HFW DISPUTES DIGEST 2023

Welcome to the second annual Disputes Digest, in which we collate our 2023 global HFW LITIGATION and International Arbitration publications in one place.

This edition includes updates from across our Disputes arena, including England and Wales, BVI, AsiaPac, and the Middle East.

As one of the world's largest and most active disputes practices, litigation is in our DNA at HFW. We have specialist disputes lawyers in offices across the Americas, Europe, the Middle East, and AsiaPac, and have continued to ramp up growth across our Disputes network in 2023 with a series of senior hires. We are recognised in all of the major directories, by Chambers UK 2024 as a "leading global disputes firm" and by the Times Best Law Firms 2024 as one of the UK's top commercial disputes practices. This is backed up by independent data from the Lawyer's Litigation Tracker which shows that we have handled more commercial litigation in the English High Court than any other firm over the past eight years.

The firm is also one of the founding members and signatories of both the Greener Litigation Pledge and Greener Arbitration Campaign - legal industry initiatives to reduce the environmental impact of dispute resolution.

We hope you enjoy reading this Digest, please contact the authors (see the end of this publication), or your usual HFW contact, if you wish to discuss any of the articles.

HFW DISPUTES DIGEST 2023

HFW Litigation

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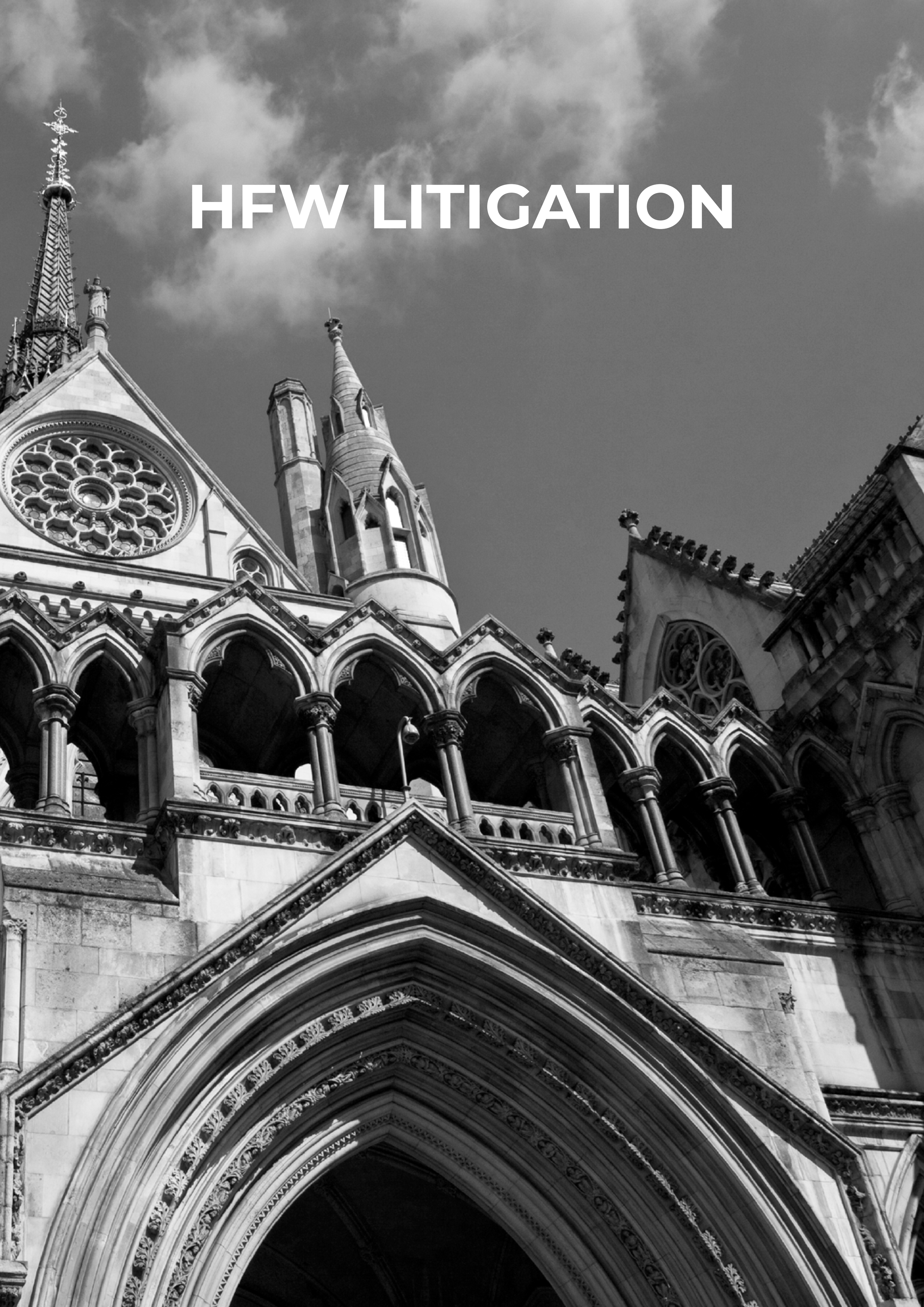

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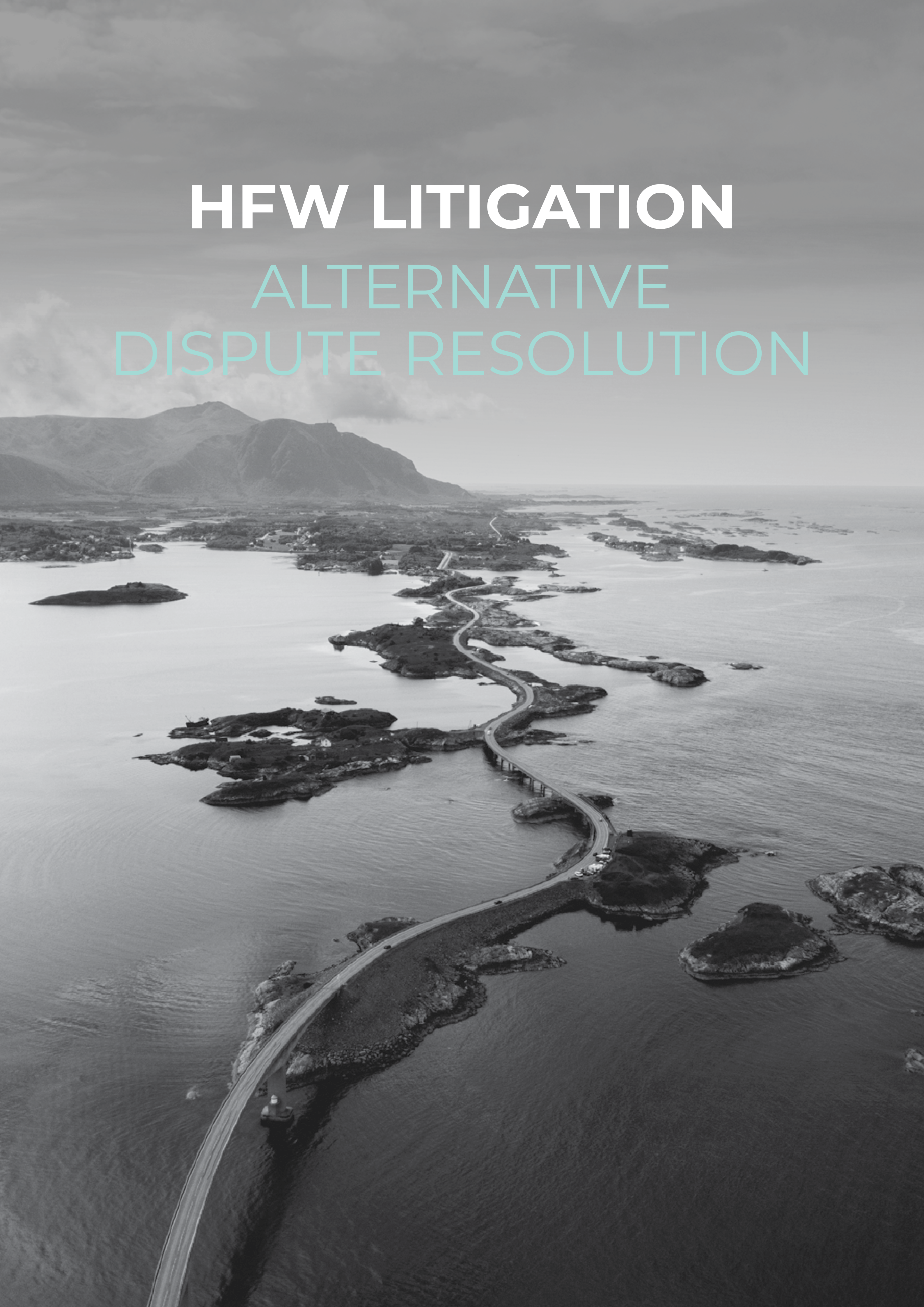
ALTERNATIVE DISPUTE RESOLUTION



COMMODITIES | DECEMBER 2023

ENGLISH COURT OF APPEAL DEPARTS FROM THE RULE IN *HALSEY* AND ENABLES THE COURTS TO ORDER ADR

On 29 November 2023, the Court of Appeal in a specially convened panel including the Master of the Rolls, Sir Geoffrey Vos, gave the most significant alternative dispute resolution (ADR) related judgment in the last 20 years.

In *Churchill v. Merthyr Tydfil County Borough Council* [2023] EWCA Civ 1416 (**Churchill**), it was held that the courts have authority to stay proceedings in favour of ADR or non-court-based dispute resolution methods, where it is proportionate to do so and where so doing preserves the essence of the parties' right to a judicial hearing.

Facts

Mr Churchill made a claim against the Council, which owned the adjoining land to his property, for damage caused by Japanese knotweed encroachment. Mr Churchill's solicitors sent a letter before action to the Council and the Council responded querying why Mr Churchill had not made use of its complaints procedure. Mr Churchill refused to engage in the non-court-based dispute resolution and proceeded to issue the claim. The Council subsequently applied for a stay of proceedings.

The stay application was initially dismissed by the court at first instance, where the judge held that he was required to follow Dyson LJ's comment in *Halsey v. Milton Keynes General NHS Trust* [2004] EWCA Civ 576, [2004] 1 WLR 3002 (**Halsey**), namely that "*to oblige truly unwilling parties to refer their disputes to mediation would be to impose an unacceptable obstruction on their right of access to the court*". However, the judge also held that Mr Churchill and his lawyers had acted unreasonably by failing to engage with the Council's complaints procedure, which was contrary to the relevant pre-action protocol. The Council was later granted permission to appeal on the ground that it raised an important point of principle and practice, which would impact many other similar cases, as evidenced by those allowed to participate as intervenors, including the Civil Mediation Council (CMC), the Centre for Effective Dispute Resolution (CEDR), and the Chartered Institute of Arbitrators (CIArb) The following issues were considered by the Court of Appeal:

1. Was the judge right to conclude that *Halsey* was binding and required the Council's application for a stay of the proceedings to be dismissed?
2. Can the courts lawfully stay proceedings for, or order, the parties to engage in a non-court-based dispute resolution process?
3. How should the courts decide whether to stay the proceedings, or order, the parties to engage in a non-court-based dispute resolution process?

Decision

Considering the issues above, the Court of Appeal concluded that:

1. Dyson LJ's comments that the courts could not order ADR were obiter (i.e. made in passing) and therefore not binding on other Court of Appeal judges or lower courts. Consequently, the court of first instance in *Churchill* was not required to follow the *Halsey* judgment in that regard.
2. The court has the power to lawfully stay the proceedings or to order the parties to engage in a non-court-based dispute resolution process provided that:

- it does not impair the claimant's rights to a fair trial (per Article 6 of the European Convention on Human Rights);
- is in pursuit of a legitimate aim; and
- is proportionate to achieving that legitimate aim.

3. The court considered that each case should be assessed on its merits rather than setting out principles on what will be relevant to determining the stay of proceedings or ordering the parties to engage in a non-court-based dispute resolution process.

What does this mean for litigants?

Churchill moves away from the longstanding Court of Appeal decision in *Halsey,* and continues the now well established judicial approach of placing emphasis on the "resolution" rather than the "dispute" in dispute resolution.

Whilst ADR offers various advantages and has emerged as a valuable and often preferred method for resolving disputes outside of traditional court proceedings, it is still necessary to explore whether it can entirely replace traditional dispute resolution mechanisms such as litigation.

The most common ADR methods include negotiation, mediation and arbitration. These approaches emphasise cooperation, flexibility, and efficiency, aiming to provide parties with more control over the resolution process. In particular, ADR processes often incur lower costs, offer quicker resolutions, allow parties to tailor the resolution process to meet their specific needs and prioritise communication and collaboration, fostering a more positive atmosphere.

However, ADR requires "two to tango" and is of little use if one party refuses to engage in the process. Often, parties end up in court because they cannot reach an agreement to resolve their dispute. Therefore, it is important to note that ADR decisions lack the same enforceability as court judgments. Also, from a wider legal point of view, ADR does not contribute to the development of legal precedent in the same way that court judgments do.

