A Note From The Editors

Fried Frank’s International Arbitration Group is pleased to welcome you to the first edition of the International Arbitration Newsletter™. This publication is designed to be an informative resource regarding selected significant developments in international arbitration. The International Arbitration Newsletter™ will be published several times a year and will provide an analysis of recent events and developments from across the world.

Unilateral Jurisdiction Clauses Undermined in Russia, France

A unilateral jurisdiction clause is a dispute resolution clause that gives one party a jurisdictional option that the other party does not have. For example, a clause could provide for disputes to be resolved by international arbitration but, in addition, give only one of the parties a unilateral option to refer disputes to a competent national court instead of resorting to arbitration. Or, a clause could provide for disputes to be resolved in the courts of a certain jurisdiction, but give one of the parties an option to resort to a court of another jurisdiction. Such unilateral clauses are commonly used in international financing agreements, where the lenders wish to have flexibility to resort to litigation or arbitration, or choose a venue for litigation to recover amounts due. However, recent decisions by the Supreme Arbitration Court of the Russian Federation and the French Cour de Cassation undermine the validity of such clauses and put parties on notice to rethink dispute resolution clauses in current, as well as future, financing agreements, especially if the parties or the assets are in Russia or France.

Russia

The relevant dispute arose between CJSC Russian Telephone Company (“RTC”) and Sony Ericsson Mobil Communications Rus LLC (“Sony Ericsson”) under a distribution agreement for the sale of mobile phones. The contract gave Sony Ericsson a right to commence arbitration or litigation to resolve disputes between the parties, while RTC only had a right to arbitrate. When a dispute arose over alleged defects in mobile phones, RTC filed a claim against Sony Ericsson in a local Arbitrazh Court of the City of Moscow. Relying on the jurisdiction clause, the court refused to entertain RTC’s claim. The decision was affirmed by two appellate courts. But, on further appeal to the Supreme Arbitration Court, the highest court disagreed, reversing the judgment and remanding the case to the Arbitrazh Court of Moscow. On 19 June 2011, the Presidium of the Supreme Arbitration Court decided that RTC should have equal access to justice and be allowed to resort to litigation. The court found that the provision continued on next page
Recent cases have renewed concerns among practitioners of international arbitration and litigation about the breadth of Chinese state secrecy laws and the effect these laws may have on disputes involving Chinese companies.

**SEC Moves Against Accounting Firms**

In the first week of December 2012, proceedings were issued against the Chinese subsidiaries of five large accounting firms, Deloitte Touche Tohmatsu ("Deloitte"), Ernst & Young ("E&Y"), KPMG, PricewaterhouseCoopers and BDO China Dahua, charged with breaking US securities laws by the US Securities and Exchange Commission ("SEC") for refusing to disclose documents related to accounting fraud investigations at nine Chinese companies. The SEC said that the companies refused to cooperate and impeded the government's investigations notwithstanding the companies' reliance on Chinese state secrecy laws. In response, the companies noted the difficulties of navigating the conflicting disclosure laws of the United States and China, and expressed hope that US and Chinese regulators will sort out these conflicts.

**Cases Against E&Y and Deloitte**

In August, Hong Kong's securities regulator, the Securities and Futures Commission, took E&Y to court, seeking records related to the failed listing application of Standard Water, a Chinese company and former E&Y client, on the Stock Exchange of Hong Kong. Under the Hong Kong Securities and Futures Ordinance, E&Y has an obligation to provide the records unless it can demonstrate a "reasonable excuse" for not doing so. E&Y refused to provide the records, citing Chinese state secrecy laws. In September, the Hong Kong Court of First Instance ordered E&Y to explain its basis for relying on Chinese state secrecy laws in refusing to turn over the requested accounting records. The court has not yet ruled on whether E&Y has demonstrated a "reasonable excuse."

The case in Hong Kong parallels a case in the United States that began approximately one year earlier. In September 2011, the SEC asked a federal court to order Deloitte to turn over work papers from an audit performed on Longtop Financial Technologies, a Chinese company, in connection with an SEC investigation into possible accounting fraud. Deloitte has claimed that the turnover of the requested information would violate Chinese state secrecy laws. The federal court action against Deloitte was reactivated after previously having been stayed.

