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Recent Developments in Legal Professional Privilege and Without Prejudice Privilege



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Privilege is a fundamental common law right. It allows a party to withhold certain evidence from being disclosed to others. The purpose of this right to confidentiality is to allow parties unfettered communication where it is in the interests of the administration of justice. On the whole, privileged communications take the form of documents but they extend beyond anything written on a page - such as verbal communications and electronically stored material.

Two of the most commonly relied upon types of privilege are legal professional privilege (LPP) and without prejudice privilege (WPP). In this article, we look at how the present state of these two main types of privilege, and review some recent developments - including the recent judgment of the European Court of Justice, deciding the appeal in the oft-debated *Akzo* case.

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Legal Professional Privilege (LPP) and *Akzo*

LPP is the right to preserve confidentiality in any communications relating to legal advice or matters between a lawyer and his (or her) client. Given the range of situations in which lawyers give legal advice, the courts have further divided LPP into legal advice privilege and litigation privilege. As the names suggest, legal advice privilege applies to general legal advice and communications passing between client and lawyer (so ‘non-contentious’

matters), whereas litigation privilege applies to "all documents brought into being for the purposes of litigation".¹

Legal advice privilege has been in the spotlight recently as a result of the European Court of Justice ruling in the *Akzo* appeal. The Court's final judgment, handed down on 14 September 2010, has now determined that an organisation's internal communications with its in-house lawyers are not privileged for the purpose of investigations by the European Commission into violations of European competition law.

In *Akzo*, a search took place at the UK offices of Akzo and Akros during a competition law investigation by the European Commission. During the raid, Commission officials located a number of internal documents that had been communicated to in-house lawyers. Akzo claimed privilege over those. The Commission insisted on seeing the documents, regardless. The European Court of First Instance (now the General Court) had to be called on to decide, and it said the documents were not privileged.

which a business received from its in-house lawyers, at least for the purposes of a Commission investigation. Privilege in actions before the English courts is unaffected, and domestic competition law investigations would still be governed by the Competition Act 1998. The Act expressly provides for communications with legal advisers to be privileged, and that would be interpreted consistent with the general English law so as to preserve privilege in internal communications where it existed before.³

Under English law generally, communications between an organisation and employed counsel can remain privileged. For the purposes of LPP, the English courts will treat communications with qualified in-house advisers the same way as communications involving an external lawyer. However, extra caution is still needed: the roles of many in-house lawyers extend to advising on general business affairs. Any communications not relating to legal advice will not be protected by LPP. Consequently, it is advisable to separate any

An organisation's internal communications with its in-house lawyers are not privileged for the purpose of investigations by the European Commission into violations of European competition law

The parties in *Akzo* agreed that litigation privilege was not applicable to the documents in this case so the focus of the arguments in the appeal was on legal advice privilege. The Court's conclusion is that an organisation's internal communications with its in-house lawyers cannot be privileged as, under European law, legal advice privilege applies only to lawyers who are independent of their clients. The judges found that this requirement for 'independence' precluded, and was fundamentally inconsistent with, any relationship of employment - quite irrespective of rules of professional conduct that might apply to any particular in-house counsel. The in-house lawyer's "economic dependence and the close ties with his employer" meant that he or she could not "enjoy a level of professional independence comparable to that of an external lawyer"². The Court rejected the notion that this would infringe a party's fundamental right of defence.

After *Akzo*, there can therefore be no privilege in any advice

communications relating to legal advice from general business advice to avoid a potential loss of privilege.

Finally, whilst LPP extends to communications of a legal nature between organisations and their in-house lawyers, it does not extend beyond the legal profession. In *Prudential v Special Commissioner of Income Tax*⁴ an attempt was made to widen the scope of LPP to include legal advice given by accountants on tax law issues. This was roundly rejected by the court, which reinforced that LPP is only ever available to lawyers.

Without Prejudice Privilege - WPP

WPP protects any communications between parties aimed at a genuine settlement of a dispute between them. WPP is meant to facilitate resolving disputes by giving the parties a safe framework within which they can negotiate compromises freely,

¹ *Three Rivers District Council & Ors v Governor and Company of the Bank of England* [2004] UKHL 48

² Case C-550/07 P, Judgment of the Court (Grand Chamber), 14 September 2010, paragraph 49.

³ Section 30 of the Competition Act 1998 provides for privilege in communications between professional legal advisers and their clients, or communications made in connection with or in contemplation of legal proceedings and for the purposes of legal proceedings and for the purposes of those proceedings.

⁴ *R (on the application of (1) Prudential Plc (2) Prudential (Gibraltar) Ltd v (1) Special Commissioner of Income Tax (2) Philip Pandolfo (HM Inspector of Taxes)* [2009] EWHC 2494 (Admin)

without concern that their efforts or any concessions they might be prepared to put on the table will damage them in proceedings.

When recording communications with their employers, it would be prudent for in house lawyers to take account of the following:

- ⊙ *Not all communications between an organisation and its in house lawyers will be privileged*
- ⊙ *Legal advice is best separated from any other business advice*
- ⊙ *Circulation of legal advice should be limited*
- ⊙ *If possible, legal advice should be filed separately and identified as privileged on its face*
- ⊙ *Office manuals and company policy should be clear and strict on how to handle and store privileged documents*
- ⊙ *Where there is any doubt about a communication attracting privilege, it would be wise to circulate it through an external lawyer*
- ⊙ *If there are any comments on advice from external lawyers, they should ideally be given orally*
- ⊙ *Privilege rules may need to be clarified in each jurisdiction in which the client operates*

WPP applies to oral and written communications. A document must be a true 'negotiating document' in order to be given without prejudice status. The courts have accepted that where a letter is marked "Without Prejudice", "This prima facie means that it was intended to be a negotiating document."⁵ and "...if a letter is expressly stated to be "without prejudice" that gives rise to the rebuttable presumption that the communication is a without prejudice communication within the meaning of the rule unless it is clear that the expression has been used with some other meaning or purpose."⁶ Of course, this still means that if a document is marked "Without Prejudice" and it is not actually a true 'WP' document, then it will not be privileged. Conversely, if a document is not marked "Without Prejudice" and it is in truth a negotiating document, the court may still allow it privileged status.

It is of course best to avoid any doubt and properly mark all negotiating documents as being "Without Prejudice". To determine whether a document is WP, the court will consider whether the document is part of settlement discussions by taking into consideration, "...what, on a reasonable basis, the intention of the author was and how it would be understood by a reasonable recipient."⁷ In practice, "settlement discussions"

⁵ *South Shropshire District Council v Amos* [1986] 1 WLR 1271 at 1277, Lord Justice Parker

⁶ *Williams v Hull* (2009) EWHC 2844 (Ch), Justice Arnold

⁷ *Schering Corporation v Cipla* [2005] EWHC, Justice Laddie

extends to the "opening shot"⁸ in negotiations and is not limited to offers, but extends to all documents "which form part of negotiations, whether or not they are themselves offers". On the other hand, the court has held that communications must be a negotiating document and not merely an assertion of a party's rights.⁹

The protection accorded to WP communications is based in part on a public policy of encouraging the settlement of disputes, but also on an implied agreement between the parties themselves to attempt to settle. Parties may also enter into an express agreement. An implied agreement between the parties generally arises out of what Lord Justice Hoffman described in *Muller v Linsley*¹⁰ as, "what is commonly understood to be the consequences of offering or agreeing to negotiate without prejudice." The most common form of express agreement is a "without prejudice save as to costs" provision which allows WP communications so marked to be admissible to the court on the question of costs after the matter has been decided.