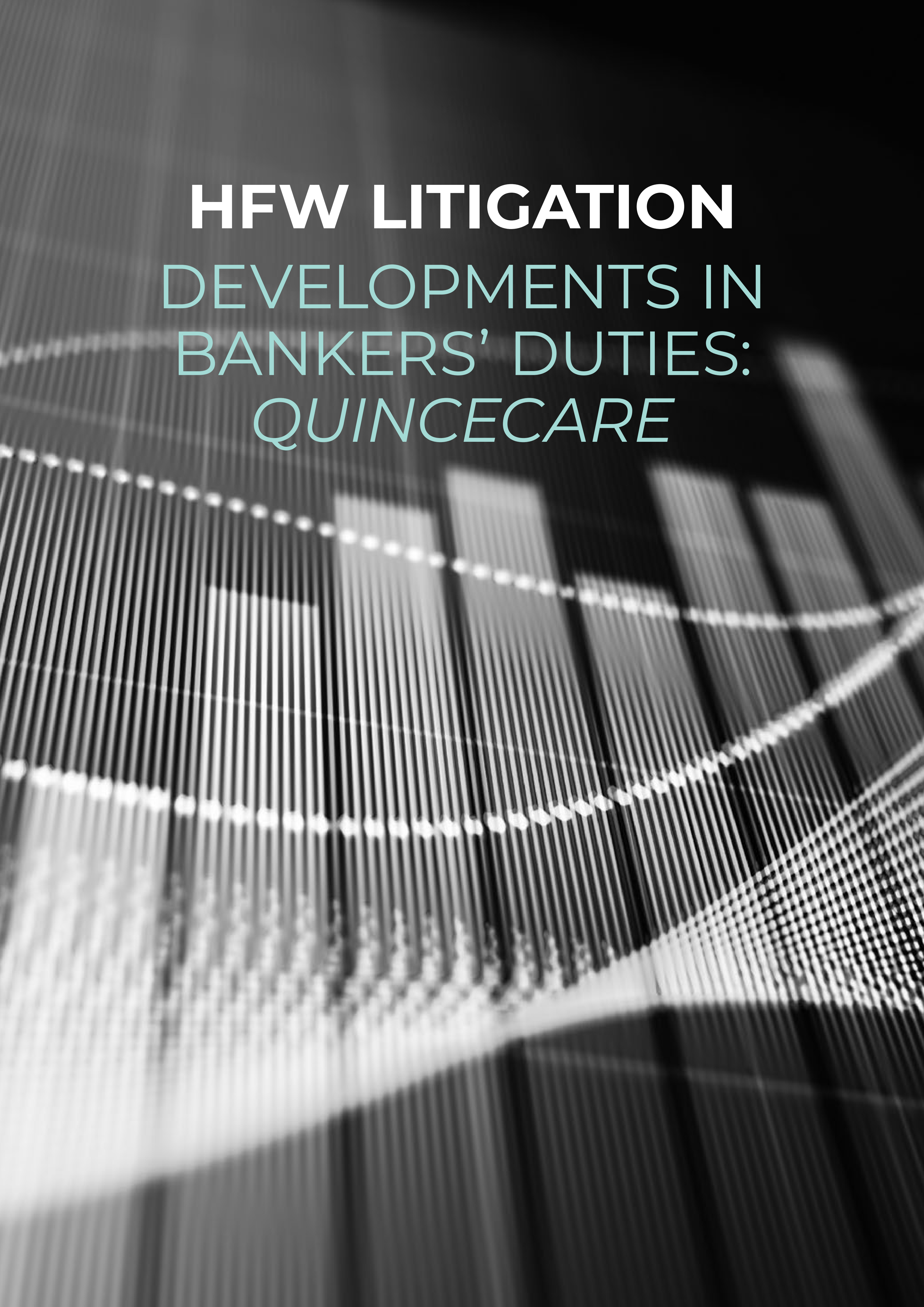
Whilst ADR offers significant benefits, it is unlikely to replace the traditional dispute resolution mechanisms entirely. The future of dispute resolution lies in the integration of ADR and traditional court-based methods, where they both play a vital role in delivering efficient, fair, and accessible justice.

For more information, please contact the author(s) of this alert.

ANDREW WILLIAMS
Partner, London
T +44 (0)20 7264 8364
E andrew.williams@hfw.com

NICOLA GARE
Knowledge Counsel, London
T +44 (0)20 7264 8158
E nicola.gare@hfw.com

KAREN IP
Trainee Solicitor, London
T +44 (0)20 7264 8822
E karen.ip@hfw.com.



HFW LITIGATION

DEVELOPMENTS IN BANKERS' DUTIES: *QUINCECARE*

HFW LITIGATION

HONG KONG | MARCH 2023

FRAUDULENT BANK TRANSACTIONS: HONG KONG COURT OF FINAL APPEAL EXAMINES CUSTOMER REMEDIES AND BANKERS' DUTY OF CARE

The Hong Kong Court of Final Appeal has handed down the appeal judgment in *PT Asuransi Tugu Pratama Indonesia Tbk*[1], a decision of significant interest to banks, financial institutions and their customers, which discusses the remedies available under Hong Kong law when unauthorised payments are discovered, including the nature and scope of bankers' duty of care, the availability of a claim for repayment of a debt, and limitation.

Background

This appeal arises from an action by the Appellant (**Tugu**), for whom Holman Fenwick Willan (**HFW**) acted throughout, seeking recovery of monies paid out of its bank account (the **Account**) maintained with the Respondent bank, Citibank N.A. (the **Bank**), on the dishonest instructions of two of Tugu's authorised signatories (the **Instructing Officers**).

The Account mandate provided that any two of Tugu's officers could give instructions in relation to the Account. Between 1994 and 1998, 26 payments totalling US$51.64 million, were made from the Account (the **Disputed Payments**) and paid into accounts held by four of Tugu's officers (the **Fraudulent Officers**). Although the Disputed Payments were all effected in accordance with the mandate, they had no apparent connection with Tugu's business. The Hong Kong Court of First Instance (**HKCFI**) found that the Account's sole purpose was to serve as a "*temporary repository of funds*" from Tugu's operating subsidiaries into the pockets of the Fraudulent Officers personally.

In July 1998, in compliance with written instructions received from the Instructing Officers, the Bank transferred the remaining balance in the Account to certain of the Fraudulent Officers' personal accounts and closed the Account.

On 6 October 2006, upon discovering the existence of the Account and the Disputed Payments, Tugu informed the Bank that the Disputed Payments were unauthorised transfers, and demanded payment of their aggregate amount. Payment was not made. In early 2007, Tugu therefore commenced proceedings against the Bank in Hong Kong seeking (amongst other things):

1. reconstitution of the Account and the reversal of the Disputed Payments (i.e. a debt claim); and / or

2. damages for breach of duty of care (i.e. breach of the so-called Quincecare duty).

Trial: The HKCFI held that the Bank breached its duty to Tugu. A pattern had emerged by the time the third transfer was instructed, a pattern which indicated impropriety in the operation of the Account, and the Bank ought to have carried out investigations. Tugu was therefore entitled to reconstitution of the Account by reversing all but the first two of the Disputed Payments. However, the Bank argued that the claim was statute-barred and the HKCFI agreed. The HKCFI held that the closure of the Account in 1998 was authorised and, because Tugu's cause of action arose upon closure of the Account, Tugu had failed to bring the claim within the applicable six-year limitation period[2].

Appeal: Tugu appealed. The Hong Kong Court of Appeal (**HKCA**) agreed with the HKCFI that a pattern had emerged and held that the Bank ought to have made the "*necessary inquiries*". However, the HKCA agreed with the HKCFI's finding that the claim was statute-barred, albeit on slightly different grounds. Although the HKCA disagreed with the HKCFI and held that the closure of the Account in 1998 was, in fact, unauthorised, the HKCA's view was that the closure of the Account amounted to repudiation of the banking contract, was effective in bringing the banker / customer relationship to an end and operated as a waiver of the need for a demand for payment of sums owed to

[1] *PT Asuransi Tugu Pratama Indonesia Tbk (formerly known as PT Tugu Pratama Indonesia) v Citibank N.A.* [2023] HKCFA 3 (***Tugu v Citibank***).
[2] Limitation Ordinance (Cap. 347).

Tugu. As such, the HKCA concluded that the six-year limitation period began in 1998 (upon the closure of the Account) and the claim was therefore statute-barred.

Final Court of Appeal: Leave was granted to appeal to the Hong Kong Court of Final Appeal (**HKCFA**) on two issues[3]:

"1. *In the context of a contract between banker and customer (debtor / creditor), if the banker invalidly terminates the contract, thereby evincing an intention no longer to be bound by the banker / customer relationship, whether the invalid termination (unless and until such termination being accepted by the customer as bringing the contract to an end) is of any relevance in identifying (for the purposes of the Limitation Ordinance) the date of accrual of the customer's cause of action to recover back the amount, which ought to be standing to its credit in its account, or any cause of action for damages for breach of the banker's Quincecare duty*[4].

2. *Whether a customer's claim to recover the balance which ought to be standing to his credit in his account with the banker, which account has been emptied by unauthorised payments, ought properly to sound in debt (to which contributory negligence is not a defence).*"

The first issue arose due to the Bank's limitation arguments regarding Tugu's failure to demand payment when the Account was closed in 1998. In short, this question amounts to whether, in circumstances where the termination of the banker / customer contract by the bank is invalid, the termination date is relevant to the question of limitation in respect of the customer's contractual claim for recovery of sums paid out of their account, or any claim for damages for breach of duty.

The second issue centres on whether customer claims for recovery of missing funds can be pleaded as straightforward debt claims, and, if so, the availability of a contributory negligence defence.

Given the circumstances of this case, and the alternative remedy sought (damages), the HKCFA also considered the laws of agency, ostensible authority and the Bank's duties. Lord Sumption delivered the unanimous decision of the HKCFA which, given the issues ventilated before the courts below, is an important Hong Kong law authority in respect of, amongst other things, bankers' Quincecare duty.

Debt Claim

The HKCFA held that Tugu's primary claim, a debt claim seeking payment of the reconstituted balance of the Account, was good in law and was not statue-barred.

Repudiation of the contract: The Bank argued that the banker / customer relationship came to an end when the Account was closed in 1998 and, therefore, the right to claim the balance of the Account as a debt had been extinguished and replaced by a right to claim damages for breach of contract. This proposition was rejected by the HKCFA:

- the closure of the Account, which was unauthorised, showed an intention on the part of the Bank to no longer be bound by its banking contract with Tugu. However, without Tugu's acceptance this was insufficient to bring the parties' contract to an end and it therefore followed that the banker / customer relationship had not been terminated; and
- in any event, there was no legal principle which entitled the Bank to unilaterally abrogate its liabilities or write off or otherwise discharge a debt without paying it. Tugu was entitled to insist in performance of the contract, namely the return of its monies held by the Bank, before the Bank could terminate the contract.

Given that the bank / customer relationship between Tugu and the Bank continued to subsist, and the unauthorised withdrawals were nullities, the Disputed Payments in the sum of US$51.64 million (being the outstanding balance on the Account) constituted a debt which was payable by the Bank on Tugu's demand.

Limitation: It is a settled principle of Hong Kong law that a cause of action in debt arises at the time of the customer's demand for payment which, in Tugu's case, was made in 2006, shortly before the claim was filed in 2007 and well within the applicable 6-year limitation period.

Contributory Negligence: At trial, the Bank also argued that Tugu was contributorily negligent. The HKCFI held (and the HKCA agreed) that Tugu's contributory fault should be assessed at 50%. Having concluded that Tugu's debt claim was not time-barred, the HKCFA considered the question of contributory negligence[5]. Having considered the relevant legislation and the decision of the English Court of Appeal in *Forsikringsaktieselskapet Vesta v Butcher*[6], the HKCFA held that Tugu's debt claim is not a claim arising out of "*damage*" as defined by the relevant Hong Kong (and English) legislation and interpreted by the courts. This is an unsurprising conclusion given that, in its debt claim, Tugu was not alleging any fault on the part of the Bank. Such debt claims simply proceed on the basis of the funds

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[3] *PT Asuransi v Citibank* at paragraph [12].

[4] Being the duty of case established in the decision of the English High Court in *Barclay Bank plc v Quincecare Ltd and another* [1992] 4 All ER 363 (***Quincecare*** and the **Quincecare duty**).

[5] Section 21 of the Law Amendment and Reform (Consolidation) Ordinance (Cap.23) sets out the position under Hong Kong law, which is identical to the equivalent English law provision in the Law Reform Contributory Negligence Act 1945.

[6] [1986] 2 All ER 488.

deposited with the bank and owed to the customer and, as such, a contributory negligence defence is not available to the defendant bank under Hong Kong law.

