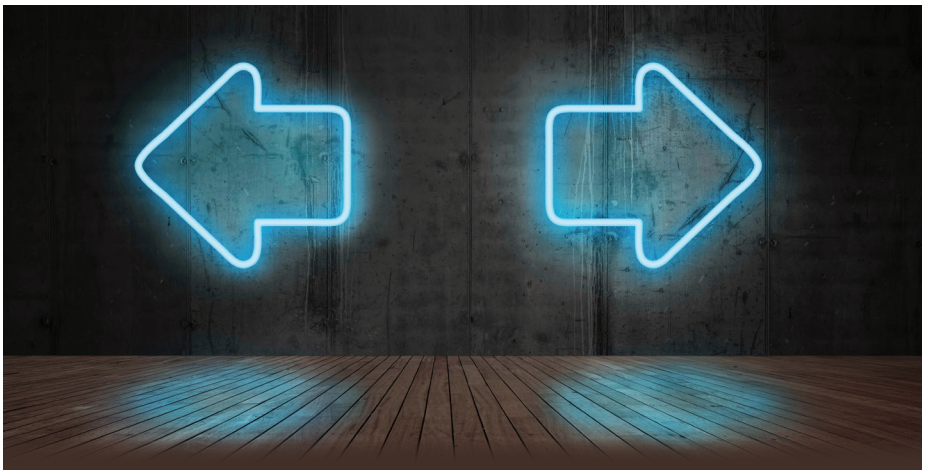

Arbitration vs litigation: choices, choices

Arbitration is becoming an increasingly attractive prospect for financial institutions dealing with disputes: **Simon Walsh** explains its appeal

IN BRIEF

- Historically, financial institutions have preferred to have their disputes determined in national courts through litigation, with their powers of enforcement and summary judgment seen as key advantages.
- However, the attractiveness of arbitration as an alternative to litigation is on the increase, given the availability of specialist technical knowledge and the ease it offers when dealing with emerging markets and the UK post-Brexit.

With the war in Ukraine showing no sign of abating and the after-effects of the pandemic only slowly subsiding, global markets are in turmoil. The markets in the UK are not immune from this upheaval and indeed have their very own localised issues to contend with. Market turmoil inevitably leads to an increase in the number of disputes between and with financial market participants, and while those disputes will largely be subject to baked-in dispute provisions, thought naturally turns to how such disputes should best be resolved in the future. Historically, financial institutions based in the financial centres of London and New York have, on the whole, preferred to have their disputes determined in the national courts through litigation, with their home courts traditionally chosen for these disputes—even when the dispute included an international component.

However, awareness of international arbitration has been growing; the attractiveness of arbitration as an alternative to litigation has increased at the same time as the gap between the powers of arbitral tribunals and state courts has narrowed, and the concerns held by financial institutions about arbitration have subsided.

The attractions of the courts

A number of factors have played into financial institutions favouring litigation for many of their disputes, with the courts having several useful powers that have traditionally made them attractive for such disputes:

- **Summary and default judgments:** In the case of pure 'debt' disputes, where a financial institution has a relatively straightforward debt claim against a debtor, there is utility in a creditor bank being able to dispose of those claims simply, quickly and cost-effectively. The courts of London and New York (two well-favoured jurisdictions for financial institutions) both have the power to pronounce a debtor in default and establish (at least prima facie) liability if a recalcitrant debtor does not appear at court. Further, again in simple cases of debt, those courts have the ability to use summary judgment procedures to quickly determine claims. Enforcement of course is another matter, but a swift establishment of liability is often a boon for a creditor.
- **Securing assets:** While an arbitral tribunal is often, through the institutional rules adopted by the parties, empowered to grant interim measures to secure property pending the outcome of the arbitration, its powers are limited and the effectiveness of any such orders questionable. For example, the ability of a tribunal to grant *ex parte* relief (that is, relief granted without notice to the other party) is rare. Giving notice often defeats the point of such a measure. Additionally, any arbitral order can bind only the parties to the arbitration agreement, which can be problematic where there are multiple parties to a financial structure.
- **Enforcement:** If an arbitral award is not satisfied by the debtor consensually, the creditor's only recourse is to the national courts, which can apply their machinery of enforcement to execute against the debtor's assets. An arbitral tribunal has no such powers.

Financial institutions are also drawn to the legal certainty provided by the breadth of binding precedent in English and US case law (especially arising out of the 2008 financial crisis). Banks faced with multiple consumer claims might draw particular comfort from the certainty that such precedent affords. In addition, given that banks and financial institutions operate in highly regulated environments, public policy concerns about the regulation of markets and their participants might dictate that state courts maintain some level of supervision over disputes in which regulatory questions might be determined.

Arbitration inflation?

There is however a growing trend towards the use of arbitration for financial disputes. That trend appears to be driven by several factors.

Increase in complex financial products

The market in complex financial products continues to expand, and disputes arising under them can require particular technical product and market understanding. If courts are ill-equipped to address these issues (such as the interpretation of market standard documentation, or the determination of disputes under International Swaps and Derivatives Association (ISDA) close-out mechanisms), that can create unwelcome precedent. This is especially the case where a financial institution is said to have fallen foul of its regulatory obligations.

