confidential unless the parties decide otherwise, which is a big plus for parties seeking to keep their dispute out of the public eye.

Disadvantages of Mediation for International Financial and Project Finance Transactions

(1) Mediation is not well-suited to very complex disputes unless the mediator is highly versed in the intricacies of the specific area of law and the nuances of the country (or countries) in which the parties operate.

(2) Mediation is non-binding, so if the parties do not reach settlement, or reach a settlement that comes apart, there is no enforcement authority and the parties may have to proceed to arbitration or litigation anyway.

(3) Mediation is not useful where there is no reasonable possibility of settlement.

Success Rate and Use of Mediation in International Commercial Matters

Mediation is particularly popular in Asian cultures, and is well-suited to matters that are small, likely to result in compromise or settlement if the parties are guided through lengthy discussions, and the parties want to continue their relationship. Indeed, statistics show that 85% of commercial matters that go to mediation are settled (citation: American Arbitration Association website (www.adr.org)). However, Mediation is not very often used in highly complex international matters.

3. Arbitration

Characteristics

(1) Arbitration is a binding procedure.

(2) Arbitration is usually unappealable to the courts in the absence of fraud, corruption or other unusual circumstances.

(3) It is more formal and adversarial than Mediation and less formal and adversarial than litigation.

(4) Use of inquisitorial or adversarial approaches varies with the Arbitrator, but most will work with the parties to use the approach most desirable and efficient for the dispute at hand.

Types of Arbitration

(1) *Ad hoc* — the parties choose the Arbitrators and write (or decide on) the rules to apply in the Arbitration. Ad hoc Arbitrations are generally the least expensive type because there are fewer administrative costs, but the parties may have to apply to the local courts to resolve any procedural problems on which they cannot agree (which would be decided by the institution in an institutional Arbitration).

(2) *Institutional Arbitration* — the parties use an international body that specializes in administering Arbitrations and provides sets of rules and procedures and lists of expert Arbitrators. This is the most common type of Arbitration in international financial and project finance transactions due to the reliability and experience of the institutions and Arbitrators involved, the presence of established, predictable rules guiding the Arbitration, and the fact that Arbitrators who are experts in the relevant field (e.g., oil & gas, project finance, M&A, securities, international banking, etc.) may be appointed. Also, local courts are less likely to interfere in institutional Arbitrations than *ad hoc* Arbitrations.

Choices Regarding Arbitrations

When drafting an Arbitration clause, the parties have to make several choices beyond whether their Arbitration will be institutional or ad hoc, and in what language the Arbitration will be conducted:

(1) If ad hoc, how will Arbitrators be appointed? If institutional, which institution/forum will administer the Arbitration? Possibilities:

- International Chamber of Commerce (ICC) — many locations worldwide
- American Arbitration Association (AAA) — primarily New York and London
- London Court of International Arbitrations (LCIA)
- World Intellectual Property Organization Arbitration Center (WIPO-AC) — Geneva, Switzerland
- International Centre for Settlement of Investment Disputes (ICSID) — Geneva, Switzerland
- Stockholm Chamber of Commerce
- Zurich Chamber of Commerce
- Many others

(2) What procedural rules will be followed?

Possibilities:

- Rules of an institution listed above
- UNCITRAL
- United Nations Commission on International Trade Law Arbitration Rules
- Commercial Arbitration and Mediation Center for the Americas Mediation and Arbitration Rules
- Gulf Cooperation Council Commercial Arbitration Centre Rules of Arbitration
- Procedural laws of a specific country

(Note that the parties might be able to choose procedural rules other than those of the institution that is chosen to run the Arbitration, i.e., you can choose the AAA or LCIA to do the arbitration using UNCITRAL rules, as long as the rules are within the limits of the venue and the NY Convention)

(3) Where will the Arbitration take place, i.e., what will be the "seat" or "venue" of the Arbitration?

Choosing the seat of Arbitration is important because it will determine which country's procedural rules will be followed (unless the parties have specifically chosen otherwise) and the extent to which the local (national) courts will intervene and review the arbitral decision. (More on how to choose a venue later.)

(4) What country's substantive law will apply?

Obviously, in international corporate, financial or project finance transactions (and other complex international transactions), it is best to choose substantive laws that are very well established (predictable) and well-developed in those areas of law — the most popular for such transactions are New York and English law.

Discovery and Evidentiary Procedure in Arbitration

Broad US-style pretrial discovery is rarely agreed to or used in Arbitrations, and the parties can agree to limit the length and complexity of the hearing.