These agreements stand apart from the principle of public policy, as the courts have deemed that there is no reason in principle why parties to WP negotiations should not expressly or impliedly agree to vary the application of the public policy rule in other respects either by extending or by limiting its reach.

Exceptions to WPP

The courts place great importance on the right and need for parties to be able to communicate freely when discussing possible settlements.¹¹ As a result, with few exceptions, WP negotiations are inadmissible as evidence. Those few exceptions were set out, in what has now become the definitive list, by Lord Justice Walker in 1999 in the Court of Appeal's decision in *Unilever*.¹²

In *Unilever*, Procter and Gamble ("P&G") had a European patent relating to a method of washing household laundry in a machine. Unilever developed a new product and needed to know whether this new product constituted an infringement of the patent. Consequently, Unilever and P&G agreed to have a WP meeting to discuss the issues.

Later on, it was alleged that at the meeting, P&G threatened to commence an action in England against Unilever for patent infringement. Unilever claimed that these threats fell foul of the

⁸ *South Shropshire District Council v Amos* [1986] 1 WLR 1271

⁹ *Buckinghamshire County Council v Moran* [1990] Ch 623

¹⁰ 30 November 1994, 139 SJ LB 43

¹¹ In *Cutts v Head*, Lord Justice Oliver emphasised the importance of allowing the parties the opportunity to "put their cards on the table" saying, "The public policy justification, in truth, essentially rests on the desirability of preventing statements or offers made in the course of negotiations for settlement being brought before the court of trial as admissions on the question of liability."

¹² *Unilever Plc v The Procter and Gamble Company* (2000) 1 WLR 2436 Court of Appeal

Patents Act 1977 which provides a remedy for groundless threats of patent infringement proceedings. The question, in essence, was whether the protection afforded to WP discussions had to yield to the provisions of the Patents Act. The Court of Appeal held that it did not.

The Court identified the eight exceptions where WP discussions may be admissible:

1. Where there is a dispute as to whether WP communications have resulted in a concluded settlement;
2. Where it is alleged that a settlement should be set aside on the grounds of misrepresentation, fraud or undue influence;
3. Even if there is no concluded settlement agreement, a clear statement which is made by one party, and on which the other party is intended to act and does in fact act, may be admissible as giving rise to an estoppel;
4. Where the exclusion of the statement would act as a cloak for perjury, blackmail or "unambiguous impropriety";

An example of the narrow scope of this exception can be seen in *Fazil-Alizadeh*.¹⁴ In a taped WP conversation, the claimant admitted to making a payment of £10,000 although he continued in his pleadings to deny such payment. The court held that this was "a mere inconsistency" and the conversation was inadmissible.

A more recent challenge to the scope of WP privilege under the "unambiguous impropriety" exception came in 2009, in *Williams v Hull*.¹⁵ *Williams* was an appeal from the county court and concerned a property dispute between former cohabiting partners. *Williams*' case was that there had been an agreement as to how, in the event of separation, the joint property would be divided up. *Hull* disputed this. However, despite the fact that *Hull* disputed that there was an agreement between the parties, in WP correspondence, he referred expressly to "the financial agreement of our cohabitation at the outset". *Williams* sought to have the WP correspondence admitted in evidence. In the

In practice, the most contentious exception to the WP rule has been the "unambiguous impropriety" exception.

5. To explain delay or apparent acquiescence;
6. To establish mitigation of loss in the conduct and or conclusion of a settlement;
7. Where there is an express saving, for example, "without prejudice save as to costs"; or
8. In matrimonial cases, there is a separate category of privilege where communications are received in confidence with a view to matrimonial conciliation.

"Unambiguous Impropriety"

In practice, the most contentious exception to the WP rule has been the "unambiguous impropriety" exception. The expression "unambiguous impropriety" was used by Lord Justice Hoffman in *Foster v Friedland*,¹³ in which he emphasised the sanctity of WP privilege, saying, "... the value of the without prejudice rule would be seriously impaired if its protection could be removed from anything less than unambiguous impropriety." The Court of Appeal warned that "unambiguous impropriety" should be applied only in the clearest cases of abuse of a privileged occasion.

county court it was held that the correspondence could be admitted as the correspondence in question was not WP and if it was, it would fall within the "unambiguous impropriety" exception. *Hull* appealed. His appeal was allowed on the basis that the letters were legitimately within the umbrella of "without prejudice", given that they were in fact a negotiating documents.

The High Court disagreed that the "unambiguous impropriety" exception applied. In reaching its conclusion, the High Court was critical of the fact that the WP letter had been "dissected", treating parts of it as being covered by privilege, but not others. This was held to be the wrong approach. The High Court cited Lord Justice Walker's conclusion from *Unilever* that "to dissect out identifiable admissions and withhold protection from the rest of without prejudice communications (except for a special reason) would not only create huge practical difficulties but would be contrary to the underlying objective of giving protection to the parties".¹⁶ The High Court ultimately found that (even) a serious and substantial risk of perjury (on the part of *Hull*) was not

¹³ 10 November 1992, Competition Appeal Tribunal "CAT" 1052

¹⁴ *Fazil-Alizadeh v Nikbin*, 1993 CAR 205

¹⁵ [2009] EWHC 2844

¹⁶ See footnote 16 at pp2448-2449

enough to warrant admission of WP documents and the inconsistency between Hull's letter and his pleaded case were not sufficient to amount to an "unambiguous impropriety".

The decision in *Williams v Hull* demonstrates the courts' policy of protecting WP communications. This same concern was at play in the Court of Appeal's decision in *Savings & Investment Bank Limited v Fincken*.¹⁷ Lord Justice Rix concluded that privilege had to be abused before it was lost. It was not enough for there to be "... merely an inconsistency between an admission and a pleaded case or position...".

exceptions. The Court of Appeal was asked to decide whether evidence of WP communications and discussions can be admitted if there is a dispute about the interpretation of a subsequent written settlement agreement. This would, if accepted, be an extra exception to the eight in *Unilever*.

At first instance Mr Justice Andrew Smith said that this exception ought to exist. He relied in part on *Chartbrook Limited v Persimmon Homes*²⁰ which held that in general contract law, evidence of negotiations might be given to establish that a fact which may be relevant as background was known to the parties. However, a split Court of Appeal disagreed.

The courts continue to prefer the policy of protecting the confidentiality of WP communications.

Recent attempts to make inroads into WPP

The courts' policy has not, however, deterred further recent attempts to challenge the scope of the WP principle and widen the list of potentially admissible WP communications.

