

To: ISDA Financial Law Reform Committee

Date: 10 November 2011

From: Peter Werner (pwerner@isda.org)

MEMORANDUM FOR MEMBERS OF THE INTERNATIONAL SWAPS AND
DERIVATIVES ASSOCIATION, INC.

**The use of arbitration under an ISDA Master Agreement:
feedback to members and policy options**

1. INTRODUCTION

- 1.1 This memorandum follows up on our memorandum dated 19 January 2011 on the use of arbitration under an ISDA Master Agreement (our **January Memorandum**¹).
- 1.2 In our January Memorandum, we noted the increasing use of arbitration in relation to derivative transactions, suggested reasons for these market trends and discussed possible advantages and disadvantages of arbitrating rather than litigating derivative disputes. Our January Memorandum invited members' comments and feedback. That invitation has been enthusiastically taken up, indicating a strong interest in the suggestion that ISDA might at least provide members with some further guidance on the use of arbitration in the derivatives market.
- 1.3 We therefore now seek members' views as to the steps that ISDA might usefully take to assist members in their use of arbitration, in those cases where members conclude that arbitration would be appropriate. Amongst the issues highlighted in our January Memorandum, we identified the following matters as areas where initiative by ISDA may be helpful:
- (a) drafting of arbitration clauses: A number of avoidable difficulties have arisen in cases where defective or otherwise poorly thought-out arbitration clauses have been inserted in ISDA Master Agreements and other financial market agreements. These difficulties have arisen surprisingly often in practice and appear to arise arising from a lack of necessary technical knowledge by those drafting the agreement and/or lack of sufficient attention being paid by the parties to the arbitration clause, perhaps under the mistaken impression that the clause is mere "boilerplate";
 - (b) availability of appropriately qualified arbitrators: there are relatively few international arbitrators with significant experience of derivative transactions and related documentation, perhaps due to the fact that it is only relatively recently that significant numbers of derivatives disputes have been arbitrated;

¹ Available at http://www2.isda.org/attachment/MjIxNQ==/FLRC_ISDA_Arbitration_Memo_Jan11.pdf

- (c) developing jurisprudence on interpretation of ISDA documentation: the fact that arbitral awards are private and carry no precedential value may be a particular disadvantage in the context of an industry-standard contract, such as the ISDA Master Agreement.

1.4 We set out in part 2 of this memorandum some policy options addressing each of these issues, on which we seek members' feedback.

2. REQUEST FOR MEMBERS' VIEWS

We should be grateful for members' responses to the following questions:

Drafting of arbitration clauses

2.1 ISDA could draft and publish one or more model arbitration clauses designed for use in conjunction with the ISDA Master Agreement, together with appropriate guidance notes. Such a clause could be accompanied by general guidance notes to assist users in understanding the meaning and significance of particular provisions. General guidance could also be provided in relation to aspects of the clauses where options are left open to be chosen by individual users. In relation to this, members are asked to respond to the following questions:

- (a) Should ISDA develop and publish one or more model forms of arbitration clause for use with the ISDA Master Agreement?
- (b) To be fully effective, an arbitration clause must specify the seat of arbitration. Given that each ISDA Master Agreement offers an election between English law and jurisdiction and New York law and jurisdiction, it would appear sensible to provide a model clause suitable for an arbitration with its seat in each of England and New York.
 - (i) Do you agree?
 - (ii) Should ISDA also provide a model clause suitable for an arbitration with its seat in any other jurisdiction(s)?
 - (iii) If so, which jurisdiction(s)?
- (c) To be fully effective, an arbitration clause must specify the relevant arbitral rules. ISDA proposes to publish at least one model clause suitable for arbitration under the rules of arbitration sponsored and published by each of the following institutions:
 - (i) the United Nations Commission on International Trade Law (UNCITRAL);²
 - (ii) the International Chamber of Commerce (ICC) Commission on Arbitration;³
 - (iii) the London Court of International Arbitration (the LCIA);⁴ and
 - (iv) P.R.I.M.E. Finance (Panel of Recognized Market Experts in Finance).⁵

² For further information regarding UNCITRAL, see its website at <http://www.uncitral.org>.

³ For further information regarding the ICC Commission on Arbitration, see its website at <http://www.iccwbo.org/policy/arbitration>.

⁴ For further information regarding the LCIA, see its website at <http://www.lcia.org>.

⁵ P.R.I.M.E. Finance was established to facilitate dispute settlement in the global financial markets. The acronym P.R.I.M.E. stands for Panel of Recognized Experts Market Experts. The Panel is composed of two sub-panels, one of financial market experts and one of dispute resolution experts, is supervised by an Advisory Board chaired by Lord Woolf of Barnes and is managed by a Management Board chaired by Professor Jeffrey Golden, Visiting Professor at the London School of Economics and Political Science. The Panel includes a number of financial market experts with significant experience in OTC derivative transactions and ISDA documentation. For further information regarding P.R.I.M.E. Finance, see its website at: <http://www.primefinancedisputes.org>.

As a matter of policy, ISDA is neutral as to the choice of arbitral institution and has chosen the institutions listed in (i) to (iii) above on the basis that the rules of these institutions appear to be at present the most commonly chosen for disputes in relation to transactions or agreements in the wholesale financial markets.