The outcome of the dispute against E&Y will have important implications on the issue of the extra jurisdictional effects of the Chinese secrecy laws. For the moment, the affected companies are stuck in regulatory limbo. If the court finds that Chinese
state secrecy laws excuse E&Y's failure to disclose information, Chinese companies will be in an even stronger position to withhold documents based on those laws.

**The Breadth of Chinese State Secrecy Laws**

The Law of the People's Republic of China on Guarding State Secrets defines “state secrets” as “matters that have a vital bearing on state security and national interests and, as specified by legal procedure, are entrusted to a limited number of people for a given period of time.” The law contains seven categories of state secrets, including a catch-all provision that covers “other matters that are classified as state secrets by the state secret-guarding department.”

This definition is notoriously vague, and Chinese authorities have been known to bring prosecutions for violation of the state secrecy laws even when the protected nature of the information is highly questionable. For example, in 2010, a Chinese-born United States citizen, Xue Feng, was convicted of divulging state secrets after helping his American employer purchase a commercial database on Chinese oil resources that was not declared protected information until after his detention.

**Implications for Disputes Involving Chinese Companies**

Because so many Chinese-based companies have dealings with the Chinese government and/or with state-owned enterprises, there is a high likelihood that these companies have been exposed to information that arguably contains state secrets, at least as the Chinese authorities might broadly interpret that concept. This has important implications for parties on both sides of an international dispute involving a Chinese company. Companies involved in international arbitration against a Chinese company can expect that it may refuse to fulfill some or all of its disclosure obligations on the basis that disclosure would violate Chinese state secrecy laws. If this occurs, the opposing party should ask the tribunal to require the Chinese company to make a showing that the requested information is in fact a state secret. Reference can be made to Article 9(2) of the IBA Rules on the Taking of Evidence in International Commercial Arbitration, which provides, in part, that the tribunal may exclude information from disclosure if a “compelling” showing is made that the information has special political or institutional sensitivity. However, because of the wide scope of the “state secrets” definition under Chinese law, it may be difficult to obtain disclosure of information alleged to be subject to these laws.

On the other side, Chinese companies should carefully review any documents potentially responsive to disclosure requests to determine whether they contain information subject to Chinese state secrecy protections. If secret information is found, the company should consider whether this information can be redacted from the document in question in order to allow for disclosure of the document. If not, the company should be prepared to make a showing to the opposing party, and potentially the tribunal, that the requested information is protected from disclosure by the Chinese state secrecy laws. There is also a risk that the party requesting the disclosure of protected information, if ordered to be disclosed by an arbitral tribunal, could face consequences under Chinese state secrecy laws. Given the complexity of the arguments surrounding the construction and effects of Chinese secrecy laws, how an arbitrator will rule when faced with the issue of disclosure is uncertain, though it is likely that an arbitrator would be slow to make an order that puts a party in potential breach of penal sanctions under Chinese law.

**Eleventh Circuit Court of Appeals Rules that US Discovery is Available in Private International Commercial Arbitration Proceedings**

One of the challenges for parties and counsel in international arbitration is obtaining evidence from third parties because arbitral tribunals generally lack the authority to compel third parties to produce evidence. However, when the third parties are located in the United States and the seat of the arbitration is outside of the United States, there may now be an opportunity to obtain third party discovery in private international commercial arbitration. In a recent decision, the US Court of Appeals for the Eleventh Circuit resolved a disputed issue of law and decided that parties in international commercial arbitration may petition the district court in the United States to take discovery from third parties located in the district. The decision is binding on the courts in the Eleventh Circuit, which includes the states of Florida, Georgia and Alabama, and will likely be influential in other circuits in future determinations on the availability of US discovery in private international commercial arbitration proceedings.

Section 1782 of Title 28 of the United States Code has attracted attention from parties and counsel in international arbitration. Section 1782 permits “any interested person” to seek from a United States district court a discovery order directing a person located within the district to produce documents, other tangible evidence, and testimony “for use in a proceeding in a foreign or international tribunal.” A number of US courts, including the Second Circuit and Fifth Circuit courts of appeals, have limited
the application of § 1782, deciding that the judicial assistance of US courts is not available to obtain evidence for use in private international arbitration proceedings. According to these courts, a “foreign or international tribunal” does not include an international arbitration tribunal. 1