In 2009 the House of Lords decided *Ofulue v Bossert*.¹⁸ Their Lordships had to rule on whether it was permissible for a property owner (Ofulue) to rely on a WP offer made by a squatter (Bossert) to purchase the property from the owner in previous proceedings as an acknowledgment of the owner's title in subsequent proceedings. The House of Lords held that Ofulue could not rely on the previous WP statement and did not extend the eight exceptions set out in *Unilever*. Lord Neuberger held that it would be impractical to weed out, from obviously WP communications, individual statements which taken in isolation might not technically qualify for protection. Whilst Lord Scott dissented on the grounds that the facts Ofulue sought to rely on were common ground and as such did not need to be protected, at present the courts appear to be following the position set out in *Unilever* quite strictly.

Can WPP shed light on the interpretation of a subsequent written settlement agreement?

In the recent case of *Oceanbulk Shipping v TMT Asia Limited*,¹⁹ the Court of Appeal again refused to extend the eight *Unilever*

Lord Justice Longmore and Lord Justice Burnett were of the opinion that no reliance could be placed on the WP correspondence for the purpose of interpreting a subsequent written settlement agreement.

That conclusion did not sit well with Lord Justice Ward, who was moved to a powerful dissent, asking: "you can use the antecedent negotiations to prove the agreement, to rescind it, or to rectify it, why on earth can you not use the negotiations to establish the truth of what the concluded agreement means? Not to do so would strike my mother as "barmy". Perhaps I should simply say it strikes me as illogical".

The majority in the Court of Appeal observed this tension between on one hand allowing the court to have before it the best and most useful evidence available and on the other hand protecting the fundamental purpose of WP privilege to promote settlements. The Court of Appeal concluded that in light of the decision in *Ofulue*, WP privilege should take precedence.

The Court of Appeal in *Oceanbulk* did distinguish two situations in which WP correspondence is admissible: as an aid to construction including claims for rectification and situations where a settlement agreement incorporates a WP document. The latter situation arose in an earlier case, *Admiral Management Services Limited v Para Protect Europe Limited*²¹ which had also been decided by Justice Stanley Burnett (as he then was). In *Oceanbulk* Lord Justice Burnett agreed with Lord Justice Longmore's interpretation of the limitations of his own

¹⁷ [2003] EWCH 719 (Ch)

¹⁸ (2009) 1 AC 990

¹⁹ [2010] EWCA Civ 79

²⁰ [2009] 1 AC 1101

²¹ [2002] EWCH 233 Ch

earlier judgment and ultimately concluded that the documents were inadmissible.

In Lord Justice Ward's dissenting judgment, he noted the contrast between the decision in *Oceanbulk* and in the earlier *Admiral Management* case. Lord Justice Ward said he preferred "the instincts of the youthful Justice Stanley Burnton before he became corrupted by the arid atmosphere of this court". It proved he went on "what every good old fashioned county court judge knows: the higher you go, the less the essential oxygen of common sense is available to you." This may have been a light hearted comment but it underlines the fundamental issue that there is a clear conflict between the position of a party such as Williams, in *Williams v Hull*, who is prevented from relying on statements despite the fact that those statements seem to have been verified in WP discussions negotiations and the public interest in keeping confidential any communications made in settlement negotiations.

At present, the *Oceanbulk* decision is the subject of an appeal to the Supreme Court and a decision is expected soon. Based on the Court of Appeal's decision in *Oceanbulk* and the current case law, it appears that the courts continue to prefer the policy of protecting the confidentiality of WP communications. Unless a contrary decision is handed down by the Supreme Court, this looks set to continue. The eight exceptions set out in *Unilever* remain the definitive list of exceptions to the admissibility of WP communications and the "unambiguous impropriety" exception has been construed extremely narrowly by the courts. This means that parties can continue to rely upon the confidentiality of any communications made in settlement negotiations.

Conclusion

While the rules of privilege remain fairly well settled under English law (subject to the decision of the Supreme Court in *Oceanbulk*), the judgment in the *Akzo* appeal has thrown the spotlight once more on the need to ensure that any legal advice that raises European competition law issues be sought from external counsel, if privilege is to be maintained in a Commission investigation. The view taken by the European Court of Justice has been criticised as undermining the ability of in-house counsel to review and ensure compliance in the first instance. However, despite submissions from a number of interested parties (including the International Bar Association), the Luxembourg judges were adamant that, for the purposes of privilege in European competition law matters, in-house counsel and external lawyers were simply in a fundamentally different position. In-house lawyers, in this regard, are not viewed as independent. ©

The UK Corporate Tax Regime - A Siren's Call?



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Many businesses which are subject to the UK corporate tax regime have their origins abroad. Most will have deliberately

arranged their affairs to bring part of their business or a particular transaction within the UK tax net whilst a few will have inadvertently become subject to UK tax. This article considers the application of the UK direct taxation system to non-UK origin businesses from those two very different perspectives. In broad terms, it explains why some foreign businesses may choose to be subject to UK tax rules and warns others about the risks of doing business with the UK whilst expecting to remain 'off shore'.

A New Hope

Businesses looking to expand into, or within, Europe have always been attracted to the UK for non-tax reasons but, until recently, may have been daunted by the tax consequences. However, as a result of recent legislative changes the UK's business tax regime is arguably as competitive as that of jurisdictions such as the Netherlands, Ireland and Luxembourg.

The current corporation tax rate is 28%, which is significantly lower than the average rate over the last 20 years, and the new UK Government recently announced that the rate is to reduce by 1% in each of the next 4 fiscal years so that from 1 April 2014 it will be just 24%.

Perhaps more importantly, the UK can now boast an attractive tax regime both for inward investment and for the establishment of European holding companies.

In building international groups and structuring cross border transactions the management of withholding tax risk is often a significant problem. Many taxing regimes require that income such as interest, dividends and rents owed to a foreign counterparty be paid subject to deduction of tax. Tax is withheld from such payments on account of the foreign recipient's liability to tax on income sourced from the payer's jurisdiction. This inevitably results in additional funding costs and often times double taxation. The recipient will usually be taxed on the same income in its jurisdiction of residence so if the withheld amount is not fully creditable against that tax, nor otherwise recoverable, there will be an element of double-taxation.

A significant benefit of having group subsidiaries held under a UK holding company is that the receipt of dividends on shares held as an investment will not usually be subject to UK tax even when received from a non-UK subsidiary. And, when the intermediate UK holding company distributes its profits to the ultimate parent that payment is also free from withheld tax because the UK does not generally impose a withholding tax on dividend payments even if the recipient shareholder is overseas.