Breach of Bankers' Duty

The Quincecare duty, being the bank's duty of skill and care when executing its customer's instructions which arises in both contract and tort, is a familiar legal concept in common law jurisdictions.

However, it remains a hot topic because, from time to time, claimants seek to expand the scope of the duty in order to pursue recovery of lost sums and, in turn, banks seek to restrict the duty to defeat such claims. Further, novel circumstances arise which require the courts to examine the duty afresh (i.e. the advent of new technology and / or new banking practices).

We have published various briefings on this topic which can be found **here**. Our briefings of **March 2020** and **June 2022** set out the background and development of E&W law and, in relation to evolving banking technology, our **briefing** on the *Philips* decision discusses the approach taken by the English Court of Appeal in claims involving "*authorised push payments*" and fraud. The Quincecare duty has also been applied by the DIFC courts, as explained in this **briefing** by our Dubai team.

The HKCFA confirmed that the nature and scope of the Quincecare duty under Hong Kong law is as set out by Steyn J in the *Quincecare* decision (and other familiar E&W authorities[7]). In short, the standard of care is that owed by an agent, it includes the duty to exercise reasonable skill and care and applies to "*interpreting, ascertaining and acting in accordance with the instructions of a customer*".

On the question of what amounts to "*sufficient notice of a want of actual authority*" (e.g. fraud) and the circumstances in which a bank ought to make inquiries before paying out the customer's funds in accordance with its mandate, the HKCFA again referred to the leading English authorities[8] noting that:

> "*a banker must refrain from executing an order if and for as long as the banker is 'put on inquiry' in the sense that he has reasonable grounds (although not necessarily proof) for believing that the order is an attempt to misappropriate the funds of the company…*"

This test has been framed differently by certain judges[9] and this has, it seems, caused "*[a] certain amount of confusion*" as to the threshold for investigations being carried out by banks in order to meet their Quincecare duty. Helpfully, Lord Sumption clarified that the test is, in fact, the same in Hong Kong (notwithstanding the terminology used in *Akai No. 2*) and the test is, and remains, whether the bank could reasonably rely on the apparent authority of the customer's agent (e.g. a company director) given the bank's knowledge of the situation. The HKCFA also clarified that in Hong Kong, as is the case under English law, regard can be had to the "*commercial context and the exigencies of business*". As such, whether the bank ought to investigate before paying out customer funds will depend on the circumstances of each case.

Conclusion

The judgment in *Tugu v Citibank* provides welcome clarification of certain Hong Kong law remedies available to victims of fraud and to other parties, such as liquidators and trustees, who seek to recover misappropriated funds.

This decision also provides guidance to banks and financial institutions on the scope of their duty to customers, highlighting circumstances in which the bank ought to make appropriate investigations into whether a transaction is legitimate and discussing the extent of reasonable inquiries.

Given the availability of a straightforward debt claim, and the position on limitation and contributory negligence, banks and financial institutions should take steps to manage their risk by putting in place systems to flag and investigate potentially fraudulent transactions.

HFW acted for the claimant throughout these proceedings and have significant global expertise in this area[10]. Should you need further information or require specific advice our **Disputes** team would be delighted to assist.

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7 E.g. *Foley v Hill* (1848) 2 HLC 28; *Selangor United Rubber Estates Ltd v Cradock (No. 3)* [1968] 1 WLR 1555.

8 E.g. the Privy Council decision in *East Asia Co Ltd v PT Satria Tirtatama Energindo* [2020] 2 All ER 294; [2019] UKPC 30 (***East Asia***); *Lipkin Gorman v Karpnale Ltd* [1989] 1 WLR 1340; *Singularis Holdings Ltd (in liquidation) v Daiwa Capital Markets Europe* Ltd [2020] AC 1189.

9 The test formulated by Lord Neuberger in the HKCFA decision in *Thanakharn Kasikorn Thai Chamkat (Mahachon) v Akai Holdings Ltd (No. 2)* (2010) 13 HKCFAR 479 (***Akai No. 2***) referred to circumstances in which it would be "*irrational*" for the bank to make the instructed payment without inquiry, whereas the language traditionally used refers to the reasonableness of proceeding without investigating matters (see e.g. *Quincecare* and *East Asia*).

10 See our further briefings in this area: **Quincecare Duty: Privy Council Rules that Duty of Care is not Owed to Non-customers of a Bank**, May 2022 which discusses duties owed to third party victims of fraud and **English Commercial Court Gives Further Clarification of the Quincecare Duty**, June 2022 which discusses the standard of a "*reasonable and honest banker*".

For more information, please contact the authors of this alert

HENRY FUNG
Partner, Hong Kong
T +852 3983 7777 / +86 21 2080 1111
E henry.fung@hfw.com

PANSY WU
Senior Associate, Hong Kong
T +852 3983 7671
E pansy.wu@hfw.com

CATRIONA HUNTER
Professional Support Lawyer,
Hong Kong
T +852 3983 7675
E catriona.hunter@hfw.com

hfw.com

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THE UK SUPREME COURT'S DECISION ON THE QUINCECARE DUTY IS GOOD NEWS FOR BANKS, BUT THEY MAY NOT BE COMPLETELY IN THE CLEAR JUST YET

In this article we provide a review and analysis of the recent UK Supreme Court decision[1] in Philipp v Barclays Bank, which has upheld the appeal by Barclays Bank (the Bank) and overturned the Court of Appeal's judgment, finding that the Quincecare duty did not apply to individuals who are victims of authorised push payment (APP) fraud.

1. Philipp v Barclays Bank UK plc [2023] UKSC 25 (12 July 2023)

“The Supreme Court commented that any change to the law around APP fraud and banking regulation would be a question for the government and not the judiciary.”

What is the Quincecare duty?

The Quincecare duty dates back over 20 years' and was first established in the judgment in Barclays Bank plc v Quincecare Ltd[2] where the Commercial Court held that the relationship between a bank and its customer was that of an agent and principal with the result that fiduciary duties were owed to customers.

Of relevance to this case is the finding that the banks owed a duty of *“reasonable skill and care”* when executing the customer's instructions, and that this would be breached in a number of ways including if the bank carried out the customer's instructions when it had reasonable grounds for believing that fraud was involved.

Background

We set out the background to this matter in our March 2022 article[3], and so will only summarise the details here.

In 2018, Philipp and her husband were instructed by fraudsters posing as representatives of the Financial Conduct Authority (FCA) and the National Crime Agency (NCA) to move their money in order to protect it from fraud. Philipp moved GBP 700,000 from a savings account with the Bank she had with her husband by way of two transfers to bank accounts held in the United Arab Emirates (the Transfers).

Philipp alleged that no safeguarding questions, nor scam warnings, were asked or given at the time of the Transfers, which point the Bank contested. Philipp sued the Bank alleging it owed her a duty of care:

- in tort;
- implied into the contract with the Bank; and/or
- by statute under s13 of the Supply of Goods and Services Act 1982.

The High Court summarily dismissed the claim, finding that there was no causation as:

1. the Bank did not owe a Quincecare duty to Philipp, which it held only applied where instructions were given by an agent or third party, and did not extend to individual customers; and
2. even if the Bank did owe a Quincecare duty, Philipp was so deceived by the fraudsters that she would not have believed the Bank had it intervened.

On Appeal to the Court of Appeal

Philipp appealed to the Court of Appeal, who held in her favour, and set-aside the summary judgment dismissing the claim.

The Court of Appeal found that the line of reasoning in the authorities:

- was not dependent on whether the instruction was being given by an agent of the customer;
- was not confined to the circumstances of those cases; and
- could properly be applied on a wider basis.

The Court of Appeal was persuaded that, in principle, the duty of care could arise in cases such as this where the customer was the victim of APP fraud, and therefore the matter should be determined by a full trial and not by way of a summary procedure.

Supreme Court decision

The Bank obtained leave to appeal to the Supreme Court, who overturned the Court of Appeal's decision and re-instated the High Court's summary judgment in favour of the Bank.

The key points from the Supreme Court judgment are that:

1. under the Quincecare duty, a bank has a general duty of care to *“interpret, ascertain and act in accordance with its customer's instructions”* and not to question the wisdom of the instructions, or to make inquiries

2. [1992] 4 All E.R. 363
3. **003892-HFW-Quincecare-and-Philip-v-Barclays-March-2022.pdf**

of its customer; maintaining the first principle of banking[4];

2. the duty is varied and banks are required to make inquiries where the instructions are via a third party and the bank has reasonable grounds for believing that the instructions are an attempt to defraud the customer
3. the duty will not apply to victims of an APP fraud where, as in this case, the instructions are clear and either given by the customer direct or by an authorised agent, in which case the bank is not required to carry out inquiries and an attempt by the bank to do so may amount to a breach of its duty; and
4. the Bank had a right to decline to follow the instruction if it considered it connected to a fraud, but that this did not impose a duty not to do so.

The Supreme Court commented that any change to the law around APP fraud and banking regulation would be a question for the government and not the judiciary. In fact, the government has acted and introduced the Financial Services and Markets Act 2023, which was given Royal Assent on 29 June 2023 and is due to enter into law in 2024. The Act provides for a mandatory reimbursement scheme, but it does not however extend to international payments, and therefore would not have applied to this case.

The Supreme Court also ruled that Philipp is able to pursue an alternative claim based on the Bank's alleged failure to act promptly to try to recall the payments after the fraud was identified.

Comment

The Supreme Court placed emphasis on the contractual relationship between Philipp and the Bank, under which the primary obligation was for the Bank to follow its customer's instruction.

As mentioned, the Supreme Court granted Philipp permission to pursue her claim that the Bank did not act sufficiently promptly to recall the payments, which may mean that the Bank is liable - and also that in similar circumstances banks will need to be alive to the issue and act swiftly to recover the funds.

The judgment will be welcomed by the banks. However, it does still place a burden on banks to act as the first level of protection in relation to APP frauds.

We anticipate that questions surrounding the Quincecare duty will continue to arise and expect further cases to come before the English courts. We will report on further developments on this case and more generally in due course.

For further information please contact:

ANDREW WILLIAMS
Partner, London
T +44 (0)20 7264 8364
E andrew.williams@hfw.com

NICOLA GARE
Knowledge Counsel
(Dispute Resolution), London
T +44 (0)20 7264 8158
E nicola.gare@hfw.com

4. *Bodenham v Hoskins* (1852) 21 LJ Ch 864

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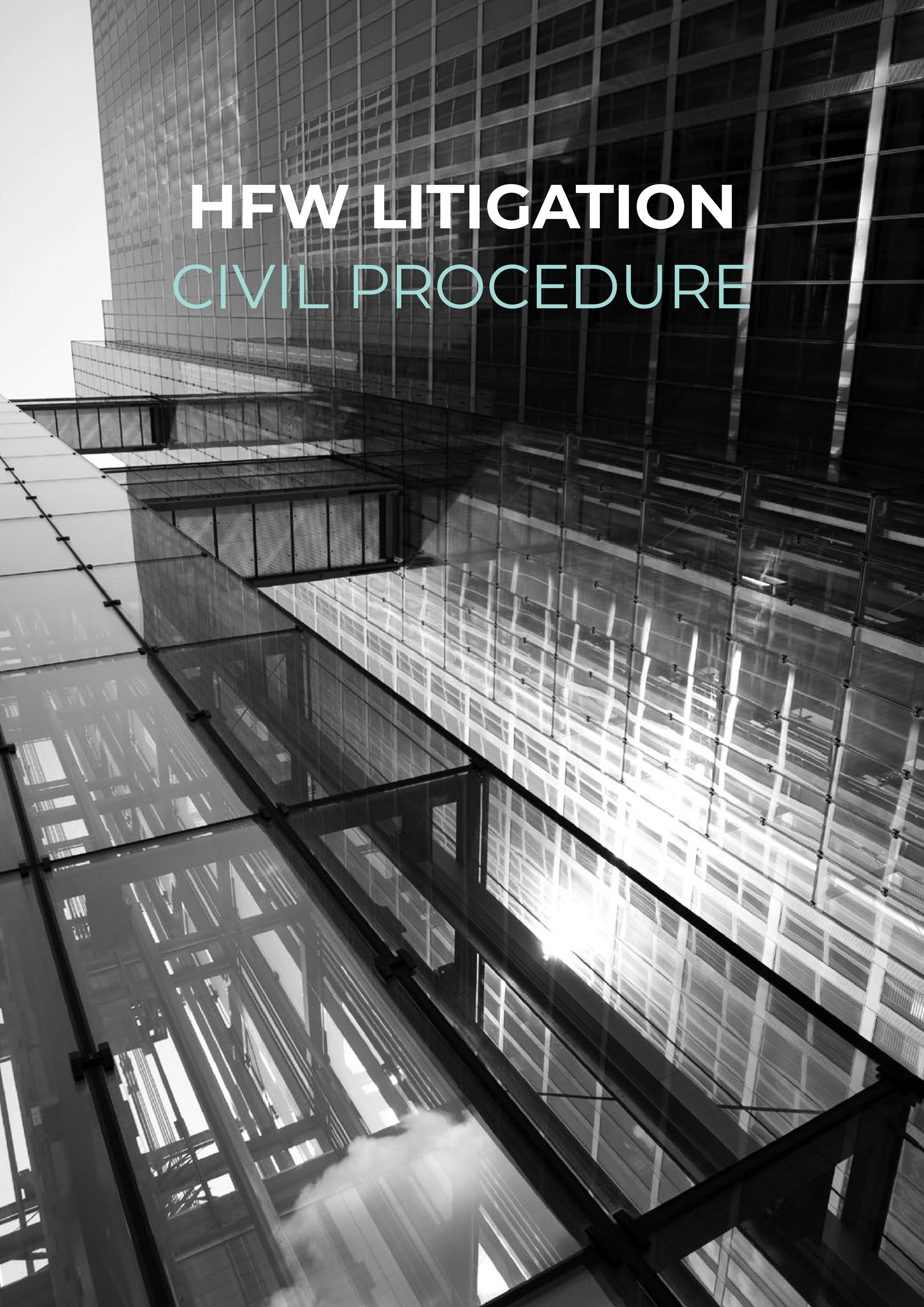

HFW LITIGATION

HFW LITIGATION | AUGUST 2023

BVI COURT PROCEDURE: A REVISED EDITION OF THE CPR COMES INTO FORCE

The 2023 revision to the Eastern Caribbean Supreme Court Civil Procedure Rules came into force on 31 July 2023. In this article we discuss the significance of the amendments and their impact upon BVI court procedure.