Subsequently, the 2004 ruling of the US Supreme Court in Intel Corp. v. Advanced Micro Devices, Inc., provided seminal guidance on the scope of § 1782. 2 The Supreme Court endorsed a broad interpretation of the term “tribunal” and refused to impose “categorical limitations” on the application of this statute. In determining whether the Directorate-General for Competition of the European Commission was a “tribunal” under § 1782, the Supreme Court reviewed its functions to consider: (i) whether the body acted as a first-instance adjudicative decision maker; (ii) whether it permitted the gathering and submission of evidence; (iii) whether it had the authority to determine liability and impose penalties; and (iv) whether its decision was subject to judicial review. Applying this functional analysis, the Supreme Court decided that the Directorate-General functioned as a “foreign tribunal” and therefore fell within the scope of § 1782. 3 The Supreme Court did not analyze or decide whether an international arbitral tribunal is a “tribunal” under the statute.

Since Intel, courts have split on the question whether the Supreme Court’s decision and statutory construction mandate inclusion of international arbitral tribunals within the ambit of § 1782. Courts have been more willing to provide judicial assistance in aid of inter-governmental arbitral tribunals than to private international arbitrations conducted under the auspices of private arbitration institutions. 4

The Eleventh Circuit recently became the first US appellate court to rule that § 1782 can be utilized to obtain evidence for use in a proceeding before a private international arbitration tribunal. "The Eleventh Circuit recently became the first US appellate court to rule that § 1782 can be utilized to obtain evidence for use in a proceeding before a private international arbitration tribunal."

The court applied Intel’s functional analysis and held that the private arbitration tribunal was a “tribunal” under § 1782 because (i) it acted as a first-instance adjudicative decision maker; (ii) it permitted the gathering and submission of evidence; (iii) it had the authority to determine liability and impose penalties; and (iv) its final award was subject to judicial review in Ecuadorian courts, albeit review that does not extend to the merits and is largely limited to procedural defects in arbitration proceedings and other constitutional challenges. 5 Hence, the Eleventh Circuit has now opened the door to a broader use of § 1782 to reach not only “state-sponsored” tribunals, but also private arbitral tribunals. Importantly, however, even where § 1782 statutory requirements are met, the district court retains discretion to decide whether or not to provide assistance. The court must weigh a number of discretionary factors set forth by the Supreme Court in Intel. Thus, for example, courts are more likely to provide judicial assistance against a non-party in international arbitration than against a party over whom a foreign tribunal can exercise jurisdiction. The court is less likely to order discovery where it believes that the foreign tribunal will not be receptive to the obtained evidence. The court will also consider whether a request is an attempt to circumvent foreign proof-gathering restrictions or other policies. In addition, the court may limit the scope of burdensome discovery. Therefore, the potential success of a § 1782 discovery application will depend not only on whether the court considers private international arbitral tribunals to fall within § 1782, but also on the circumstances of the particular case as to which the court may exercise discretion.

While the debate over the interpretation of § 1782’s application to a “foreign or international tribunal” continues, and will ultimately have to be resolved by the US Supreme Court, the Consorcio decision is significant. It may influence other US federal courts of appeals in other circuits faced with the same question of statutory construction, and in the meantime, while waiting for the Supreme Court to resolve the debate, it provides an opportunity to take discovery in aid of private international commercial arbitration proceedings of third parties located within its jurisdiction.

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3. Id. at 255-59.
5. 685 F.3d 987 (11th Cir. 2012).
6. Id. at 995-99.
Use of Arbitration under the ISDA Master Agreement

The International Swaps and Derivatives Association (“ISDA”) is undertaking a consultation on the use of arbitration under the ISDA Master Agreement. The first in a series of meetings was held in Singapore on 15 June 2012 to discuss options for inclusion of a model arbitration clause in the Master Agreement. Attendees are reported to have considered various proposals for potential arbitral seats and rules for the model arbitration clause.

As it is anticipated that further meetings will be held in the coming months in London and New York, no decisions have been reached. Based on the above discussions, it appears likely that ISDA will allow for the inclusion of one or more model arbitration clauses in its Master Agreement.

ISDA has identified three main areas of concern with regard to using arbitration for ISDA matters: (1) defective and poorly drafted arbitration clauses; (2) lack of arbitrators familiar with derivatives; and (3) lack of jurisprudence concerning ISDA. Each of these subjects is considered in turn below.