Most institutional rules on Arbitration are not very specific on the scope of discovery or document production. The International Bar Association has adopted *Supplementary Rules Governing the Presentation and Reception of Evidence in International Commercial Arbitration* (the "Supplementary Evidence Rules"), which provide for an exchange of certain information prior to the arbitral hearing on the merits — they do not provide for depositions, but do provide for limited document production. Because international financial and project finance transactions are often very complicated and document-intensive, the parties should seriously consider providing for the Supplementary Evidence Rules to apply to their Arbitrations, or at least to provide some other contractual guidelines for the type of, and limits on, discovery to be utilized in Arbitration. Otherwise, it will be completely within the discretion of the Arbitrators.

Usually, as in a court trial, Arbitrators will hold evidentiary hearings (including testimony) with both parties present, and evidence that would be inadmissible in a court (for instance, due to the hearsay or other evidentiary rules) may be heard by Arbitrators — the only test is what the Arbitrator believes is relevant.

Cost Allocation of Arbitration

Costs of the administration of an Arbitration are typically borne by the losing party, and each party bears its own costs, but this is subject to contract

and, in some countries including England and Germany (but not usually in the US), it is customary for the Arbitrator to order the losing party to pay the winning party's legal costs.

Advantages of Arbitration in International Financial or Project Finance Transactions

(1) The parties decide on the timing and how slowly or quickly the Arbitration proceeds, and there is no "court docket" to wait on — it is thus more flexible and efficient than litigation, which is very important in project finance transactions and other transactions where it is essential to settle the dispute as quickly as possible (and where Mediation isn't desirable due to the complexity of the dispute or other factors).

(2) When doing transactions in a developing country or one whose court systems are not fully developed, are subject to corruption or partiality, are unpredictable, or have long backlogs and slow appeals processes (like Russia, Ukraine, Kazakhstan, and the other Central Asian republics), Arbitration in a neutral venue, guided by established procedures, is the best alternative to litigation in those local courts.

(3) Whereas litigation judgments are difficult to enforce in other countries (due to a lack of a widely-accepted treaty on such enforceability), Arbitration judgments are much easier to enforce due to the widespread acceptance (132 countries) of the New York Convention.

(4) Arbitrators usually have extensive experience in the area of law at issue (e.g., oil & gas, international banking, project finance, etc.) and it is not necessary, therefore, to educate them as one would a judge or jury in normal litigation cases, and the final result of the Arbitration is less likely to be based on misunderstandings of the law or of the transactions at issue. Furthermore, the professional Arbitration institutions have vast experience in administering Arbitrations in international disputes and do so more efficiently and effectively than most court systems.

(5) Arbitration is usually completely confidential unless the parties decide otherwise. Confidentiality is a legal obligation in England, and all major international rules (ICC, LCIA, AAA, etc.) require confidentiality except the UNCITRAL rules (however, it is important to note that the AAA has recently begun publishing information regarding certain arbitral awards to facilitate study of international commercial Arbitration).

(6) Arbitration is usually less expensive than litigation (though not always).

(7) Evidentiary rules are more flexible in Arbitration, and it is much easier to present evidence without worrying about admissibility rules.

Disadvantages of Arbitration in International Financial or Project Finance Transactions

(1) Decisions are final and usually unappealable in New York Convention countries — except where:

(a) there was an incapacity of a party or invalidity of the arbitration agreement;

(b) the losing party was not given proper notice of the arbitrator's appointment or the proceedings or was otherwise unable to present his case;

(c) the arbitration exceeded the scope of the submission to arbitration;

(d) the composition of the arbitral panel or the arbitral procedure was not in accordance with the parties' agreement or the law of the country where the arbitration took place;

(e) the arbitral award is not yet binding on the parties or has been set aside or suspended by a lawful authority in the country where the arbitration took place;

(f) the subject matter of the dispute is not allowed to be arbitrated in the country where the dispute took place; or

(g) the enforcement of the award would be contrary to the "public policy" of the enforcing country. (New York Convention, Article V.)

(2) Arbitrators do not have the power to force non-parties to join the Arbitration (although it is possible to have all subcontractors or potential other parties submit to Arbitration in

their contracts) or to subpoena witnesses without their consent (however, the local courts in most jurisdictions will assist with this without interfering further in the Arbitration).

(3) Arbitrators do not have the power to consolidate actions (but this can be addressed through careful drafting of all relevant contracts, including those with peripheral parties and subcontractors, with the same Arbitration clauses — this is especially key for complex transactions where consolidation of actions is the only efficient way to solve a dispute).

(4) Traditionally, lenders don't like Arbitration because they want strict and literal enforcement of loan and collateral documents, which only the court system can provide. Also, the court system traditionally provides quick provisional remedies for a lender, such as attachment and preliminary injunctions. Likewise, governmental entities always prefer their home courts to solve disputes, as they tend to have a great advantage therein.

4. Litigation

Advantages of Litigation in International Financial Transactions and Project Finance

(1) Binding nature of the proceedings.

