Cross-border derivatives disputes: ISDA Arbitration Guide 2013 model clauses offer more certainty

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The 2013 International Swaps and Derivatives Association (ISDA) Arbitration Guide has been published following a two-year consultation with ISDA members.

The Guide provides model clauses for various forms of arbitration for use in derivative transactions. This is welcome news for the banking and investment community, which has not always found the standard ISDA submission to court-based adjudication of disputes to be ideally suited to complex cross-border structured product disputes.

The purpose of the consultation was to gauge member interest in using arbitration in connection with derivative transactions documented under the ISDA Master Agreement. During the consultation, members showed an appetite for using international arbitration in derivatives disputes and indicated that model clauses would be helpful.

Historically, financial institutions have tended to use agreements governed by English or New York law and jurisdiction clauses which refer disputes to the English or New York courts (the options in the current 1992 and 2002 ISDA Master Agreements) because of their reputation and experience dealing with disputes involving derivative transactions. However, recently an increasing number of parties to such transactions are based in emerging market jurisdictions[1] in which it is difficult or impossible to enforce a foreign judgment.

This is where electing to use arbitration as the preferred dispute resolution mechanism in derivative contracts can be advantageous and may explain the eagerness among members for ISDA model arbitration clauses to be published.

The model clauses

Given the increasing appetite for arbitration in derivative transactions, but in the previous absence of any clear ISDA guidance or arbitral provisions specifically related to the ISDA Master Agreement, parties have been drafting their own arbitration clauses, with the consequent risk of ineffectiveness and uncertainty. Therefore, ISDA has now set out model clauses, based on member feedback (including in relation to seats and institutions), which have been designed with cross-border transactions in mind.

Notably, ISDA has seemingly bowed to member demand for a model clause specifically providing for the Panel of Recognised International Market Experts in Finance (P.R.I.M.E. Finance) institutional rules for dispute resolution, which was not included in the six alternative model clauses ISDA published on 17 April 2013. ISDA has now drafted three such model clauses –- one providing for London seat/English law; one providing for New York seat/New York law; and a third providing for The Hague seat/English or New York law with the law of the arbitration clause being Netherlands law.

P.RI.M.E. Finance is a new player in the market, set up in The Hague in 2012 with the object of providing arbitration and mediation services, expert opinions and judicial training and education in the area of complex financial transactions. A key advantage that P.R.I.M.E. Finance claims to offer is its panel of expert arbitrators, all of whom have specialist knowledge and extensive experience in the field of financial services.

The P.R.I.M.E. Finance arbitration rules are, in essence, a customised version of the UNCITRAL arbitration rules. They offer the reliability of the framework of the UNCITRAL rules, with added options such as a procedure to appoint an emergency arbitrator similar to the ICC and HKIAC rules and a default mechanism (which fills a gap in the UNCITRAL rules) for the appointment of an arbitrator where the parties are unable to agree (the appointing authority in that case is the Secretary-General of the Permanent Court of Arbitration in The Hague).

The ISDA Guide also provides model clauses for use with the major arbitral institutions, including model clauses for use with the ICC, LCIA, AAA, HKIAC, SIAC, and Swiss arbitral rules and provides for a number of preferred seats including London, New York, Paris, Hong Kong and The Hague. Helpfully, where a seat has two arbitration regimes, domestic and international (e.g. Hong Kong and Switzerland), provisions have been included to make it clear that the model clause applies to the international regime.

Optional (or one-way) arbitration clauses have not been drafted by ISDA. This is because such clauses are rare in derivatives contracts and give rise to potential enforcement risks (some countries (e.g. France) have refused to give effect to them and in many jurisdictions their effect is untested).

In countries where it was felt appropriate (such as Hong Kong and Singapore, but not France and Switzerland), clear wording has been included to confirm the governing law of the arbitration clause.

The publication of the ISDA Arbitration Guide and the model clauses indicates that there is a real eagerness to make use of arbitration as a dispute resolution mechanism in the derivatives market. In particular, parties are drawn to the advantages of enforceability and neutrality that international arbitration can provide. However, the Guide is clear that these are model clauses which may not be appropriate in all cases, particularly in more complex transactions, where more detailed arbitration provisions may be more suitable.

Parties are also advised to consider the model clauses carefully (they are not to be viewed as boilerplate) in the context of the domicile of the counterparty and the location of assets in order to determine whether any amendments are necessary to maximise recognition and enforcement in those particular jurisdictions. Except in the case of the simplest transactions, specialist advice should be sought. To learn more about the model clauses, please contact:

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[1] ISDA now has over 840 member institutions from 60 countries. Further, a study undertaken by the Bank for International Settlements at the end of 2010 revealed that the derivatives markets in emerging markets had increased 300 percent since 2001 and by 25 percent since 2007. In addition, the emerging markets of Brazil, Hong Kong, Singapore and South Korea have now become major players in the derivatives markets (for example the Korea Exchange had a $270 billion daily turnover of equity-linked derivatives in April 2010, which was second globally only to the US CME Group.

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