Arbitration Clauses

ISDA has noted that unnecessary difficulties have arisen from the inclusion of defective and poorly drafted arbitration clauses in ISDA and other agreements. Accordingly, ISDA has proposed that it publish one or more model arbitration clauses for use with the ISDA Master Agreement. It has sought members’ views on whether this is worthwhile and, if so:

a. Which arbitral seat(s) and institution(s) should be included. Namely, the following options were the reported frontrunners:

- ICC arbitration, with a London or New York seat;
- LCIA arbitration, with a London seat;
- HKIAC or SIAC arbitration, with a Hong Kong or Singapore seat (respectively);
- UNCITRAL or PRIME Finance rules, with a London or New York seat; and
- AAA/ICDR arbitration rules, with a New York or Miami seat.

b. Whether its model clauses should include an “optional” arbitration clause that gives one or both parties (but typically just the finance parties) the right to choose between arbitration and litigation once a dispute has actually arisen. The issues surrounding this type of clause have recently been highlighted by the decision in Sony Ericsson v. Russian Telephone Company where the Russian Supreme Arbitration Court ruled that unilateral jurisdiction clauses were invalid and by the decision of the French Cour de Cassation also invalidating such clauses [see note on page 1 of this publication]; and

c. Whether the model clause(s) should provide for the use of “fast-track” arbitration procedures.

Arbitrators’ Qualifications

ISDA has noted that there is a dearth of arbitrators with substantial experience in derivatives. As such, ISDA has asked its members for suggestions on how this deficiency could be remedied. ISDA has pointed out, however, that in subsequent years, arbitrators are likely to become increasingly familiar with derivatives as disputes of this nature are becoming more common.

Developing Jurisprudence on ISDA Master Agreements

ISDA has also noted that one of the benefits of arbitration is privacy. However, ISDA has raised concerns that given the lack of jurisprudence on derivative-related issues, arbitration may hinder the development of important case law on the interpretation of ISDA Master Agreements. Thus, ISDA has asked its members for their opinions on how this problem could be addressed in a way that does not detract from the benefits of arbitration. One potential solution discussed involves the release of awards, in redacted form, that address important issues for the ISDA community.

Conclusion

It remains to be seen what effect the New York and London consultation meetings will have on the Singapore discussions. Hopefully, the outcome of the next two meetings will provide ISDA members with a clear view of what the intended changes to the ISDA Master Agreement will be.
The New HKIAC Domestic Arbitration Rules

On 2 April 2012, the new HKIAC Domestic Arbitration Rules came into effect (the “2012 Rules”). The 2012 Rules replaced the previous version of the HKIAC Domestic Arbitration Rules, which had been in place since 1993. The Hong Kong government adopted the HKIAC Domestic Arbitration Rules to apply to arbitrations in Hong Kong that are instituted in accordance with its standard form construction contracts and are, therefore, commonly used by parties in ad hoc arbitrations in Hong Kong. While the parties’ preferences regarding procedures will be respected as much as possible, the 2012 Rules seek to ensure that the arbitrator will have sufficient powers to direct the proceedings if the parties are unable to agree on procedure or are uncooperative.

The changes made to the rules largely mirror the changes in the new Arbitration Ordinance (Cap 609) (the “New Ordinance”). A number of provisions of the New Ordinance have been incorporated into the 2012 Rules, in whole or in part. The New Ordinance came into effect on 1 June 2011 to replace the previous Arbitration Ordinance (Cap 341) by providing a unified regime based on the UNCITRAL Model Law (the “Model Law”). The Model Law is therefore also incorporated, at least in part, into the 2012 Rules, rendering the 2012 Rules more user-friendly and attractive to international practitioners and parties who are already familiar with the Model Law. This note examines the more significant changes made to the rules and their implications.

Removal of Arbitrator

The 2012 Rules prescribe the circumstances under which an arbitrator can be removed, and also contain provisions for the appointment of a substitute arbitrator, who should be appointed according to the rules that were applicable to the appointment of the arbitrator being replaced.1

Power to Grant Peremptory Orders

Under the 2012 Rules, the arbitral tribunal now has the power to make a peremptory order when parties fail to comply with an order or directions from the tribunal.2 Furthermore, the 2012 Rules empower the arbitrator to penalize parties for failing to comply with such peremptory orders. These new powers will no doubt assist arbitral tribunals in enforcing their orders or directions, and thereby limit the need for recourse to the courts. The power to grant peremptory orders will also impel parties to pursue arbitral proceedings without undue delay, as a failure to comply with such orders might lead to adverse consequences.