Rental income from UK real estate can also usually be paid gross to an offshore landlord without the deduction of UK tax. True, a UK borrower may be required to withhold tax at 20% on cross-border interest payments but, in practice, the borrower's obligation is often relieved under a Double Tax Treaty, the EU Parent/Subsidiary Directive or national law or the funding may

The announced reductions in corporation tax rates and other policy statements have created a new hope that the Coalition Government will continue with business-friendly reforms to the UK tax system. For example, the Government has already indicated its intention to introduce greater stability by slowing down the pace of change in relation to tax legislation and extending the timetable for pre-legislative consultation. It seems that even HMRC may adopt a less zealous approach to tax litigation. The Financial Times reported on 19 August that Dave Hartnett, permanent secretary for tax, had said that some officials had been too "tough" in tax disputes and that HMRC had sometimes been "too black and white about the law". However, a final word of caution, the tax rules mentioned above are intended to benefit commercial business arrangements and

The UK's business tax regime is arguably as competitive as that of jurisdictions such as the Netherlands, Ireland and Luxembourg.

be structured in a way that avoids the withholding requirement.

Access to its network of over 100 Double Tax Treaties is a further benefit of doing business in the UK. The UK procedures for claiming tax relief are already more efficient than in many other jurisdictions and became more so with the introduction of a "Treaty Passport" scheme from 1 September 2010. Under the new scheme a corporate lender established outside the UK may apply to Her Majesty's Revenue & Customs ("HMRC") for a "Treaty Passport" which effectively recognises the lender as a person entitled to Treaty relief and accelerates the processing of subsequent claims.

If a UK borrower is notified by its overseas corporate lender that it holds a "Treaty Passport" and the borrower passes this notification together with the lender's identifying number to HMRC, HMRC will issue a direction to pay interest at the relevant Treaty rate on the basis of that information.

It is not only in relation to income streams that the tax rules encourage investment. A non resident company which holds UK capital assets, for example land or shares, otherwise than for the purposes of a UK branch or permanent establishment is not subject to UK tax on any capital gain realised on the eventual disposal of the assets. Furthermore, even if shares are held by a UK permanent establishment or UK resident company any gain on disposal may still be retained tax free if the shares have been held for 12 months and constitute at least a 10% stake in a trading enterprise.

as such may not apply to arrangements entered into with the main purpose of enjoying the tax benefits.

HMRC Strikes Back

So far we have looked at reasons why a foreign business might voluntarily become subject to UK taxation. The remainder of this article considers how a foreign company may inadvertently become liable to pay UK tax and some of the risks attached to having business links with the UK.

Although the UK's business tax climate is now generally benign it may not look like that when viewed from a tax haven and a business new to the UK should never assume that a structure which 'works' for tax at home will have a similar effect in the UK. Anyone who has an interest in an offshore company which has any links to the UK needs to be aware of the risks attached to such links.

A company which is incorporated outside the UK may nevertheless become resident in the UK, and therefore subject to UK tax on its worldwide income, if its central management and control is exercised from within the UK. The risk is particularly acute for single or special purpose companies which are established in low/no tax jurisdictions but are effectively controlled by UK entrepreneurs.

HMRC has shown a marked willingness to challenge the residence of such companies on the basis that their central

management and control is actually being exercised from the UK either because the Board Of Directors in fact makes strategic decisions from the UK or because some other committee or person located in the UK has usurped the strategic decision making powers of the Board.

Where transfer of residence to the UK is a potential problem it is important that the documented procedures of the company should address in detail the precautions which are necessary to limit the risk. UK tax counsel can assist on this procedural framework but it will only be effective to the extent that the company's managers follow the procedures in practice and accurately record the exercise of central management control in detailed and contemporaneous documentation.

The rules on the taxation of non-UK individuals who come to work in the UK have also changed significantly in recent years, from the 'day counting' counting rules in relation to the 183 days residence test through to the meaning of 'remittance' for resident but non-domiciled individuals. Consequently, employers who are seconding employees to the UK and, of course, individuals moving to the UK, even for only a few weeks, should always take advice on the UK tax consequences.

A second area of concern is the UK use of financial and business products which have been structured for an overseas tax regime. For example, successful foreign companies which are looking to expand in the UK may seek to attract staff with the offer of remuneration packages, including equity grants and options, on the same terms as those offered in their home jurisdiction. The UK has extensive legislation on the taxation of management incentives and a foreign incentive plan should never be used for UK staff or consultants without having been reviewed by tax counsel to ensure that it does not result in unexpected fiscal costs both for the employee and the employing company or give rise to reporting obligations which might otherwise have been overlooked.

Other common commercial documents which need to be reviewed by tax counsel before being used for UK parties included loan documents (to ensure both that the lender receives gross payments and that the UK borrower is entitled to tax relief on interest); all transaction between connected parties (the UK has extensive transfer pricing legislation based on the OECD model); and, all agency relationships.

Foreign businesses often choose to 'test the market' for their products and services in the UK by appointing a selling agent expecting that by doing so they can avoid any UK tax on their profits. Businesses familiar with civil law jurisdictions, in particular, may look to transact with UK customers through a "commissionaire" structure like that employed in continental Europe. However, UK law does not recognise the "commissionaire" concept and is likely to interpret it as a simple agency. In that case, the offshore company may be subject to UK

tax on the profits from the agent's activity and the agent may be liable to HMRC to account for that tax.

Fortunately, this charge to tax may often be avoided under an applicable Double Tax Treaty or UK legislation, for example the statutory investment manager exemption. But for these exemptions to apply, the agent should be both demonstrably independent of its principal and acting in the ordinary course of its business. HMRC has published extensive guidance on its approach to UK agents and any non-UK business should seek advice from tax counsel before appointing a UK based agent or "commissionaire".

So, in conclusion, although the UK tax systems offers many benefits it also has significant traps for the unwary. In particular, foreign businesses which have UK connections but intend to remain 'offshore' should consider having the consequences of their UK links reviewed by tax counsel.©

'MOTHS CROSSING THE ATLANTIC'

US Discovery in Aid of International Arbitration Revisited



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Introduction

In 1983, Lord Denning said:

*"As a moth is drawn to the light, so is a litigant drawn to the United States. If he can only get his case into their courts, he stands to win a fortune."*¹

Part of the reasons for wanting to litigate in the United States may, of course, be gaining access to the wide-ranging discovery process. Twenty-seven years on from Lord Denning's musings, however, there is a view among international businessmen (rightly or wrongly) that litigation in the United States is unattractive precisely because of this extensive, and costly, discovery process. Those with a civil law background may experience the greatest culture shock, as their system does not

¹ *Smith Kline & French Laboratories, Ltd v Block* [1983] 2 All E.R. 74 (Court of Appeal)

ask parties to provide documents beyond those they rely on. Advocates of discovery, on the other hand, stress that each side ought to put their (evidentiary) cards on the table to give the decision-maker the full picture. Internal documents that never left a claimant corporation can paint a quite different picture from those on which a claim is based.

Parties who find extensive US or common law-style disclosure or discovery an obstacle to efficient resolution of their disputes may opt for international arbitration as their chosen forum. Arbitration seeks to strike a balance when it comes to disclosure: some documents can be required from the opponent, but the disclosure obligation is narrower than in litigation in most

courts have been interpreting the provision. Will it lead to gumshoe tactics in treaty claims?