The Eastern Caribbean Supreme Court Civil Procedure Rules (**ECSC CPR**) were last revised in 2000. The introduction of this recent update (**Revised CPR**) is therefore a welcome development.

Common law court practice and procedure has moved on significantly since 2000 and technology has an increasing influence on court practice globally. For example, the BVI Commercial Court has used a sophisticated e-filing system since 2018, which, together with its willingness to hold hearings and trials by video conference, enabled the BVI courts to keep the wheels of justice turning during the recent global pandemic.

Familiar Concepts

The central tenet of the ESCS CPR remains unchanged: the "*overriding objective*" of the CPR requires the BVI Court to "*deal with cases justly*", which includes, amongst other things:

– ensuring *'equality of arms'*;

– saving expense;

– dealing with cases in a manner which is proportionate to the value and importance of the claim, the complexity of the issues involved and the parties' financial positions; and

– dealing with cases expeditiously.`

The overriding objective, and the quality of the Commercial bench in the BVI, means that parties litigating before the BVI Court can rest assured that their claims will be handled in a professional, expeditious and just manner.

The Amendments

The Revised CPR, which came into force on 31 July 2023 and applies to all new proceedings filed after that date, includes several significant amendments to BVI Court procedure, including:

– service of court process out of the BVI;

– judicial settlement conferences;

– default judgments;

– relief from sanctions;

– disclosure;

– translations;

– appeals; and

– costs;

all aimed at ensuring that BVI Court procedure is efficient, effective, fit for modern dispute resolution purposes[1] and appropriate for a court which regularly handles cross-border litigation, insolvency and restructuring.

We discuss these amendments in greater detail in forthcoming articles.

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[1] See, for example, the comments of the Honourable Chief Justice, Dame Janice M. Periera, DBE, LL.D in the *Eastern Caribbean Supreme Court Annual Report 2021 – 2022*, page 9.

Commentary

Given the extent of the amendments to the CPR, and the implications for parties who litigate before the BVI Court, it is now, more than ever, important to select knowledgeable and experienced BVI lawyers.

HFW has BVI lawyers across our global network all of whom specialise in complex, high value, cross-border litigation, insolvency, and restructuring.

Contact Us

This article provides a high-level overview of the introduction of the Revised CPR. Should you need further guidance please contact our BVI team or your usual HFW contact.

Authors

CATRIONA HUNTER
Knowledge Counsel, Asia
T +852 3983 7675
M +852 6385 4935
E catriona.hunter@hfw.com

NICOLA GARE
Knowledge Counsel, Disputes
T +44 (0)20 7264 8158
M +44 (0)7795 612270
E nicola.gare@hfw.com

Global BVI team contacts

SCOTT CRUIKSHANK
Partner, BVI
T +1 (284) 494 6864
M+1 (284) 340 4722
E scott.cruickshank@hfw.com

NOEL CAMPBELL
Partner, Hong Kong
T +852 3983 7757
M +852 6113 9280
E noel.campbell@hfw.com

RICK BROWN
Partner, London
T +44 (0)20 7264 8461
M +44 (0)7855 766 885
E rick.brown@hfw.com

KEVIN WARBURTON
Partner, Hong Kong
T +852 3983 7629
M +852 9728 3167
E kevin.warburton@hfw.com

HENRY FUNG
Partner, Hong Kong
T +852 3983 7777
M +852 9070 3383
E henry.fung@hfw.com

NICK BRAGANZA
Partner, Dubai
T +971 4 423 0587
M +971 52 923 3335
E nicholas.braganza@hfw.com

JAMES HENSON
Senior Associate, BVI
T +1 (284) 494 6864
M +1 (284) 340 5131
E james.henson@hfw.com

EDWARD BEELEY
Senior Associate, Hong Kong
T +852 3983 7737
M +852 5181 4956
E edward.beeley@hfw.com

THILO JAHN
Senior Associate, Shanghai
T +86 21 2080 1175
M +86 1350 188 1665
E thilo.jahn@hfw.com

DAVID CHALCRAFT
Senior Associate, London
T +44 (0)20 7264 8228
M +44 (0)7810 524851
E david.chalcraft@hfw.com

WHITNEY CHAN
Senior Associate, Hong Kong
T +852 3983 7763
M +852 5189 7624
E whitney.chan@hfw.com

HUGO COSTA LIZIARIO
Associate, BVI
T +1 (284) 494 6864
M +1 (284) 340 8286
E hugo.costaliziario@hfw.com

NEIL CHAUHAN
Associate, London
T +44 (0)20 7264 8376
M +44 (0)7557 052893
E neil.chauhan@hfw.com

JUSTINE PORTER
Registered Foreign Lawyer, Hong Kong
T +852 3983 7696
M +852 6627 0997
E justine.porter@hfw.com

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CRYPTOCURRENCY AND BLOCKCHAIN DISPUTES

GLOBAL REGULATION IS COMING TO STABLECOINS

WILL CENTRAL BANK DIGITAL CURRENCIES FOLLOW?

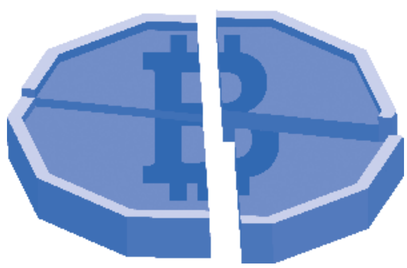
Authored by: Dan Perera (Partner) and Justine Barthe-Dejean (Senior Associate) - HFW Singapore

Amid recent signs that we may be slowly emerging from a two-year crypto winter, “stable” is a word which one would not easily attribute to the crypto markets. Indeed, high volatility has always been a hallmark of the space, with huge daily fluctuations in token prices commonly being driven by rapidly-changing and fickle public sentiment. Many tokens presently sit at over a 99% loss in value from their peak bull-run highs. Even some so-called ‘stablecoins’, which are intended to mirror the value of their underlying base fiat currency equivalent, have suffered from this volatility, with Terraform Labs’ algorithmic stablecoin, $USDT, spiralling to a collapse and losing 18bn in market capitalisation virtually overnight, caused partly by a rapid loss in public confidence. Other major stablecoins also suffered, with Circle’s cash-collateralised $UST depegging temporarily from its US dollar equivalent, amidst the freezing of deposits at Silicon Valley Bank in March this year, before eventually recovering.

The significant devaluation or collapse of supposedly “stable” crypto tokens has the potential to result in losses for retail and corporate investors; disputes; and insolvencies on an incredibly significant scale, as has been seen recently through the claims relating to Terraform Labs and FTX.

It is in this context which we now see a number of progressive jurisdictions globally seeking to regulate stablecoins within their jurisdictions. Partly, no doubt, to prevent incidents which may cause investors significant losses; but, most likely, with the ultimate goal of moving towards the adoption of Central Bank Digital Currencies (CBDC) – essentially, state-issued digital money on blockchain, permitting states to track the movement of money with full, granular-level, visibility, and in a manner which is simply impossible with traditional fiat alternatives such as cash and credit cards.

2023 has seen a number of jurisdictions moving to regulate the stablecoin space. Some of the most significant developments globally, by some of the first-moving jurisdictions to introduce regulations, are discussed below.



Japan

Japan has become known as one of the leading jurisdictions globally, when it comes to the regulation of stablecoins. Under revised regulations which came into effect in June 2023, through amendments to the Payment Services Act, the focus is on the value and security of the underlying assets backing the relevant stablecoin. These assets are now essentially required to be held on trust within the jurisdiction and in a limited range of forms. Holders of such regulated stablecoins have a right to redeem them to fiat at their face value.

Regulatory approval and licensing is necessary for issuers of stablecoins in Japan, which requires a significant level of scrutiny – to the point that this has not yet been achieved by any issuer – although major player Circle has made clear its intent to examine entering the market, potentially with a joint venture partner. It is anticipated that the first locally-licensed stablecoins will be seen in circulation within 2024.

Singapore

In August 2023, the Monetary Authority of Singapore (MAS) announced the introduction of a new framework for the regulation of stablecoins, following the conclusion of a public consultation which had been open since October 2022. The regulations apply to all stablecoins issued in Singapore which are pegged to the Singapore Dollar (SGD) or any of the fiat currencies issued by the G10 states.

The focus of the MAS appears to be ensuring that the underlying value of the relevant stablecoin remains equivalent to its intended fiat peg, through a range of rules relating to capital adequacy; regulation of the composition underlying assets backing the stablecoin; liquidity requirements; disclosure and audit obligations; and other protections, together aimed at avoiding value fluctuations and maintaining fiat pegs. A redemption to fiat option will exist for holders, and issuers can apply to the MAS for permission to use of the term: "MAS-regulated stablecoin", which can be bestowed upon those stablecoins issued in Singapore and which meet all relevant compliance criteria.

Licensing will also be a requirement for issuers who intend to have more than SGD $5m of tokens in circulation, and who are not banks licensed in the jurisdiction.

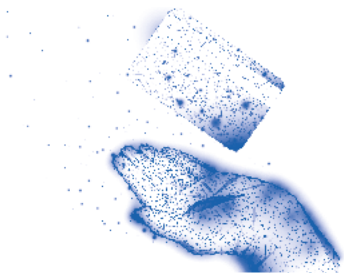
These new MAS regulations will sit alongside pre-existing requirements for the regulation of digital assets, including those aimed at avoiding money laundering and terrorist financing under the Payment Services Act 2019.

Dubai

In September 2023, the Virtual Asset Regulatory Authority (VARA) of Dubai took steps to add a virtual assets category to its comprehensive Virtual Assets Issuance Rulebook governing crypto activities and services within and provided to the jurisdiction (save for the Dubai International Finance Centre (DIFC), known as fiat-referenced virtual assets, (FRVAs), which are not themselves legal tender – i.e., stablecoins.

Dubai's new rules require, amongst other things, the Virtual Asset Service Provider (VASP) issuers of stablecoins to be licensed and authorised by VARA, and place ongoing reporting and disclosure obligations on the VASPs in relation to the number of FRVAs in circulation and their value, to be confirmed by independent audit.

The definition of FRVA is sufficiently narrow so as to exclude any United Arab Emirate Dirham (AED)-denominated stablecoin, and the regulation of such products – and any Central Bank Digital Currency, which remains within the purview of the Central Bank of the United Arab Emirates. In May this year, the Central Bank itself published guidance regarding the conduct of VASPs and Licensed Financial Institutions (LFIs) active in the jurisdiction.



United Kingdom

Most recently, we have seen the UK move towards the implementation of stablecoin compliance requirements, through the publication of discussion papers by the Bank of England and the Financial Conduct Authority who, between them, will regulate the industry.

While we await detail of the proposed regulations, which are not likely to be in place prior to 2025, these proposals follow the adoption by the European Union of the Markets in Crypto Assets regulation (MiCA), which itself takes on the role of regulating stablecoins, amongst other crypto assets. It is likely that the UK's eventual equivalent will seek to differentiate its own regulations from MiCA in a number of meaningful ways to offer it a competitive advantage against the bloc which it eventually split from in 2020.

Regulation a progressive step, and a means to an end?

While a number of jurisdictions have actively sought to move quickly to regulate the stablecoin space, other major jurisdictions remain slow to do so.

The USA, in particular, remains in a state of inertia as regulators compete against each other to establish their territory, whilst making licensing for crypto issuers largely a practical impossibility and instead taking action against them for the issuance of unregulated investment contracts.