The financial crisis acted to accelerate the concern that national courts may lack the necessary expertise to provide the

best resolution to this type of dispute. Arbitration has always had the benefit of providing the parties with the ability to select experts with relevant market experience to determine their disputes, in light of contemporary market practices. This has been built upon by the Panel of Recognised International Market Experts in Finance (P.R.I.M.E. Finance). In 2012, P.R.I.M.E. Finance launched a set of arbitral rules aimed squarely at the arbitration of complex financial disputes. The latest iteration of those rules was issued at the start of 2022, following an extensive global public consultation to address the feedback and reservations of financial market participants. As well as providing a set of arbitral rules focused on financial disputes, P.R.I.M.E. Finance also maintains its own panel of over 250 technical and financial market experts in areas such as derivatives, private equity, and asset management who can act either as arbitrators hearing a dispute or provide expert evidence to tribunals.

The rules are specifically designed with complex financial disputes in mind, including those concerning derivatives, an area where particular expertise of the complex nature of the transactions involved and the market practices in which they operate could be said to benefit from disputes being determined by persons with appropriate expertise and market understanding. A significant number of those transactions are underpinned by the market standard ISDA form, which in 2018 issued its Revised Arbitration Guide (which was originally issued as long ago as 2013). The Revised Arbitration Guide provides model arbitration clauses for parties to adopt when using the ISDA form, and suggests a number of different sets of institutional rules, including the P.R.I.M.E, Finance rules. Given the prevalence of the ISDA form, the adoption by ISDA of arbitration in this way has a significant market effect in moving parties to adopt a new norm of arbitration for resolution of disputes.

The English courts were not blind to the perceived concerns regarding the financial expertise of the judiciary. So much so that in 2015, the English courts instigated a new division of the High Court: the Financial List. The aim of the Financial List is to ensure that cases which would benefit from being managed and heard by a judge with particular expertise and experience in the law relating to the financial markets, or which raise issues of general importance to the financial markets, are dealt with by judges with suitable expertise. Judges sitting for cases assigned to the Financial List receive specialist training in combination with the Financial Markets Law Committee. Parties in financial disputes therefore now have a range of sophisticated choices of fora.

Summary & expedited procedures

Many institutional rules have reacted to a concern which went much wider than the financial community: that arbitral tribunals did not have the appropriate powers to dispose of claims on a summary or expedited basis, making an early determination of the parties' dispute through arbitration impossible. However, now a number of institutional rules do provide for expedited proceedings or the appointment of 'emergency' arbitrators to deal with urgent applications for relief (for example: SIAC, LCIA, ICC, SCC and HKIAC). This is also the case with the financial market-specific P.R.I.M.E. Finance rules. P.R.I.M.E. Finance has addressed these concerns in its 2022 rules in many ways, providing for tightened procedural timetables (such as providing for the first case management conference to occur within 30 days of the constitution of the tribunal, and requiring awards to be rendered within 90 days (for a three-member tribunal) and 60 days (for a sole arbitrator)). The rules also provide parties with the ability to challenge awards on the basis of 'tardiness' by the arbitrator.

Emerging markets

There has always been a more widespread use of arbitration when counterparties are located in emerging markets, where financial institutions might be concerned that the local courts of a counterparty may lack the relevant expertise of the particular financial products or market practices required to come to a just conclusion in relation to a financial dispute. This is also true where counterparties are sovereign states. Conversely, those counterparties may not trust the neutrality of the 'home' state courts of banks located in the UK and US.

In these circumstances, it has always been valuable to lenders and financial institutions that such disputes can be determined before neutral arbitral tribunals (which is also likely to be quicker than many state courts). There is a further, and very important benefit to arbitration: the resulting award can be easily enforced under the Convention for the Recognition and Enforcement of Foreign Arbitral Awards 1958 (the New York Convention), often far more easily than seeking to enforce a UK or US judgment in the local court of an emerging market state. The New York Convention provides harmonisation of the recognition and enforcement process for arbitral awards in the signatory states (which number approximately 160) and (generally) prohibits domestic courts from reviewing foreign arbitral awards on their merits.

Brexit

Although the primary driver in the greater use of arbitration has been the improvement of the suitability of arbitral rules for the needs of financial disputes, and the ever-expanding exposure of financial institutions into emerging markets, Brexit is also playing a part in the increasing adoption of arbitration. Since the UK left the European Union on 31 January 2020, no agreement has been reached between the UK and the EU on the reciprocal enforcement of judgments, nor as regards the effect in the EU of non-exclusive jurisdiction clauses providing for disputes to be determined in the English courts.

While it is unlikely that courts in the EU would reject a choice of the English courts by the parties, the uncertainty brought about by a clear lack of reciprocal enforcement of the judgments of state courts has led financial institutions to consider whether the harmonised enforcement regime of the New York Convention is now a preferable alternative, at least until such time as the question of reciprocity of enforcement of judgments between the UK and the EU is resolved.

What next?

Factors that have led financial institutions to use arbitration rather than litigation (such as acting in emerging markets or contracting with sovereign states) are likely to remain constant. However, the evolving nature of institutional rules to specifically cater for the disputes of financial market participants, as well as the evolution of arbitral rules more widely to cater for what were perceived to be limitations of the arbitral process even outside of the financial sphere (such as the ability of tribunals to grant relief on an expedited basis, especially for smaller claims), are likely to lead to a greater adoption by financial market participants of arbitration over litigation.

Post-Brexit, certainly in the context of disputes with an EU nexus, the use of arbitration is likely to continue to rise given concerns over the level of reciprocity that the courts of the EU will grant to judgments of the English court now that the mutual recognition provided by the Brussels Regulation (recast) has been removed. NLJ

Simon Walsh is special counsel in the Global Litigation Group at Cadwalader (*www.cadwalader.com*).