Disclosure in International Arbitration

There is, generally, no automatic obligation of disclosure in most international arbitrations, in contrast with litigation in the major common law jurisdictions.³ The principle underlying disclosure, as well as any other aspect of arbitral procedure, is that of party autonomy.⁴ The parties are free to agree on the regime for exchanging documents, and if they do not agree, then the tribunal decides.

One particular procedural power in the arsenal of US courts the power to order discovery in support of foreign proceedings - has consistently generated debate.

common law jurisdictions (certainly England and the US).

One particular procedural power in the arsenal of US courts - the power to order discovery in support of foreign proceedings - has consistently generated debate. There have been warnings that the power under 'Section 1782', if it were applied to international arbitration proceedings, would undermine the arbitral process and interfere with its autonomy. Recently, Section 1782 has even injected some drama and detective work into bilateral investment treaty arbitrations. It now seems fairly clearly established that tribunals established under treaties are, in the eyes of the US courts, of a sufficiently international character to bring them within Section 1782. In one recent example, Chevron, the investor-claimant, sought US discovery of hundreds of hours of unreleased footage from the makers of a documentary on an environmental situation in Ecuador. The pollution in question had triggered national litigation and measures against Chevron in Ecuador, which had, in turn, led to Chevron's investment treaty claim seeking to recover losses caused by the Ecuadorian sanctions. Within the 600 hours of footage that Chevron subpoenaed was alleged to be evidence of collusion or contact between parties that were meant to be at arm's length, which (if proven) could taint Ecuador in the treaty claim. Chevron's request was upheld.²

This article looks at how disclosure of documents is generally approached in international commercial and investment treaty arbitrations, before considering Section 1782 and how the US

Article 20 of the ICC Rules of Arbitration provides that:

"1. The Arbitral Tribunal shall proceed within as short a time as possible to establish the facts of the case by all appropriate means."

Some commentators⁵ have suggested that Article 20 of the ICC Rules means something more than the adversarial approach a common lawyer expects of the tribunal. While an ICC arbitrator might, in certain cases, go beyond merely weighing the cases as presented by both parties and adopt a more inquisitorial or investigative stance, the ICC Rules do not envisage that "*establishing the facts of the case by all appropriate means*" means embarking on an extensive disclosure exercise,

³ An automatic obligation of "standard disclosure" is recognised in the English Civil Procedure Rules, Part 31. This is limited to documents that either support or go against the case of a party, and no longer includes documents that are merely relevant or might lead to a train of enquiry (see further footnote 11 below), which was considered to be a wide-ranging obligation. In the US, the Federal Rules of Procedure ("FRP") also contain an express duty of disclosure. FRP Rule 26(a)(1) requires anything to be disclosed that is within "... the possession, custody, or control of the party and that the disclosing party may use to support its claims or defenses". FRP 26(b)(1) explains the scope of discovery and provides that documents are discoverable provided they are "relevant" to the issues. It is also common for parties to attend pre-trial discovery meetings.

⁴ Procedure in arbitrations falls to be determined according to the law of the seat, and most such laws consider the detail of arbitral procedure to be a matter for the parties or, absent agreement, the tribunal. Article 19(1) of the UNCITRAL Model Law ("**Model Law**") ("*The parties are free to agree on the procedure to be followed by the arbitral tribunal*"). Article 19(2) gives the tribunal the power to consider weight and admissibility of all evidence. It is implicit in this that the tribunal also has the power to take (or request) evidence from the parties. The Model Law has been used as basis for the national arbitration legislation of many countries worldwide.

⁵ See for example *Craig, Park and Paulsson*.

² *In re Application of Chevron Corp.*, 2010 WL 1801625 (S.D.N.Y. May 6, 2010)

and this is borne out by general arbitral practice.⁶

Similarly, under the LCIA Rules there is no default disclosure of documents. Article 22.1 of the LCIA Rules allows an arbitrator to require a party to produce documents,⁷ including of his or her own motion.

In investment treaty arbitrations, such as under the auspices of the International Centre for the Settlement of Investment Disputes (“ICSID”) and the Washington Convention of 1965, or *ad hoc* under UNCITRAL Rules, tribunals are equally aware of the need to reign in any excesses of disclosure.

Under the ICSID Convention, tribunals have the power to order the parties to produce documents at any stage of the proceedings if the tribunal deems this is ‘necessary’⁸. While

truth, that had to be balanced by the need to seek to do so efficiently.¹⁰

The International Bar Association has published Rules on the Taking of Evidence in International Arbitration Proceedings (“**IBA Rules**”) (revised in May 2010) which aim to bridge the gap between civil and common law, and the range of procedural approaches in national litigation. The IBA Rules provide for ‘document requests’, which need to set out (Article 3.3) “*a description of a requested document sufficient to identify it, or...a description in sufficient detail (including subject matter) of a narrow and specific requested category of documents that are reasonably believed to exist.*”. A party must also say why it believes the documents it seeks are “*relevant and material to the*

Though well-known, the IBA Rules are not adopted in all international arbitrations and it may simply come down to convincing your arbitrator.

there is no further guidance in the ICSID Convention as to what necessity means, investment treaty tribunals are not in the habit of allowing wide-ranging discovery-style requests. In an investment claim against the United States, the tribunal noted that⁹:

“With respect to the differences between domestic litigation and international arbitration, the Tribunal recognizes that it is generally understood that one reason parties choose arbitration is to avoid the relatively extensive document production practices of courts generally and United States courts in particular.”

Another tribunal noted, when deciding a request for documents, that while its mission was ultimately to discover the

outcome of the case.” The 2010 update to the IBA Rules now makes some specific provision for electronic documents - though it stresses the electronic searches should be made in an “*efficient and economic manner*”, for example by reference to specific search terms.

Under the IBA Rules, as is usually the case, the tribunal may draw adverse inferences where a party refuses to comply with a properly made request for documents, (Article 9.5). The tribunal can also impose cost penalties where a party has failed to act in good faith in connection with the ‘taking of evidence’ and the exchange of documents (Article 9.7). That provision would allow the tribunal to order that a party who has resisted requests without good grounds, delayed production, or even produced far too many, irrelevant documents, pay the costs of the other side caused by such obstructive conduct.

Though well-known, the IBA Rules are not adopted in all international arbitrations and it may simply come down to convincing your arbitrator that you should be given the documents. As rules on disclosure in most international arbitrations tend not to set down detailed guidelines,¹¹ arbitrators may fall back on the concept of ‘reasonableness’. A

⁶ Under Article 20.5, an ICC tribunal does have the power to summon a party to provide further evidence at any stage during the proceedings. However, one would expect an ICC tribunal to exercise that power if it is not satisfied by the evidence on a particular issue, rather than to use it to allow the parties to conduct an extensive process of discovery of potentially relevant evidence.

⁷ As with all matters of procedure, the arbitrator has the power to decide any issue if the parties cannot agree.

⁸ ICSID Convention, Article 43: “*Except as the parties otherwise agree, the Tribunal may, if it deems it necessary at any stage of the proceedings, (a) call upon the parties to produce documents or other evidence, and (b) visit the scene connected with the dispute, and conduct such inquiries there as it may deem appropriate.*” This reflected by Rule 34 of the ICSID Arbitration Rules, which extends the tribunals’ procedural powers to request experts and witnesses.