The legal clarity which innovative jurisdictions bring to this area of law will give major players in the space the confidence they need to establish their presence in the relevant jurisdiction, and lead the development of the local market, to the detriment of other jurisdictions, which are riddled with regulatory infighting and inertia. Once stablecoins in those regulated markets become commonly adopted by the general public, the launch of a CBDC by the relevant authorities will not likely appear at all out of place.

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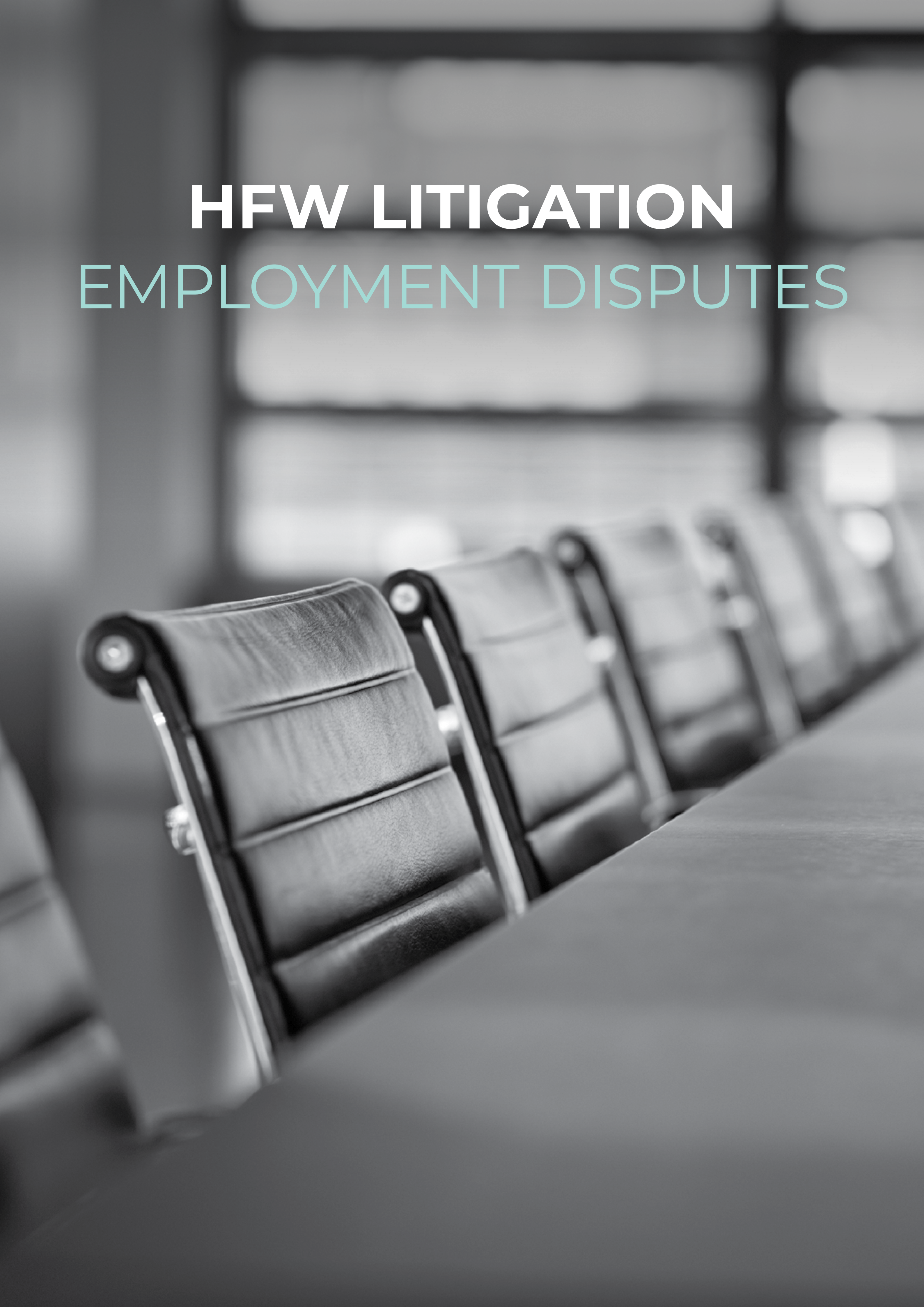
EMPLOYMENT DISPUTES



EMPLOYMENT | MAY 2023

LEGAL UPDATE: DIFC COURTS PROVIDE GUIDANCE ON FLY-IN, FLY-OUT EMPLOYEES

The DIFC Courts have provided useful guidance to DIFC companies, whose employees have DIFC employment contracts but are not ordinarily based in the UAE. The Courts have held that they may not be entitled to protections under the DIFC Employment Law, including penalty clauses.

On 12 May 2023, the DIFC Court of First Instance issued judgment in the case of *Musaab Tag Elsir Abdelsalam v Expresso Telecom Group Limited*. HFW was representing Expresso in this case.

The DIFC Court of First Instance dismissed all of the claims brought by the Claimant against his former employer Expresso for payments in respect of unused annual leave, flight tickets, end of service benefits and penalties for late payment.

Background

The Claimant brought claims under three fixed term contracts of employment running consecutively between 2008 and 2014. The Claimant made various claims under each of the contracts. The Claimant also sought penalties for late payment of his entitlements under all three agreements.

Claims were initially brought in the DIFC Courts in 2019 but through a series of procedural errors by the Claimant, the matter only came to trial earlier this year.

Expresso resisted the claims on a number of different grounds. It was Expresso's position that the claims under the first two agreement were time barred. Expresso further argued that the claims failed on the basis of an absence of entitlement on contractual and factual basis and upon matters of law.

Some claims failed because they were time-barred

The Court found that indeed the claims under the first two agreements were time barred.

The Court did not find that a series of fixed term contracts constituted one period of employment. The trial judge, Justice Sir Jeremy Cooke, noted as follows:

> "*A direct application of the statutory provisions applicable to claims under the 2005 Law and/or the 2012 Law necessarily results in any cause of action accruing prior to 21 March 2013 being barred by effluxion of time. The causes of action giving rise to claims under Agreements 1 and Agreement 2 accrued well before that time*."

The Court resisted attempts by the Claimant to rely on provisions of English law, and followed recent case law in confirming English law does not automatically apply in the DIFC Courts.[1] In relation to the Claimant's reliance upon the s.29-30 of the English Limitation Act (relating to acknowledgement of debt), he noted as follows:

> "*That is a statutory principle under English law which has no equivalent provision in any statute in the DIFC and it is not permissible to import into the statutory regime which is applicable in the DIFC a foreign provision of this nature*."

Claims failed because Claimant was not based in the DIFC

During the Claimant's employment under the third agreement. the Claimant was predominantly based outside of the UAE (residing in Sudan) and had in fact only spent about 5 weeks in the UAE in total.

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1 *The Industrial Group Ltd v Abdelazim El Shekh El Fadil Hamed* [2022] DIFC CA 005

Significantly, the Judge found that despite the agreement being expressly governed by the laws of the DIFC, this did not in and of itself result in the application of the 2005 Employment Law or the 2012 Employment Law.

He noted as follows:

> "*It is what happened on the ground which counts and that does not fall within Article 4 of the 2005 or 2012 Law*."

Penalty claims also rejected

The Court rejected the claims for penalties because of the existence of a dispute as to entitlement to any sums at all.

The Judge made a significant finding in relation to this. He found that since the Claimant's claim for penalties were not originally pleaded in the Claim Form and were only pleaded after the expiry of the 6-year limitation provision, the Claimant had lost the right to make a claim in respect of these.

Additionally, he held that when the 2019 Employment Law came into force, Article 1(4)(a) provided that a penalty pursuant to Article 19(2) "*will be waived*" by the Court in respect of any period during which "*a dispute is pending in the court regarding any amount due to the Employee under Article 19(1)*". As is made plain on the decision of the Court of Appeal in *The Industrial Group* case, the accrued rights to a penalty survives the new law coming into force, but thereafter there is no continuing right because of the terms of the 2019 Law.

All other claims were also dismissed.

Take-away points

Of course, the case should be very much considered on its facts and it is unlikely that there will be many more disputes on the application of the DIFC Employment Laws pre 2019.

Notwithstanding, employees and employers (with DIFC employment contracts) must take note that if they are not ordinarily based in the DIFC, then the DIFC Employment Law may not apply.

Further, fixed term contracts may be considered individually and even if they are consecutive, may not be determined to be a continuous period of employment under DIFC law.

The Judgment is available here. We await to see whether the case is referred to appeal.

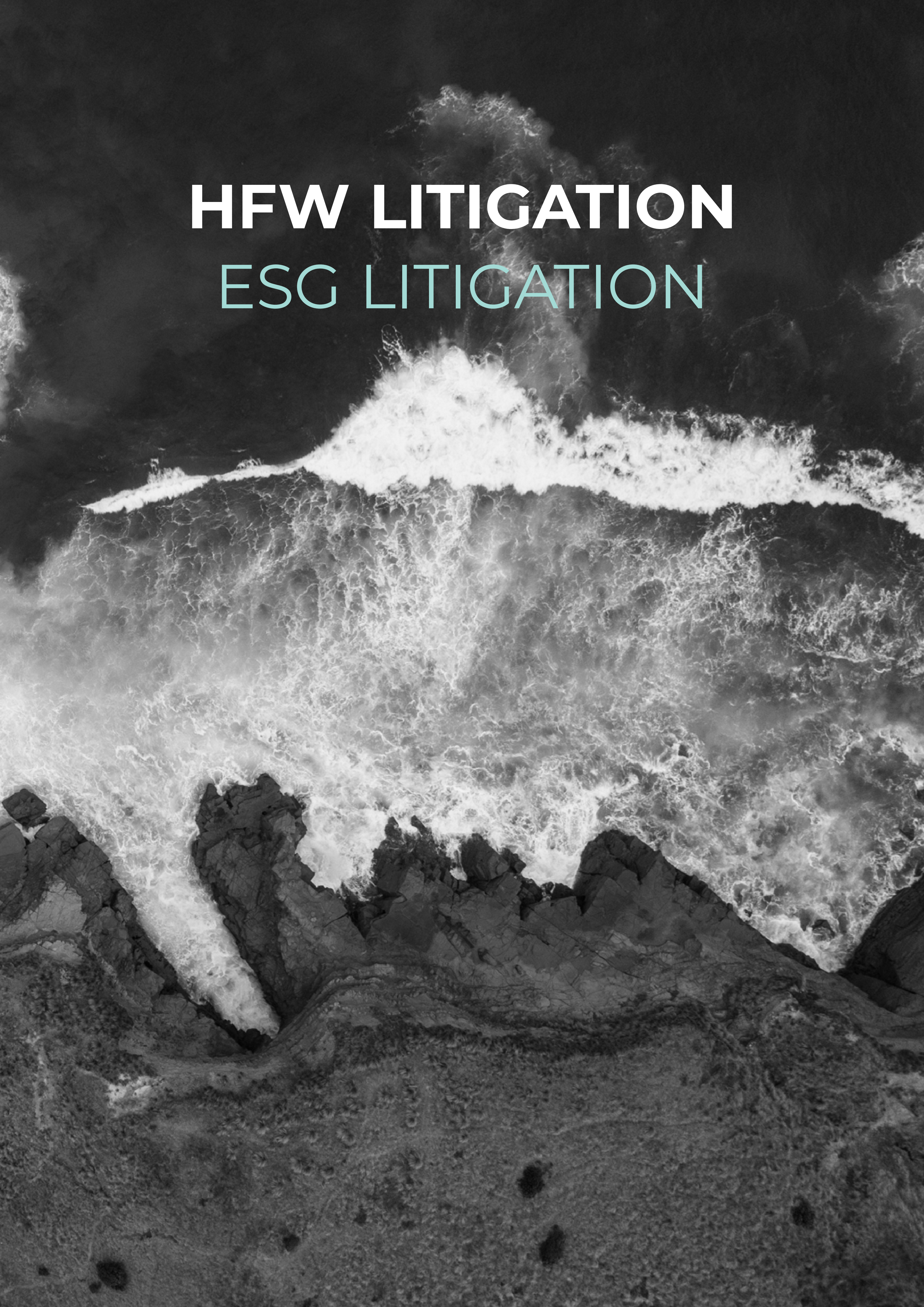
For more information, please contact the authors of this alert

NICK BRAGANZA
Partner, Dubai
T +971 4 423 0587
E nick.braganza@hfw.com

TANISHA SAXENA
Associate, Dubai
T +971 4 423 0582
E tanisha.saxena@hfw.com

HFW LITIGATION

ESG LITIGATION



RICK BROWN
PARTNER, LONDON

NEIL CHAUHAN
ASSOCIATE, LONDON

ESG LITIGATION AND CLIMATE RISK

COP 28 will reveal that participating governments do not yet have the levels of ambition needed to achieve the goals set out in the 2015 Paris Agreement (by which member countries agreed to limit the increase in global average temperatures to "*well below*" 2°C above the pre-industrial average, and ideally to 1.5°C). Accordingly, and in these circumstances, it is highly likely that the private sector will be called on to do better. And, to date, many private corporations have agreed, either voluntarily or otherwise, to make various climate-related pledges, including the pledge to achieve net-zero carbon emissions by 2050. However, as corporations make greater voluntary commitments, the risk of so-called "ESG litigation" increases. In this article, we therefore consider the impact of ESG litigation (with a focus on the Environment) and how corporations might seek to reduce the risk of climate-related claims.