In relation to (iv), P.R.I.M.E. Finance is relatively recently established and therefore may be less well-known than the others to some ISDA members. We have included it in this memorandum for various reasons, but principally because in contrast to the other institutions, it was established specifically for the purpose of assisting in the resolution of disputes in the financial markets. It therefore has an offering that may be of particular interest to ISDA members in relation to the resolution of derivatives-related disputes.

Nonetheless, we remind members that ISDA has no formal affiliation with P.R.I.M.E. Finance, and each member should make its own enquiries as to whether the arbitration rules of P.R.I.M.E. Finance, or any of the other arbitral institutions, are suited to its needs and objectives. As of the date of this memorandum, the arbitration rules of P.R.I.M.E. Finance remain in draft form. The rules are modelled on the UNCITRAL arbitration rules, but with adaptations intended to adapt them more fully to the needs of the financial markets.

In relation to the ICC Commission on Arbitration, members may recall (and as mentioned in our January Memorandum⁶) that Section 13(c) of the ISDA/IIFM Tahawwut Master Agreement for Islamic derivative transactions provides for arbitration under the ICC rules unless a different forum is chosen by the parties. The ICC rules were chosen in that case as reflection of perceived market practice in the Islamic finance market. As in the case of the other institutions, ISDA has no formal affiliation with the ICC Commission on Arbitration or with the ICC more generally.

Members are asked to respond to the following questions:

- (A) Do members agree that it would be useful to have a model clause adapted for use with the arbitration rules of each of the institutions listed in (i) to (iv) above? If some, but not all, which ones?
- (B) Are there any other arbitral institutions that should be added to this list?
- (d) In paragraphs 5.3 – 5.4 of our January Memorandum, we discuss the advantages and disadvantages of a clause that allows one or both parties to choose between arbitration and litigation after the dispute has arisen. Should ISDA provide a model for an optional arbitration clause of this type?
- (e) In the Appendix to our January Memorandum, headed “Key Features of Arbitration”, we mentioned the disadvantage that is sometimes raised in relation to arbitration, relative to litigation in New York or England, that arbitration offers no procedure comparable to default or summary judgment, where a claim or defence has no real prospect of a success.⁷ The January Memorandum mentions that this disadvantage is sometimes overstated and also goes on to mention the possibility of including “fast-track” provision in an arbitration clause to speed up the arbitration. Such provisions may operate, for example, by shortening deadlines prescribed by the arbitral rules, and/or imposing a long-stop date for the rendering of the award. Should ISDA include “fast-track” provisions for use with the model clauses?

⁶ Footnote 16 of our January Memorandum.

⁷ Paragraphs 10 and 11 of the Appendix to our January Memorandum.

- (f) Is there any other specific type of provision that members would like to see included in one or more ISDA model arbitration clauses?

Availability of appropriately qualified arbitrators

- 2.2 Paragraphs 5.5 to 5.7 of our January Memorandum discuss the perceived lack of international arbitrators with sufficient experience of the derivatives markets in particular. We understand that one of the aims of P.R.I.M.E. Finance is to help to develop a body of such arbitrators, and we expect that over time there will be a growing number of international arbitrators associated with the other leading arbitration institutions with relevant experience.
- 2.3 The question for ISDA members is whether there are any steps that ISDA can and, if so, should be taking to address this issue, or whether members consider that this is an issue that will, in a sense, resolve itself over time.

Developing jurisprudence on interpretation of ISDA documentation

- 2.4 Paragraphs 5.8 to 5.11 of our January Memorandum highlight the fact that arbitral awards are normally private and therefore carry no precedential value. While the privacy of the award may be considered an advantage of arbitration, where the parties value confidentiality in relation to their dispute, some market observers are concerned that the diversion of a significant number of disputes from the courts, whose judgments are normally given in public and subsequently published (at least in sufficiently important cases), to arbitration could mean that useful potential jurisprudence, which could provide guidance to other market participants in the structuring and documentation of their derivatives transactions, would be lost.
- 2.5 The question for ISDA members is whether members believe that this is a significant issue and, if so, how best to address it?
- 2.6 One possibility would be to enter discussions with one or more of the leading arbitral institutions on this issue with a view to discussing the ways and means of persuading parties to agree to publication of their awards, with the names of the parties and other confidential information redacted. Publication of a redacted award in this way would carry no precedential value, but might have some persuasive value where a subsequent arbitral tribunal is confronted with the same or a similar issue. The published award might also, as suggested above, provide guidance to market participants on the structuring and drafting of their documentation. We understand that there is some practice already along these lines in relation to certain arbitral institutions and certain types of disputes, but members are asked whether this should be a priority for further work by ISDA members interested in arbitration.

3. CONSULTATION

As the first stage in consulting on these proposals, ISDA invites responses to its questions in part 2 above as well as any additional comments or questions about the issues raised in this memorandum or otherwise related to arbitration and other forms of dispute resolution in the derivatives market. Please address any such response, comments or questions to Peter Werner, Senior Director, ISDA EMEA Office in London (pwerner@isda.org) by 19 December 2011. Following this, we propose to arrange one or more meetings to provide a forum for further discussion of these issues with members.