⁹ *Glamis Gold Ltd v United States*, UNCITRAL (Decision on the Parties’ Requests for Production of Documents) 17 November 2005, at paragraph 20.

¹⁰ *International Thunderbird Gaming Corp. v. Mexico*, UNCITRAL (Procedural Order No. 2 of July 31, 2003).

¹¹ It is always open to the parties to include a disclosure obligation and a defined procedure for the exchange of documents in the arbitration clause in the relevant contract if they prefer certainty over leaving the matter in the discretion of the arbitrator. The arbitrator will be bound by any procedural agreement set out in the arbitration agreement. However, such sophistication or foresight in the drafting of arbitration agreements remains rare.

reasonable request would be one aimed at documents relate to a specific issue, or a fact that has been asserted, and should relate to specific documents that are likely to exist and be within the control of the opponent.¹² In the words of one tribunal, a request was granted since it was aimed at¹³:

“specifically identified, narrow category of documents that are of obvious potential relevance and materiality to the issues in dispute”

An arbitrator’s view of what is reasonable may still be coloured by his or her own personal background and experience. A US-trained arbitrator may not find a request for general

for instance, in English Court proceedings. Some civil lawyers frown upon officers or employees of a company giving evidence on behalf of that party at all: such testimony is considered inherently biased, and impermissible in certain civil law jurisdictions. Depositions, commonly and extensively used in US litigation to interview and test potential witnesses before the main evidentiary hearing, are not common in international arbitrations outside the US. Contemporaneous documents tend to be the most important evidence in international arbitrations.

So if the arbitrator refuses to give you the right contemporaneous documents, where else can a disappointed party go? The answer might be the Courts in the US.

An English lawyer may see such a request as tantamount to a fishing expedition

categories of documents (which may or may not exist, but which (if they do) might relate to the subject matter of the claim), objectionable: “conjectural” documents are routinely requested in US litigation. An English lawyer may see such a request as tantamount to a fishing expedition. English law has abandoned any notion that documents that could only lead to a ‘train of enquiry’ (which would, in turn, lead to a new argument or exposing a different kind of document that might be relevant) must be given to the opponent.¹⁴ Such differences in approach do, occasionally, clash and will need to be resolved by the tribunal.¹⁵

In addition to documentary evidence, witnesses of fact may of course also be relied on. However, witness evidence is not always as important a feature in international arbitration as it is,

Discovery in the US in Aid of Foreign Proceedings – Section 1782

As noted above, the discovery obligation in US Court proceedings is considered to be amongst the widest in the common law world. The Federal Rules of Procedure in principle allow discovery of:

“Relevant information [which] need not be admissible at the trial if the discovery appears reasonably calculated to lead to the discovery of admissible evidence...”¹⁶

This is reminiscent of the old ‘train of enquiry’ test in English law.

US legislation has extended the power of the US Courts to order discovery, making it available in support of judicial proceedings that take place abroad. 28 U.S.C. § 1782 (or “Section 1782”) allows a party to proceedings outside of the US

¹² It may be that the claimant asserts an oral agreement was reached at a meeting. Are there any formal minutes of that meeting? Were notes taken during the meeting? Did those who attended report the outcome of the meeting by internal email afterwards? It is only fair that those documents should be made available to an opponent who should be entitled to test the assertion.

¹³ *Biwater Gauff (Tanzania) Ltd v Tanzania*, ICSID ARB/05/22 (Procedural Order No. 1 of March 31, 2006), paragraph 104.

¹⁴ As previously under the rule in *Compagnie Financiere du Pacifique v. Peruvian Guano Company (1882)* 11 QBD 55. Brett LJ had expressed the old test as follows:

“It seems to me that every document relates to the matters in question in the action, which not only would be evidence upon any issue, but also which, it is reasonable to suppose, contains information which may - not which must - either directly or indirectly enable the party ... either to advance his own case or to damage the case of his adversary. I have put in the words “either directly or indirectly”, because, as it seems to me, a document can properly be said to contain information which may enable the party ... either to advance his own case or to damage the case of his adversary, if it is a document which may fairly lead him to a train of inquiry which may have either of these two consequences...”

¹⁵ In an ICC arbitration in which the writer was involved, counsel for the parties had a very different approach to disclosure. The claimant insisted on specific requests for identified documents that could reasonably be supposed to exist and be under the control of the claimant. The respondent made in excess of 50 requests for broad categories of documents, seeking to push the burden of reviewing and identifying actual documents that would fit the categories onto the claimant. The respondent argued that the equivalent of the English Civil Procedure Rules for High Court litigation be applied in the arbitration. Many international arbitrators would be very slow to adopt that approach. This particular arbitrator, although he had previously been an English judge, did not accept the respondent’s argument. However, there was some uncertainty until the tribunal had firmly grasped and ruled on the issue.

¹⁶ See FRP, Rule 26(b)(1) – *Discovery Scope and Limits*. In addition to documents, discovery extends to oral depositions “... of any person ... without leave of the court” – see FRP Rule 30(a)(1) – a freedom that is only subject to a limited number of exceptions.

to ask a US Federal or District Court to compel anyone who is within that US Court's jurisdiction to provide discovery (either by the production of documents or through depositions).¹⁷ The relevant Federal or District Court has discretion as to whether to grant a request for discovery, which is to be for use in the foreign proceedings, and will apply the FRP when considering whether to do so.¹⁸

The public policy behind Section 1782 has been described as giving the 'benefit' of US discovery to those engaged in proceedings abroad, thereby encouraging other jurisdictions to provide the same kind of assistance to the US Courts and those litigating before them (reciprocity).¹⁹ Whether one sees Section

Section 1782,²³ noting that:

"We are confident that a significant congressional expansion of American judicial assistance to international arbitral panels created exclusively by private parties would not have been lightly undertaken by Congress without at least a mention of this legislative intention."

However, some lower US Courts have made Section 1782 available to private international arbitrations: that was the conclusion reached by the Georgia District Court in *In re Roz Trading Ltd*,²⁴ relying on the Supreme Court in *Intel*. In *Roz*

The public policy behind Section 1782 has been described as giving the 'benefit' of US discovery to those engaged in proceedings abroad, thereby encouraging other jurisdictions to provide the same kind of assistance to the US Courts and those litigating before them.

1782 as conferring a real benefit, or as the unwanted, extra-territorial application of a peculiar US concept depends on one's view of US-style discovery.

In 2004, the US Supreme Court considered the scope and application of Section 1782.²⁰ This arose out of AMD's attempts to get discovery in the US from Intel, which could then be used by AMD in connection with a competition complaint that AMD had made against Intel before the European Commission (and in any subsequent determination by the Commission of whether there had been an infringement by Intel).²¹ The Supreme Court held that Section 1782 was available in principle, rejecting the argument that a mere complaint made to the Commission was not sufficient to constitute "proceedings" for the purpose of Section 1782.²²

Before the decision in *Intel*, two US Courts of Appeal had ruled that private arbitration proceedings were outside the scope of

Trading, the District Court found that the Section 1782 jurisdiction extended to an arbitration before a tribunal sitting in Vienna (the International Arbitral Centre of the Austrian Federal Economic Chamber). The District Court relied on passages in *Intel* suggesting that an arbitral tribunal was simply a "tribunal" within the meaning of the word in Section 1782 (although the Supreme Court did not decide that particular point).