The "E" in ESG Litigation

ESG litigation and, more particularly, climate change litigation, is still in its infancy. However, it is certainly gathering pace and has momentum. Companies, and directors, should therefore be aware of the risks they face and how they can reduce these risks. That is particularly so given that regulations in the UK and elsewhere are only likely to increase, widening the scope for potential breaches of those regulations. Furthermore, an increase in the availability of litigation funding for ESG claims and class actions is making it easier for claimants to bring such claims. Should this trend continue, this will likely lead to an increase in ESG litigation in the coming years.

The recent case of *ClientEarth v Shell*[1] is a good example of what we can expect. ClientEarth, an environmental law charity and a minority shareholder of Shell, brought a claim against the company's directors for breach of their duties under the UK Companies Act 2006. They alleged that the directors had failed to set appropriate targets or adopt a strategy sufficient to meet the company's goal of achieving net zero by 2050. Although the claim was rejected by the English court, the case is illustrative of the type of actions which companies and directors may face in the future.

In a less favourable 2021 decision for Shell, the Dutch courts held that Shell was under an obligation to cut its emissions and that the company's current climate policies were insufficient to achieve that result. The court ordered Shell to cut their global emissions by 45% by 2030.[2] Shell has appealed.

The risk from shareholder claims such as ClientEarth should not be underestimated, and the risk of ESG litigation for so-called 'hard to abate' sectors is also particularly acute. These are sectors for which clean alternatives are not technically or economically feasible. International shipping and aviation are prime among these, with Climate Action Tracker rating the policies and actions of these industries as "highly insufficient"[3] and "critically insufficient"[4] respectively.

Advertisements can also be a source of risk for businesses

Regulators, particularly the UK's Advertising Standards Agency ("ASA"), are increasingly focusing on so called "greenwashing" in publicity materials. Recent examples include the following:

- Ryanair's advert branding itself as "Europe's … Lowest Emissions Airline". This was based on the airline's young fleet, its use of fuel-efficient engines and high load factors to substantiate the claim. However, the ASA held that the data used to back up the advert was not sufficiently transparent and robust and prohibited the advert from appearing again.[5]
- HSBC's advert about its net zero financing goals. The advert promoted the bank's aim "to provide up to $1 trillion in financing and investment globally to help … [its] clients transition to net zero". The ASA ruled in 2021 that while this aim was contained in HSBC's annual report, that same report showed that it was financing emissions of at least 65 million tonnes of carbon dioxide a

year, and likely more. The overall message of the advert was therefore misleading, as the bank "*was continuing to significantly finance investments in businesses and industries that emitted notable levels of carbon dioxide*".[6]

- 4AIR LLC's paid-for Google Ad, in which it offered to provide "eco-friendly" and "sustainable" aviation advice and offered businesses the chance to "learn how to turn flying into a force for good." The ASA concluded that the claims were "likely to mislead businesses in relation to 4AIR's capability to ensure that aviation operations which purchased its services did not negatively impact the environment."[7] What is perhaps most interesting is that the advert was identified by the ASA through its recently launched Active Ad Monitoring System. The system, which uses AI technology to proactively search for online adverts that potentially break the rules, is currently processing more than 100,000 adverts a month.

Conclusions and Key Takeaways

COP 28 is likely to reveal a high level of global underperformance by governments. There will therefore be a call for greater action from the public sector. The magnifying glass will be on companies in all industries to ensure that proper ESG policies are in place and, where they are in place, are being adhered to. And whilst ESG litigation is still in its early stages, the likely rise in regulations will likely lead to a rapid increase in ESG litigation in the next few years.

Companies should therefore be careful to reduce their risk of climate-related claims from shareholders, investors, and others. We have set out below some the key steps companies can take to avoid this:

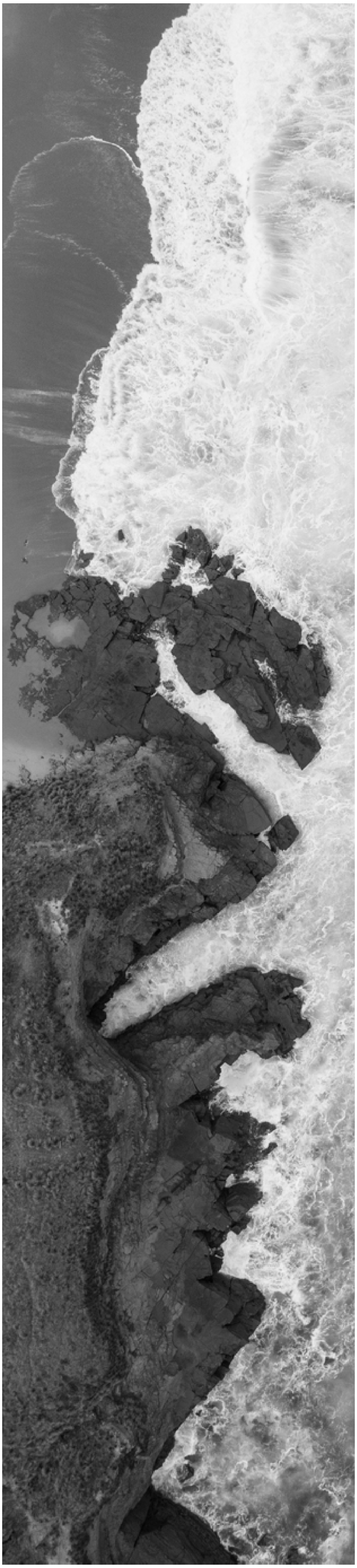
- Regularly monitoring and checking publications and products – ensuring that reports and products do not contain misstatements or false accreditations is key to guarding against potential 'greenwashing litigation'.
- Being joined up internationally - ensuring that subsidiaries or operations around the globe are saying the same things on the climate as in the UK, is a key method in ensuring consistency across the board and not being caught out.
- Taking advice - when making any claims about the environmental benefit of a new product, or a proposed course of action, consider first obtaining the advice of an expert as to whether these claims are verifiable. This is important to avoid accusations of 'greenwashing', which is increasingly attracting regulatory attention. Seeking expert scientific and legal advice can also provide strong protection for a director against a shareholder claim, such as that in *ClientEarth*.
- Full and timely compliance with new and emerging regulatory requirements – this will ensure that a company is fully aware of all potential risks in, for example, the supply chain and will allow a company to identify risk and take timely action to resolve it.
- Taking action - genuine and positive engagement on all matters related to ESG can demonstrate goodwill.

RICK BROWN
Partner, London
T +44 (0)20 7264 8461
E rick.brown@hfw.com

NEIL CHAUHAN
Associate, London
T +44 (0)20 7264 8376
E neil.chauhan@hfw.com

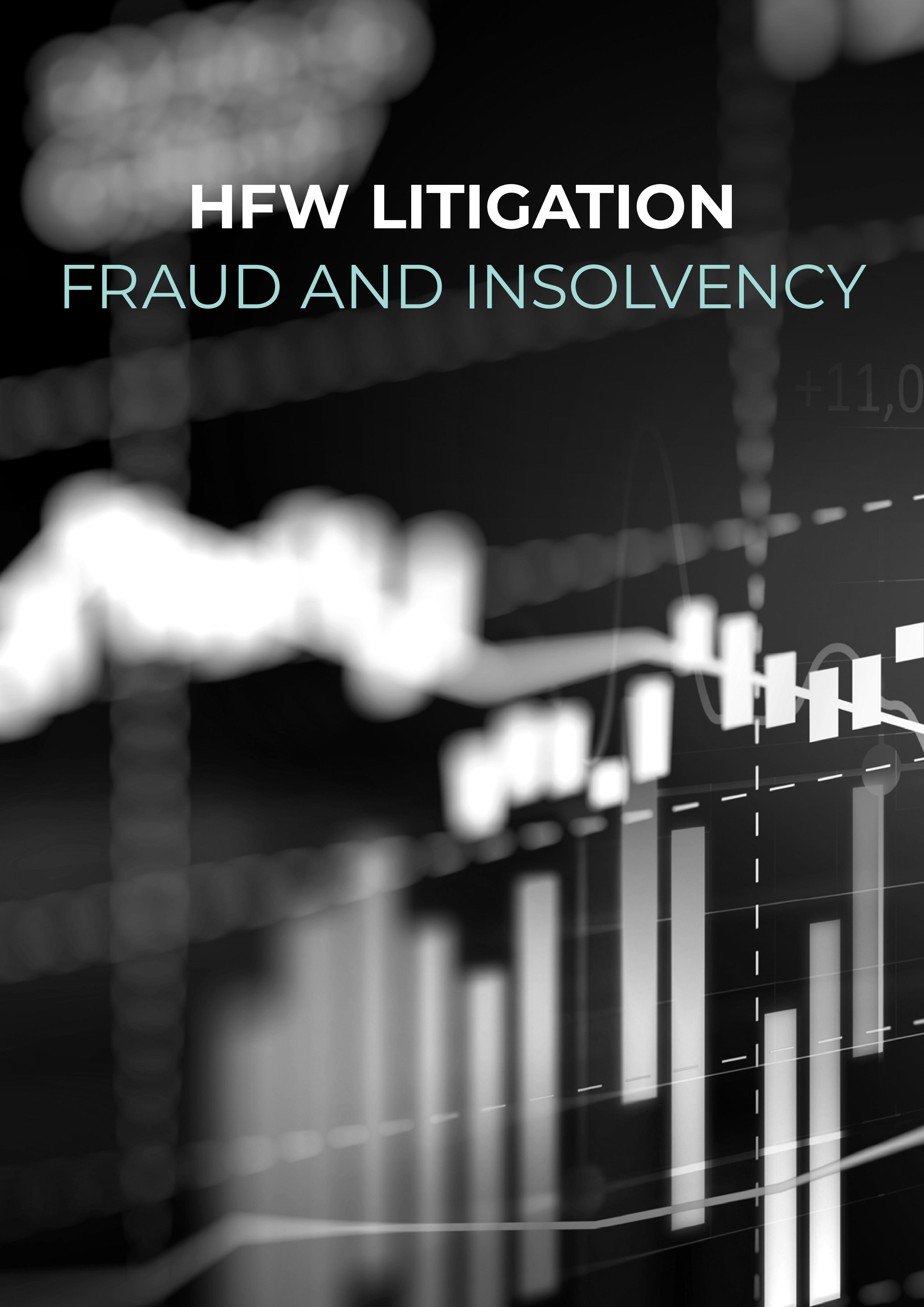
Footnotes:

1. [2023] EWHC 1897 (Ch)
2. Rechtbank Den Haag, C/09/571932, 26 May 2021
3. International Shipping | Climate Action Tracker
4. International Aviation | Climate Action Tracker
5. Ryanair Ltd - ASA | CAP
6. HSBC UK Bank plc - ASA | CAP
7. 20230830_21489_decision.pdf (climatecasechart.com)



HFW LITIGATION

FRAUD AND INSOLVENCY



DUTIES OWED BY DIRECTORS OF BVI COMPANIES IN LIQUIDATION

In *Greig William Alexander Mitchell & Ors v Sheikh Mohamed Bin Issa Al Jaber & Ors*[1] the English High Court considered whether the duties owed by directors of BVI companies persist after the company is placed in liquidation. This is the first reported decision on this question of BVI law and provides useful guidance to directors, shareholders and liquidators.

1 [2023] EWHC 364 (Ch)

"Given the narrow scope of the duty expressed by the English High Court, future litigants may seek to expand the scope of the duty before the BVI Court. How the BVI Court will approach such claims, given the differences between the BVI and English insolvency regimes, remains to be seen."

Summary

The English High Court (Court) found that directors of BVI companies do not owe any general duties to the company post-liquidation. However, where the director assumed stewardship of company property and retains (or continues to control) that property post-liquidation, they do so in a fiduciary capacity. If, instead of delivering the property to the liquidators, the director deals with the property, without authority, in a manner adverse to the liquation, they breach their fiduciary duty of stewardship and must account for the property as if they were a constructive trustee.

Background

Proceedings were brought by the liquidators (**Liquidators**) of a BVI company, MBI International & Partners Inc (in liquidation) (**Company**) against the Company's former directors (**Directors**), alleging breach of statutory and fiduciary duty, breach of trust and negligence in relation to certain pre- and post-liquidation transactions, in particular the transfer of shares in the Company's subsidiary (**Shares**) from the Company to another entity.

The claim was tried before the English High Court, pursuant to orders for recognition and assistance obtained by the BVI Liquidators, and the Court heard evidence from the parties' BVI law experts. Of particular significance was the fact that, unlike the position under English law[2], the Directors remained in office after the commencement of the liquidation, pursuant to section 175 of the BVI Insolvency Act 2003 (the **Act**).