(2) Appeals process is available.

(3) Treaties and bodies of law for enforcement in some other countries are established (though these are less straightforward and apply to fewer countries than enforcement procedures for arbitral awards under the New York Convention).

(4) Courts have the power to consolidate actions, force non-parties to join the litigation, or subpoena witnesses without their consent.

(5) Ready availability of injunctive and other interim relief is advantageous in some circumstances.

Disadvantages of litigation in international financial and project finance transactions

(1) It is time-consuming, and the parties bear little (if any) control over the timing of the litigation.

(2) It is the most expensive dispute resolution alternative.

(3) Results (and sometimes trials themselves) are public and can rarely be kept confidential.

(4) Courts in some developing countries (including Russia) are subject to corruption and inconsistent application of the law, as well as some inexperienced and apathetic judges.

(5) One party will likely have "home court advantage" over the other.

Which Dispute Resolution option is used most often in international financial transactions and project finance?

Litigation remains the most popular option in international capital markets transactions because of the preference of lending institutions for the strict interpretation by courts of their lending agreements and also for the relative ease of enforcing their judgments. However, Arbitration is becoming increasingly popular in other international financial transactions and international project finance transactions for the reasons listed as its advantages.

Note that because project finance transactions often involve governmental entities, it is particularly important for the other parties to such transactions to ensure that the arbitration is held in a neutral country, or they run the risk of getting "railroaded" in the government entity's home courts (especially countries like Russia, where the courts are inconsistent and not experienced in complex financial transactions, and tend to naturally side with government entities regardless of the merits of the case).

Further, since parties opposite the governmental entities in these transactions are often banks/lenders who much prefer dispute resolution in the form of litigation in their own home courts, Arbitration in a neutral third country provides a good compromise for both parties.

The American Arbitration Association notes that there is presently particular growth in the area of securities Arbitrations.

The institution and seat of the Arbitration

If Arbitration is chosen, how should the parties choose the institution and seat of the Arbitration (e.g., London, Sweden, NY) and which seats are most common in international financial and project finance transactions? Which set of procedural rules are best for these types of transactions?

1. Choosing the seat/venue for the Arbitration

The decision of where to hold an Arbitration is very important because regardless of which substantive law rules the Arbitration, the Arbitration laws of the venue country will determine whether the courts in that jurisdiction will respect or interfere with the Arbitration process. It is best to choose a forum where local courts will not unduly interfere and will hold the parties to their agreement to arbitrate. The laws of the US, England, France, Canada, Switzerland, Sweden, the Netherlands, Germany and New Zealand are non-invasive with respect to Arbitrations and highly respectful of the Arbitration process.

On the other hand, if you choose Russia as the venue for your Arbitration, the existence of an Arbitration agreement does not in itself prevent a party from beginning court proceedings before the Arbitration starts (in the "State Arbitration Courts," which are commercial courts, not Arbitral tribunals). In Russia, international commercial arbitrations usually are ruled by the Law of July 1993 on International Commercial Arbitration, which is not as flexible and liberal as the laws of the countries listed above, and results in arbitrations in Russia often being slower and just as expensive as trial (without accounting for appeals). In Russia, international Arbitrations are usually conducted at the International Commercial Arbitration Court of the Chamber of Commerce and Industry of the Russian Federation in Moscow.

Further, it is important to choose a venue where the arbitral award will be enforced by the courts of other countries (e.g., where the transaction or project exists or where there are executable assets). Thus, it is highly preferable to choose a country that is a party to the New York Convention (132 countries are signatories, including all western European countries, the US and Russia; a complete list of signatories appears at http://www.jurisint.org/cgi-bin/disp.pl/pub/01/en/152.htm).

In international financial and project finance transactions, it is important to choose the substantive law from a jurisdiction where corporate law and legal precedents are well-established, and to choose an arbitral organization with vast experience in these areas of law. New York and English law are the most used, and New York City and London are the premier sites, for international Arbitrations in financial and project finance transactions because many of the companies involved (including lenders and sponsors of project finance transactions) are either seated in or do substantial business in New York or London), the corporate law is the best-established and developed in the world, and many of the Arbitrators who are expert in these areas live in the New York and London areas or can very easily travel there. New York and England also have very favorable local laws with respect to non-interference by the courts in Arbitrations. Other venues often chosen by parties in international transactions include Geneva, Zurich, Paris, Stockholm (the historic favorite of Russian parties), and Washington, DC.

2. Choosing the Arbitral Institution for International Financial Disputes

For disputes between individuals and government entities (which are frequent in the project finance context), the most-used arbitral institution is ISCID, the International Centre for Settlement of Investment Disputes, which is a part of the World Bank.