The District Court noted that the Vienna Arbitration Centre was "fundamentally international in nature" (1229) and that it therefore could "rely on the aid of courts beyond its jurisdiction – such as United States District Courts acting pursuant to [Section 1782] – to enforce its demands and to aid its inquiries, both within and without Austria". While, it is suggested, judicial support by the national courts in aid of international arbitration tribunals is to be welcomed, the District Court appears to have assumed that discovery would always (by its nature) be an appropriate form of judicial assistance.²⁵ The decision has attracted some criticism, especially since the party requesting documents could have sought to request these before the Vienna arbitrators first (which was not done). Though the documents may have been held by a parent company of the

¹⁷ Section 1782 refers to discovery taking place before a person appointed by the Court, so it anticipates a degree of judicial oversight over the process.

¹⁸ See *Bayer AG v Betachem, Inc.*, 173 F.3d 188, 191 (3d Cir. 1999).

¹⁹ See for instance *Lancaster Factoring Co. v Mangone*, 90 F.3d 38, 41 (2d Cir. 1996)

²⁰ *Intel Corp. v. Advanced Micro Devices, Inc.* 542 U.S. 241 (2004)

²¹ The "DG" (Direction-Generale) of the Commission that is responsible for competition receives complaints and carries out preliminary investigations. Decisions made by the Commission may be subject to review by the Court of First Instance of the European Court of Justice.

²² The *Intel* decision was a case of construing the terms of a US statute. In deciding that the definition of a "tribunal" under Section 1782 was broader than Court proceedings, the Supreme Court considered the legislative history of the provision and noted that Congress had deleted the phrase "in any judicial proceeding pending in any court in a foreign country", replacing it with "in a proceeding in a foreign or international tribunal" (see 542 US, 248-249).

²³ *National Broad. Co. v. Bear Stearns & Co.*, 165 F.3d 184, 191 (2d Cir. 1999); *Republic of Kazakhstan v. Biedermann International*, 168 F.3d 880, 883 (5th Cir. 1999).

²⁴ 469 F. Supp. 2d 1221, 1228 (ND Ga 2006).

²⁵ There is no requirement of "foreign disclosability" under Section 1782: a District Court is not prevented from ordering discovery when the materials requested would not be discoverable under the (procedural) law of the foreign proceedings: see *Intel*, 542 U.S. at 260-61.

subsidiary that was a party to the arbitration, a failure by the parent to hand over documents that were reasonably requested to the subsidiary for use in the proceedings would have led to the arbitrator's drawing adverse inferences against a group company - something the parent company would want to avoid.

Section 1782 and Investment Treaty Arbitrations

While the question whether Section 1782 applies to private arbitrations may not be conclusively settled, there are a number of decisions by the US Courts to the effect that tribunals set up under investment treaties are within the ambit of the section. These decisions also illustrate further how Section 1782 can, and

2010, Chevron used Section 1782 to obtain a subpoena for a considerable amount of unreleased documentary footage from the District Court for the Southern District of New York.²⁷ Chevron's aim was to use this footage to assist with an UNCITRAL claim that it had brought against Ecuador under an investment treaty. The relevant footage had been shot by documentary filmmakers following US and Ecuadorian counsel who acted for the native claimants in a claim before the courts of Ecuador seeking US\$20 billion for environmental damage and pollution to the Lago Agrio region. Chevron hoped that the footage would show collusion or inappropriate dealings between the judge, the court expert, representatives of the Ecuadorian government and the claimants and their adviser. Chevron intended to use this material both in Ecuador, and in

Though the documents may have been held by a parent company of the subsidiary that was a party to the arbitration, a failure by the parent to hand over documents that were reasonably requested to the subsidiary for use in the proceedings would have led to the arbitrator's drawing adverse inferences against a group company

cannot, be used.

The first decision is that in the *Oxus Gold* case. Oxus Gold, an international mining company based in the United Kingdom had secured an license from the Kyrgyz Republic allowing Oxus to develop a gold deposit, as a joint venture with the State. The license was then unilaterally revoked by the Kyrgyz authorities, which led Oxus Gold to commence an UNCITRAL arbitration under the United Kingdom - Kyrgyz BIT. Some time into the proceedings Oxus decided to seek documents and compel evidence from a Mr Barbanel, who was not a party to the arbitration. Mr Barbanel had little to do with New Jersey - although, while he was ordinarily resident in Moscow, he did rent a flat in New Jersey. On that basis, Oxus applied to the New Jersey District Court.

The District Court granted Oxus the order for discovery from Mr Barbanel, finding that he was sufficiently 'present' in New Jersey for the purpose of Section 1782, due to his rental property. As to the nature of the tribunal, the District Court held the UNCITRAL proceedings were a public international law arbitration, since the relevant BIT:

*"specifically mandates that disputes between nationals of the two countries would be resolved by arbitration governed by international law ... [and the UNCITRAL claim] is thus being conducted within a framework defined by two nations."*²⁶

The second case relates to a dispute with Ecuador. In May

the UNCITRAL proceedings.

The court for the Southern District of New York found that while Section 1782 did not permit discovery in relation to any commercial arbitration proceedings between purely private parties, it did apply to tribunals established under investment treaties. Applying the test for discovery under US procedural law, the application was granted. There currently rages a fully-fledged discovery battle, with motions being filed by both sides and with the documentary evidence being used by Chevron's attorneys.²⁸ Whatever may come of it, without the order by the New York this material would not have been available to Chevron as the ICSID tribunal would not have had the power to order discovery against a third party.

But merely applying under Section 1782 where the relevant arbitration is an ICSID or investment treaty tribunal does not guarantee success. Most recently, the District Court of Washington rejected an application on grounds that sound very sensible to conservative arbitration lawyers who are not enamoured of wide ranging discovery.²⁹

The claimant in the arbitration is Caratube, a company owned by a Mr Hourani, a US national. Caratube is presently pursuing Kazakhstan under the US-Kazakhstan bilateral investment

²⁶ *In re Oxus gold plc*, 2007 W: 1037387, at *5

²⁷ *In re Application of Chevron Corp.*, 2010 WL 1801625 (S.D.N.Y. May 6, 2010)

²⁸ For a summary, see <http://www.courthousenews.com/2010/08/05/29342.htm>.