The statutory position

Section 175(1)(b) of the Act provides that:

> *"with effect from the commencement of the liquidation of a company... its directors and other officers of the company remain in office, but they cease to have any powers, functions or duties other than those required or permitted under [Part VI of the Act[3]] or authorised by the liquidator".*

The Court noted that the duties "required or permitted" under Part VI of the Act were limited to:

(i) duties applicable in the context of an execution process; and

(ii) the duty to prepare and submit a statement of affairs;

(neither of which were relevant in this case) and that a liquidator's power to require a director to provide documents and attend for questions arises under Part XI of the Act (specifically, section 282).

The Liquidators' case: Directors' duties persist during liquidation

Notwithstanding the terms of the Act, the Liquidators contended that after the commencement of the liquidation the Directors continued to owe duties to the company, in their capacity as directors, on the following basis:

1. the general duties of directors under BVI law survive post-liquidation, relying on the recent English decision in *Re Systems Building Services Group Ltd (in Liquidation)*[4], in which ICC Judge Barber held that, in circumstances where a company had entered administration and the effect of the Insolvency Act 1986 was such that the commencement of the administration did not in and of itself operate to remove directors from office, the general duties of directors under sections 170-177 of the English Companies Act 2006 survive (the **Re Systems Building Services Argument**);
2. the Directors owed a fiduciary duty to the Company, alternatively each was a constructive trustee liable to account to the Company after the commencement of the Liquidation in respect of any property of the Company that remained in their hands or under their control, or under the control of a corporate entity that the director in question exercised control – the **"Fiduciary Duty/ Constructive Trust Argument"**); and
3. the Directors owed a duty to account to the Company for (i) their stewardship of the Company and its assets prior

2 Under English law, a director's appointment is automatically terminated upon compulsory liquidation (this does not apply to a creditor's voluntary liquidation – as explained in our article. https://www.hfw.com/High-Court-gives-guidance-on-duties-owed-by-Directors-Feb-20

3 (Part VI of the Act deals with 'Liquidation'.)

4 [2020] All ER (Comm) 565 (**Re Systems Building Services**).

to the commencement of the Liquidation; and (ii) their stewardship of any assets that remained in their hands or otherwise under their custody or control (the "**Duty to Account Argument**").

Decision of the English High Court

1. The Re Systems Building Services Argument

Having regard to the evidence of the parties' BVI law experts on the proper interpretation of section 175 of the Act, the Court held that the powers and duties of the directors of a BVI company cease upon the commencement of the company's liquidation, unless a director holds company property (see below).

Accordingly, the Court did not discuss the English law position at length, albeit Smith J. observed that the Court's reasoning in *Re Systems Building Services* included factors which would not apply to any analysis of the Act, given that the BVI and English insolvency regimes differ on this point.

2. The Fiduciary Duty/Constructive Trust Argument

The Court commented that it was very hard to see how a director's fiduciary duties could, ordinarily, persist during liquidation given that, pursuant to section 175 of the Act, BVI directors are automatically divested of their powers and duties upon the commencement of the liquidation.

However, the Court accepted that, where a director assumes stewardship of company's property and retains (or continues to control) that property post-liquidation, they do so in a fiduciary capacity. If the director then deals with the property, without authority, in a manner adverse to the liquation, they breach their fiduciary duty of stewardship and must account for the property, as if they were a constructive trustee.

The Court considered two further strands of English authority which support this analysis: the English courts have held that fiduciary duties were owed to companies by *de facto* directors:

(i) a shadow director who dealt with the assets of a company, acting as if he were a director[5]; and

(ii) a retired director who, after his retirement, exploits a business opportunity belonging to the company[6];

The Court commented that it was difficult to see why, if *de facto* directors owe such duties, a *de jure* director who deals adversely with company property after liquidation would not, similarly, owe a fiduciary duty to the company in relation to their dealings with its property.

The scope of this duty is limited, and the Court clarified that whether such a duty will arise will depend on the facts and circumstances of each case and, in particular, *"whether the directors were in possession or control of the property and whether the directors set up any beneficial rights to the property that were adverse to those of the [c]ompany"*[7].

Having found that one of the Directors owed a duty to account to the Company as constructive trustee of the Shares and that he had breached that duty by misappropriating the Shares, the Court ordered the Director to pay approximately €67million to the Company in equitable compensation.

3. The Duty to Account Argument

The Court rejected the Liquidators' arguments that there was: (i) any duty on a director under BVI law to disclose his own wrongdoing after commencement of the liquidation; and/or (ii) any wider, more general, duty of disclosure on a director post-liquidation.

Conclusion

The BVI is an overseas territory of the United Kingdom, its legal system is a common law system based on English law and practice and English authorities are persuasive before the BVI Court. It is therefore likely that this decision would be persuasive before the BVI Court (if it remains good law - see below).

Given the narrow scope of the duty expressed by the English High Court, future litigants may seek to expand the scope of the duty before the BVI Court. How the BVI Court will approach such claims, given the differences between the BVI and English insolvency regimes, remains to be seen.

We understand that the English Court of Appeal has granted permission to appeal and await the outcome of the appeal with great interest.

Should you need further guidance please get in touch with the authors of this briefing below, our wider BVI team overleaf or your usual HFW contact.

SCOTT CRUICKSHANK
Partner, BVI Office Head
Qualified in BVI and Scotland
T +1 (284) 494 6864
M +1 (284) 340 4722
E scott.cruickshank@hfw.com

JAMES HENSON
Senior Associate, BVI
Qualified in BVI, England & Wales, Hong Kong and South Africa
T +1 (284) 494 6864
M +852 6625 0582
E james.henson@hfw.com

CATRIONA HUNTER
Knowledge Counsel, Hong Kong
Qualified in BVI and Scotland
T +852 3983 7675
M +852 6385 4935
E catriona.hunter@hfw.com

5 (see *Vivendi SA v Richards* [2013] BCC 711.)

6 (see *CMS Dolphin Ltd v Simonet* [2001] 2 BCLC 704.)

7 Paragraph 397.

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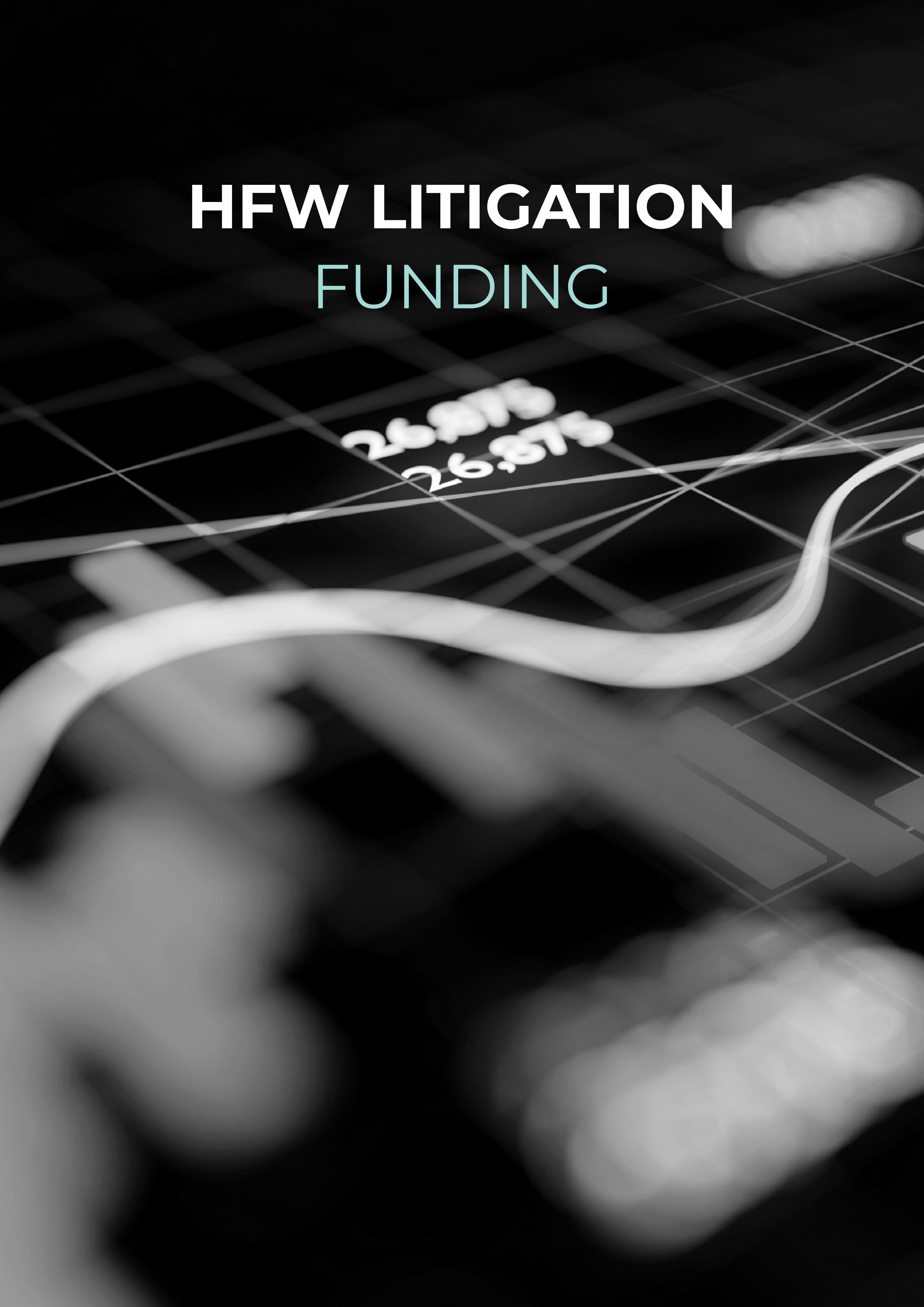
FUNDING



HFW LITIGATION

DECEMBER 2023

BEYOND PACCAR HOW SHOULD THE ENGLISH LITIGATION FUNDING INDUSTRY NOW PROCEED?

Introduction

The majority UK Supreme Court judgment in R *(on the application of PACCAR Inc and others) (Appellants) v Competition Appeal Tribunal and others (Respondents)* [2023] UKSC 28, 26 July 2023, (Paccar) has come as a surprise to many.

Until now, the litigation funding industry had assumed that Litigation Funding Agreements (**LFAs**) were not Damages Based Agreements (**DBAs**), and, therefore, were not impacted by legislation applicable to DBAs.

However, the Paccar judgment has reversed this common understanding, by concluding that LFAs entitling funders to payment based on the level of damages recovered are unenforceable: (i) if they are used to fund opt-out collective proceedings before the Competition Appeal Tribunal (**CAT**) (as to which see Section 47C(8) of the Competition Act 1998, which states that damages-based agreements are "unenforceable" to the extent they relate to "opt-out collective proceedings" before the CAT); or (ii) "***unless they comply with the DBA regulatory regime***" [**Emphasis added**].

What are Damages Based Agreements?

Section 58AA(4) of the Courts and Legal Services Act 1990 (**CLSA**) states that a DBA will be unenforceable unless it complies with the requirements of the Damages Based Agreements Regulations 2013 (**DBA Regs**).

Section 58AA(3) of the CLSA states that:

> "*(a) a damages-based agreement is an agreement between a person providing advocacy services, litigation services or claims management services and the recipient of those services which provides that—*
>
> *(ii)* *the recipient is to make a payment to the person providing the services if the recipient obtains a specified financial benefit in connection with the matter in relation to which the services are provided, and*
>
> *(ii)* ***the amount of that payment is to be determined by reference to the amount of the financial benefit obtained…***" [**Emphasis added**].

The CLSA refers to Section 419A of the Financial Services and Markets Act 2000 (FSMA) (which replaced Sections 4(2) and 4(3) of the Compensation Act 2006 (CA)) for the definition of a "*Claims Management Service*". This states that:

> "*Claims Management Services*" include "*advice or other services in relation to the making of a claim*"; and
>
> "*other services*" includes the provision of "*financial services or assistance*".

The Judgment

For a case that has already received significant 'airtime' it is notable how simple the conclusions reached in the judgment of Lord Sales are (affirmed by Lord Reed, Lord Leggatt and Lord Stephens, dissenting Lady Rose). There is a logic that suggests that Paccar should not be considered an error.

What was the question before the Supreme Court?

Paragraph 3 of the *Paccar* judgment states:

> *"The specific issue for determination is whether litigation funding agreements ("LFAs") pursuant to which the funder is entitled to recover a percentage of any damages recovered constitute "damages-based agreements" ("DBAs") within the meaning of the relevant statutory scheme of regulation ("the DBA issue"). This depends on whether litigation funding falls within an express definition of "claims management services" in the applicable legislation, which includes "the provision of financial services or assistance". If the*

LFAs at issue in these proceedings are DBAs within the meaning of the relevant legislation, they are unenforceable and unlawful since they did not comply with the formal requirements for such agreements."