Interim Measures and Preliminary Orders

An important change in the 2012 Rules is the adoption of the Model Law’s provisions regarding interim measures. Accordingly, arbitral tribunals have the power to grant interim measures (e.g., injunctive relief) at the request of a party.3 When applying for interim measures, a party may also consider whether it is necessary to also apply for a preliminary order on an ex parte basis. If granted, a preliminary order will direct the other party not to frustrate the purpose of the interim measure requested.4 The arbitral tribunal may grant a preliminary order if it considers that prior disclosure of the request for the interim measure to the other party risks frustrating the purpose of the measure.5

Are Arbitrations Adopting the 2012 Rules “domestic arbitrations”?

One of the major changes made to the New Ordinance is the elimination of the distinction between domestic and international arbitration regimes. Although the New Ordinance provides for a unified regime, it includes optional provisions (contained in Schedule 2) allowing parties to opt-in to some or all of the provisions in the domestic arbitration regime under the previous Arbitration Ordinance (Cap 341). The opt-in provisions were included as a result of lobbying by the construction industry in Hong Kong in an attempt to preserve features of the domestic regime, and will most likely be used by parties in the construction industry. These provisions include arbitration by a sole arbitrator in the absence of agreement, consolidation of arbitrations, the decisions of preliminary questions of law by the Court of First Instance (the “Court”), the challenging of an arbitral award on the grounds of serious irregularity6, and appeals on questions of law. The opt-in provisions will automatically apply to

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arbitration agreements entered into at any time until 2017 (i.e., six (6) years after the commencement of the New Ordinance) if the agreement provides that arbitration under the agreement is a “domestic arbitration.”

One issue that practitioners and parties should be mindful of is that the adoption of the 2012 Rules in an arbitration agreement will not, by itself, have the effect of providing that arbitration under the agreement is a “domestic arbitration” for the automatic application of the opt-in provisions under the New Ordinance. If the parties desire to adopt all or any of the provisions of Sections 2 to 7 of Schedule 2 to the New Ordinance, this must be specified in the arbitration agreement.

Conclusion
As explained above, many of the changes to the rules give additional powers to the arbitral tribunal to direct the proceedings and reduce the Court’s power to intervene. This reflects one of the main themes of the New Ordinance, which is based on the Model Law. In light of the general acceptance of the Model Law by both civil law and common law jurisdictions, the recent changes to the arbitration regime will further promote Hong Kong as a major center for international arbitration.

It is important for practitioners and parties to understand the recent changes to Hong Kong’s arbitration regime, and to prepare and review arbitration agreements accordingly to ensure that the intended results are achieved.

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Supreme Court of India Delivers Landmark Arbitration Decision in Bharat Aluminium, Overruling Bhatia International

In a landmark decision in September 2012, the Constitutional Bench of the Supreme Court of India overruled its earlier controversial decision in Bhatia International v. Bulk Trading SA. In the case of Bharat Aluminium v. Kaiser Aluminium, the five-judge panel held that Part I of the Indian Arbitration and Conciliation Act 1996 (“IACA”) will not apply to international commercial arbitrations which have their seat outside of India.

In Bhatia International, the court had previously interpreted Section 2 of the IACA so as to enable Part I of the IACA, which provides for remedies such as interim relief or setting aside of arbitral awards, to be applied even where the seat of arbitration was outside of India. This interpretation was widely criticized as having too wide an impact on foreign arbitrations and for creating uncertainty among parties to an arbitration.

The five-judge panel in Bharat Aluminium reconsidered whether it was reasonable for Part I of the IACA to be applied to arbitrations held outside of India.

In addition to overruling the earlier decision of Bhatia International, the Supreme Court of India held that:

a. Part I of the IACA would only apply to arbitrations seated in India;

b. Awards which are rendered in foreign seated arbitrations will only be subject to the jurisdiction of the Indian courts when they are sought to be enforced in India under Part II of the IACA;

c. Indian courts cannot order interim relief in support of foreign seated arbitrations; and

d. The decision of Bhatia International will continue to apply to any arbitration agreements entered into before 6 September 2012.

The decision of the Supreme Court of India has been welcomed by the international arbitration community because it limits the intervention of the Indian courts in arbitrations seated abroad. Nonetheless, as the decision in Bharat Aluminium will only apply to arbitration agreements entered into after 6 September 2012, the Bhatia International legacy will live on for a number of years.
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