²⁹ *In re Caratube Int'l Oil Co.*, 2010 U.S. Dist. LEXIS 81512 (D.D.C. Aug. 11, 2010)

treaty of 2008. The claim relates to Caratube's oil concessions in North-western Kazakhstan which were terminated, essentially due to misgivings following a family argument with political dimensions. Caratube's case is that it and its representatives were pursued and treated unfairly by Kazakh authorities due to a connection with Mr Rakhat Aliyev, the former son-in-law of President Nursultan Nazarbayev. Mr Aliyev's sister is married to Mr Hourani's brother. Caratube claims that as political tensions between Mr Aliyev and Mr Nazarbayev rose, so did its difficulties with the concessions. Ultimately expropriation followed at the hands of the Kazakh secret service who seized Caratube's assets following an enquiry.

Caratube asked the District Court to subpoena a number of US nationals who it suspected of acting as agents for Kazakhstan and Mr Nazarbayev. It did so without the consent of the tribunal in the ICSID arbitration, and shortly before the (limited) disclosure deadline in the arbitration. The Washington court saw this as a tactical manoeuvre:

"The evidence suggests that Caratube is using section 1782 in an attempt to circumvent the tribunal's control over the arbitration's procedures...."

Even assuming that the ICSID tribunal fell within Section 1782 ("proceeding in a foreign or international tribunal."), the District Court stressed that it did not have to grant the order simply because it had the power to do so - a discretionary approach. Little time was spent on the character and nature of the tribunal, with the District Court instead focussing on what it saw as the crucial question: what discovery or disclosure regime had the parties adopted? Here, the parties had opted for ICSID arbitration, so that applying the ICSID Rules were part of the "parties' bargained-for expectations concerning the arbitration process." The court reviewed the ICSID Rules on disclosure (as set out above) and the IBA Rules. The claimant investor had "side-stepped these guidelines" by forging ahead, which was a powerful reason for rejecting the petition.

Conclusion

The approach taken by the Washington District Court in the *Caratube* case is a welcome reminder (if one were needed) that the US courts will review Section 1782 applications critically, and has given opponents facing a tactical petition a new precedent to cite if they find themselves drawn into the US courts. Nonetheless, the fact that Section 1782 applies to ICSID tribunals in principle remains, and can lead to tactical applications. ☺

CASE ALERT

Discrimination in Arbitration Clauses



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The Court of Appeal has recently ruled that arbitrators are 'employees' for the purpose of a particular piece of legislation that prohibits discrimination on religious grounds - see *Nurdin Jivraj v Sadruddin Hashwani* [2010] EWCA Civ 712.

The arbitration clause that was before the Court of Appeal provided that:

"All arbitrators shall be respected members of the Ismaili community and holders of high office within the community."

The Court of Appeal concluded that arbitrators fell within the Employment Equality (Religion and Belief) Regulations 2003. These prohibit any discrimination on religious grounds when it comes to offering, or setting conditions for, employment. Regulation 2(3) defines "employment" as including employment under a contract of service or a contract personally to do any work. Regulation 7 allows an exception where a particular religion or belief is a 'genuine occupational requirement'.

The Court of Appeal considered whether being Ismaili was a genuine occupational requirement for the arbitrators. It held that this was not the case - the arbitrators were asked to decide the dispute under English law. They did not need to be Ismaili to do that.

It was suggested¹ (obiter) that, if the arbitration clause had asked the tribunal to act *ex aequo et bono* (decide based on principles of equity and good conscience), then perhaps only an Ismaili could have applied the moral principles and understanding of justice and fairness that are recognised within that particular community. Ismaili ethnicity might then have been a genuine occupational requirement.

The Court of Appeal also held that the arbitration clause could not be saved by severing the offending parts, and so the dispute had to go to court.

Both parties have sought permission to appeal to the Supreme Court. Pending a decision by the Supreme Court, *Jivraj*

¹ Paragraph 29 of the judgment.

has generated something of a furore in the arbitration community. It has been suggested that the Court of Appeal's reasoning means that arbitration clauses, or even institutional rules, which provide for a sole arbitrator or the chairman to be of a nationality other than that of the parties might be struck down under English law.

This is because the Race Relations Act 1976 uses the same definition of 'employment' as the Regulations. It imposes equivalent restrictions on discrimination as to 'race', which is defined to include 'nationality'. The Race Relations Act 1976 and the Employment Equality (Religion and Belief) Regulations are both due to be repealed from 1 October 2010 when the Equality Act 2010 comes into force. The 2010 Act consolidates UK discrimination legislation, and will continue to use the same definition of 'employment' as in the previous legislation. A restriction on the nationality of an arbitrator could, therefore, be a prohibited restriction, or discrimination in view of the very wide definition of 'employment' in the legislation.

However, restricting the nationality of arbitrators does not, it is suggested, have anything to do with discrimination of the kind the law should seek to eradicate. Rather, it reflects a concern by the parties to ensure that there cannot be the slightest chance of the appearance of bias. The identity of the arbitrator is of fundamental importance to the parties. The law allows them to require 'qualifications' of their chosen arbitrator (see for example Section 19 of the Arbitration Act 1996). This should extend to requiring a truly neutral third party, who could not possibly be seen to be affected by a national loyalty, preference or any other kind of bias.

The general consensus in international arbitrations is that a sole arbitrator or the chairman should not be of the same nationality as the parties (unless, of course, agreed otherwise between the parties). Both the ICC Rules (Art. 9.5) and the LCIA Rules (Art. 6.1) reflect this, and so does the ICSID Convention (ICSID Rules of Arbitration, Rule 1). This is consistent with the parties choosing international arbitration instead of having disputes decided by the national courts of the home state of one of the parties. The concern here is the lack of any appearance of bias (rather than actual bias), and (conversely) the appearance of complete neutrality and impartiality. Of course, to say that nationality always brings with it an ingrained desire to find for a compatriot would be a gross generalisation. Nonetheless, nationality restrictions in appointment rules have been part and parcel of international arbitrations for many years.

The question now is whether English law should go so far as to overturn accepted practice. It is hoped that it will not do so. The reason is this. Under both the Regulations and the

new Equality Act 2010, imposing a restriction (such as, arguably, a nationality requirement for arbitrators) is permissible if it reflects a genuine occupational requirement. This is at the heart of the issue. Impartiality and fairness are undoubtedly a genuine occupational requirement for arbitrators, enshrined in Section 33 of the Arbitration Act 1996. The parties should be free to require their own standard of impartiality. Section 1 of the Arbitration Act 1996 states that the object of arbitration is:

"... to secure the resolution of disputes by an impartial tribunal..."

and that:

"... the parties should be free to agree how their disputes are resolved, subject only to such safeguards as are necessary in the public interest."

In the context of international arbitration, much as in sports refereeing and in foreign relations between states, nationality is an accepted factor in choosing an impartial decision-maker. Although this may be a matter of perception over fact, in those specific areas, limitations as to the nationality of impartial referees, arbitrators or mediators do not carry with them any notions of being undesirable discrimination. To put it at its simplest, would we accept that the next World Cup game would be refereed by an experienced umpire with the nationality of one of the teams? Of course not. If the Supreme Court were to hold that nationality requirements for arbitrators are in breach of English law, then one would wish for Parliament to legislate for an exception.

We will produce an update if and when the Supreme Court decides the point. ☺

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