Where no government entity is involved, a large majority of international financial Arbitrations are administered by either the International Chamber of Commerce ("ICC") (although they have branches and arbitrators all over the world, London, New York, Paris, Stockholm, Washington, DC, Zurich and Geneva are the most popular sites) or the American Arbitration Association ("AAA") (usually in New York or London). Also popular are the London Court of International Arbitrations ("LCIA"), the Stockholm Chamber of Commerce (the long-time favorite of Russian parties) and the Zurich Chamber of Commerce. If there are complex intellectual property issues involved, the World Intellectual

Property Organization Arbitration Center in Geneva is frequently used.

Generally, the ICC has the most expensive filing fees and up-front costs (a percentage of the amount at issue), whereas the LCIA and AAA have much lower filing fees (based on an estimate of hourly fees to be charged). However, the ICC's rulings tend to be a bit more respected and stand up better in enforcement because the Arbitrators' awards must be approved by the "ICC Court" as valid and enforceable in the countries where they will be enforced, which renders them more reliable and trusted by both participants and governments. (However, this extra step means that ICC Arbitrations take a bit longer than Arbitrations before other institutions.) Also, the fixed fee of the ICC could end up being cheaper than the hourly fees charged by other institutions if it is a very time-intensive case. Some practitioners find that despite the high filing fees and extra step of approving the decision, the ICC handles matters in the most efficient possible manner (for instance, making decisions on the briefs where the amount at issue is smaller).

The AAA and ICSID make public some (AAA) or all (ICSID) of their awards and proceedings, so if confidentiality is important, do not choose these institutions.

3. Choosing the Procedural Rules for the Arbitration

The UNCITRAL rules, which are not attached to any specific arbitral institution, are often used because there are many published decisions interpreting the rules (since there were used in the US/Iran Claims Tribunal). The AAA and the LCIA will use UNCITRAL rules if requested by the parties.

All of the major institutions' rules are very similar, with minor exceptions (e.g., only the LCIA and WIPO expressly allow cross-examination of witnesses giving oral testimony; only AAA and WIPO provide for the Arbitrators to enter a default ruling where a party doesn't comply with the rules or the tribunal's orders; only the ICC does not require knowledge on the part of a party waiving an objection). However, it is worth consulting with an expert who is familiar with all of the major sets of rules to ascertain if a certain set are more conducive to your interests than others in a particular transaction.

Interim Measures & Enforcement

1. Interim Measures

All of the major international Arbitration rules (ICC, LCIA, AAA, etc.) allow the parties to apply to the local courts for interim relief. However, countries vary in whether they allow their courts to provide interim relief pending completion of an Arbitration (even within the US, the eleven different federal circuits vary in their policies on this point), and whether they will provide procedural assistance to the Arbitration, such as securing the attendance of witnesses. Russia and most countries in Europe will provide injunctive relief where there would be irreparable harm (as well as the other requirements necessary for an injunction such as likelihood of success on the merits) without an injunction (e.g., in the case of perishable goods or intellectual property protection). The parties' contract may also empower the Arbitrator to have such injunctive powers, and some countries and arbitral rules already empower the Arbitrators in this manner.

Signatory countries within the New York Convention differ in how they handle challenges to the Arbitration panel's jurisdiction. For example, Russia and other countries that adopted whole-sale the UNCITRAL Model Law entitle parties to "appeal" an Arbitrator's decision on jurisdiction within 30 days of that decision (i.e., not before the Arbitrator's decision), whereas Sweden allows a party to apply to a court for a finding of lack of jurisdiction either before or after the Arbitrator addresses the issue. In England, the challenging party must obtain the consent of the other party or the Arbitrator to have the jurisdictional issue reviewed by a court before the Arbitrator decides the issue.

2. Enforcement

Enforcement of an arbitral award will depend on the country, but if the enforcing country is a member of the New York Convention, the courts can overturn an Arbitration award only on one or more of the grounds described above (in I.C.7(a)). An Arbitrator is given a great deal of discretion under the Convention; barring irrationality, the Arbitrator can err in applying the law or in a contract interpretation without providing a justification to set aside the award. (Note: because Arbitrators are generally specialists in the subject matter of the Arbitration, mistakes of

law are unlikely.) In Russia, the "public policy" exception is defined with reference to whether the foreign arbitral award is against "the basis of the social system of the Russian state." Although this is a vague standard and is subject to wide interpretation, we understand that a mere difference between Russian law and the law of another country cannot alone be the basis for a Russian court to refuse to enforce a foreign arbitral award.

Apart from these exceptions, national laws of all New York Convention signatories should enforce arbitral awards in their national courts if the award comes from an Arbitration held in another signatory country. Further, the national courts of New York Convention signatories will stay court proceedings regarding disputes submitted to Arbitration, and will refuse to consider a judicial resolution of a dispute regarding a contract that contains an Arbitration clause. □