Q: *Is litigation funding a Claims Management Service?*

A: *Yes.*

The judgment is primarily concerned with deciding whether litigation finance amounts to a "*claims management service*" within the meaning of Section 58AA(3) of the CLSA. Contrary to prior thinking in the industry, the Supreme Court found that litigation funders are offering financial services, and this is sufficient to make litigation funding a claims management service. Various reasons were given: (i) the language in the CLSA and Explanatory Memorandum to the CA are wide; and (ii) the phrase "*claims management service*" has no established meaning through which this issue must be interpreted, hence giving the Supreme Court a wide discretion.

Q: *What is the meaning of Sections 4(2) and 4(3) of the CA and could interpretation of this superseded legislation nonetheless inform the current question?*

A: *Yes.*

Section 4(1) provides that a person cannot provide *regulated* claims management services unless certain conditions are fulfilled.

Contrary to the findings of the Divisional Court, there was no reason to infer that Sections 4(2) and (3) of the CA were only intended to regulate "*claims intermediaries*". The scheme of the relevant Part of the CA was to regulate "*activities*", not persons of a particular description.

Therefore, in the eyes of the Supreme Court: (i) litigation funding is an activity regulated by the relevant legislation; and (ii) litigation funders are "*claims intermediaries*".

To the extent that any divergence of meaning exists between the CA and 58B of the CLSA, it was determined that the two items of legislation are to be interpreted together. This is because, at the time of enactment of the CA, Section 58B of the CLSA had ceased to be a "*comprehensive scheme of regulation*" for litigation funders.

Q: *Are Sections 4(2) and 4(3) of the CA superior to the CLSA and DBA Regulations?*

A: *Yes.*

The Supreme Court found that the CLSA and DBA Regs are subordinate to the CA because the latter is an Act of Parliament.

Q: *Does the Jackson Review or Association of Litigation Funders' Code of Conduct 2011 effect this interpretation?*

A: *No.*

The Jackson Review endorsed the use of third-party funding in England & Wales. However, in Paccar, the conclusion was that the Jackson Review did not assist with interpreting the relevant provisions of the CA. The majority opinion of the Supreme Court was that the Association of Litigation Funders' Code of Conduct 2011 was irrelevant as it was issued in line with the Jackson Review. In addition, the Supreme Court concluded that the prior assumption by the industry that LFAs could not be DBAs under the legislation was erroneous and irrelevant.

Q: *Are all Litigation Funding Agreements also Damages Based Agreements?*

A: *Probably not. Our opinion is that whether an LFA is a DBA will depend on its terms.*

If a LFA determines the payment to the funder "*by reference to the amount of the financial benefit obtained*" then that LFA is a DBA. By extension, that LFA / DBA must comply with all the procedural steps that are required for a DBA to be enforceable.

In our view, any LFA where the return is calculated based on a percentage of the damages or settlement is caught. Any LFA where the return is on a 'ratchet' calculated by reference to the quantum of damages is also likely to be considered a DBA.

The questions arise as to whether LFAs where the investors fees are calculated based on a multiple of the investment made but capped by reference to a percentage of the overall damages may also be caught by *Paccar*.

Paccar's Breadth of Impact

For litigation funders operating in the UK perhaps the most immediate thoughts will turn to: (i) whether Paccar applies to their business and disputes they have funded or might fund; and (ii) consider how their LFAs can comply with the DBA Regs in the future.

What is Paccar's jurisdictional scope of effect?

If the LFA is governed by the law of England & Wales and the dispute is before an English Court (or English seated arbitration) then we consider it clear and logical that Paccar will apply.

However, what if the governing law of the LFA is English law, but the dispute is before a court of another jurisdiction? What if the LFA is governed by non-English law but the dispute is before an English Court?

In a case before the English Courts, where the underlying contract is governed by a non-English governing law, the English Courts usually hear that case based on expert evidence of the foreign law. This may lead to a situation where the foreign law position on litigation funding is applied by the English Court. However, if the foreign law is silent on the matter, it may be that the English Court is left with no choice but to fall back on English law to determine the dispute.

How a non-English court would hear a case where the underlying contract is governed by English law would be a matter for the procedural rules of that court. However, it is possible that where a non-English court determines a case according to English law, it would apply Paccar.

Thus, the effects of *Paccar* may be felt more widely than one might first imagine.

Does Paccar impact funding of arbitral disputes?

It is unclear under English law the extent to which the laws regarding third-party funding of cases before an English court are applicable to arbitration. Without judicial guidance on this point, most arbitration practitioners have adopted a conservative interpretation, and have applied the English law regarding third-party funding to English-seated arbitration. This approach was broadly validated in *Diag Human SE and Mr Josef Stava v Volterra Fietta* [2022] EWHC 2054 (QB).

Given that there are already questions as to whether the third-party funding regime in England & Wales applies to arbitral disputes, it is possible that some funders may take the view that *Paccar* does not apply to English seated arbitration. However, we anticipate that many funders will adopt a cautious approach to the matter, and proceed on the basis that *Paccar* does apply to English seated arbitration.

Past LFAs, Current LFAs, and funding of future disputes

Legal analysis aside, the crux of the matter for litigants and funders will be the commercial realities that exist in a post-*Paccar* world. We consider that *Paccar*'s impact falls into three categories: (i) funded disputes that have concluded, where the LFA is considered to be a DBA and was in breach of the DBA Regs; (ii) funded disputes that are ongoing, where the LFA is considered to be a DBA and is in breach of the DBA Regs; and (iii) future funded disputes that will go before the English courts or are English-seated arbitration.

Conceivably, the most complex situation to untangle will be those cases where the dispute has ended, an award or settlement distributed, and now, following *Paccar*, the applicable LFA is considered to be a DBA and where funds have already been distributed and basis on which funds were distributed were in breach of the DBA Regs.

We are anecdotally aware of several parties that availed themselves of litigation funding, received a profitable return, and the litigation funder took a share of those profits under an LFA which would now be considered invalid, who are already reviewing their legal positions.

Indeed, it may be the case that there is a fiduciary responsibility on parties (e.g. Boards of Directors or Liquidators) to consider whether they should seek recourse against their third-party funder. Of course, considering it is not the same as deciding to pursue it, but legal obligations may make claims following Paccar more likely. We anticipate that there will also be at least some opportunistic parties that envisage an opportunity to 'claw back' amounts paid to their funder.

However, there may be one or two practical reasons which may limit the number of cases brought by potential claimants. Parties that needed litigation funding in the first place may not be in a strong enough financial position to launch a further claim. They may also be suffering sufficient litigation fatigue, or simply not regard further hardship as being worth it, if they have already obtained an award that they are happy with.

One must also question whether litigation funders will be keen to finance claims against other litigation funders. Litigation funders co-fund cases with each other regularly and we suspect that some funds would hesitate before funding a case against their colleagues.

Litigation funders are also well capitalised and sophisticated entities. At face value this might make them an attractive target. However, potential claimants may also be wary of a defendant that is more than capable of putting up stiff opposition. In addition, cases may have been funded out of sub-entities that have subsequently been liquidated and funds distributed, further complicating the issue.

This may mean that claimants will find it very difficult to pursue claims against their funder. In these circumstances, claimants may instead file claims against law firms who advised them on the meaning and content of their LFA. Law firms should be considering their possible exposure to this type of claim and preparing themselves to manage issues arising, including notifying their insurer.

In cases that are ongoing, parties are going to have to review the LFAs that govern their funding relationships. It may be the case that funding provisions are now partly or entirely in breach of the DBA Regs and they are partly or entirely unenforceable. Many LFAs will contain provisions on severability, so to the extent that any LFA is now partly unenforceable, those terms will be struck out and the remaining terms of that LFA will remain.

Where an existing LFA does need to be re-negotiated one would hope that the funder and funded party are sufficiently aligned in their aims that they can agree to amendments that make it legally compliant. In addition, parties may not want to be distracted from their ongoing dispute, by side-issues around the terms of their LFA. Of course, reaching agreement may prove challenging for some, as the matter strikes at the heart of what both parties care about most – their financial return.

Looking forward, the question becomes; how hard is it to comply with the DB Regs? If very challenging or uncommercial then funders may be deterred from entering the English funding market for fear their LFAs will be in breach of Paccar. If relatively easy, then *Paccar*'s impact may be limited to past and ongoing LFAs that are in breach of the DB Regs.

In simple terms, the DBA Regs provides that:

> "*The terms and conditions of a damages-based agreement must specify—*
>
> *(a) the claim or proceedings or parts of them to which the agreement relates;*
>
> *(b) the circumstances in which the representative's payment, expenses and costs, or part of them, are payable; and*
>
> *(c) the reason for setting the amount of the payment at the level agreed, which, in an employment matter, shall include having regard to, where appropriate, whether the claim or proceedings is one of several similar claims or proceedings*."

The DBA Regs also contains a cap on the percentage of damages that can be taken by a litigation funder (in some cases 50% net of costs) and a methodology as to how that cap is to be calculated.

In reality, then, the DBA Regs are not overly onerous. They are, in fact, conditions that in our opinion broadly make good sense.

However, we should reflect on one thing. A cap on damages may at first glance look to be totally beneficial to the claimant. But the reality of any cap is that some cases will not be capable of funding as a result of such a cap. A case with the same quantum of costs but a lower expected quantum of damages will at some stage breach the cap, thereby making some cases non-fundable thereby blocking their access to justice. An unintended consequence or a necessary claimant protection?

How does Paccar impact the litigation funding industry more widely?

As we have already noted, <u>Paccar</u> certainly applies to cases before the English courts, and probably to English seated arbitration. There may be disputes where the substantive law of the dispute is English law but that dispute is heard before the court of another jurisdiction or before an arbitral tribunal seated outside of England & Wales.

Some words in the dissenting judgment of Lady Rose in Paccar should be referred to on this topic. Quoting Ms Dunn, chair of the Association of Litigation Funders:

> "*These consequences will extend to all or most litigation funding agreements that have been agreed since litigation funding began in England and Wales. This would be massively damaging both for the administration of justice in relation to the existing cases which involve funding by litigation funders, and the future access to justice of parties who would otherwise have employed litigation funding agreements to fund their cases. It would bring to an abrupt end hundreds of funded claims with potentially catastrophic financial consequences for all involved in the case. It would have a major impact on the development of group litigations before the English Courts*…"

Time will tell whether these concerns are well founded.

Conclusion

Paccar itself is a relatively simple case, with clear outcomes:

- it has not created new law. It is a clarification and restatement of the existing law;
- litigation funders are offering financial services, and this is sufficient to make litigation funding a claims management service;
- crucially:
  - if a LFA determines the payment to the funder "by reference to the amount of the financial benefit obtained" then that LFA is a DBA;

    that LFA / DBA must comply with all the procedural steps that are required for a DBA to be enforceable; and.

- in our view, any LFA where the return is calculated based on a percentage of the damages or settlement is caught. Any LFA where the return is on a 'ratchet' calculated by reference to the quantum of damages is also likely to be considered a DBA

The complexity of *Paccar* perhaps really lies in its effect. It will, no doubt, cause funders and their clients to review past, present, and future funding agreements.. We anticipate that it will lead to a spate of disputes the majority of which will be brought by parties who were formerly clients of litigation funds against those funds.

We are already aware of the matter of *Therium litigation Funding v Bugsby Property* [2023] EWHC 2627 (Comm), where the English High Court has granted Therium (a litigation funder) a freezing order against its client (Bugsby), where Bugsby refused to pay Therium following an award of damages on grounds that the LFA between Therium and Bugsby was no longer valid pursuant to the judgment in Paccar.

The LFA in issue provided for three types of payment to be made by the funded party to the funder: (i) return of the investment sum; (ii) a return calculated as a multiple of that funding; and (iii) a return calculated as a percentage of the damages / settlement sums above a certain threshold. Therium argued, relying on *Zuberi v Lexlaw* [2021] EWCA Civ 16, that a DBA is not the entire retainer but only those provisions that deal with payment of recoveries.

Whilst the Court found that the third type of payment was unenforceable (in line with Paccar) it also concluded that there was a "*serious issue to be tried*" (*per American Cyanamid*) as to whether the entire LFA was unenforceable or whether the provisions were several. No doubt this case will be watched by the litigation funding industry with much interest.

In addition, hidden in the Digital Markets, Competition and Consumers Bill currently going through Parliament, is an amendment that will effectively permit LFAs provided by litigation funders in the Competition Appeal Tribunal. However, it is recognised that even this amendment does nothing to address the uncertainty in relation to funded cases outside the CAT. Even with this proposed amendment there are still question marks over the timing of its implementation and even greater uncertainty as to when or if the Government will turn its attention to the wider issue. It is a rather unhelpful case of “watch this space”.

We do not believe that *Paccar* will end litigation funding in England & Wales. Far from it. Litigation funders have often demonstrated adaptability and we believe this will continue. But adapt they must.

The industry may well see *Paccar* as an inflexion point. A moment where it recognises that some parts of this industry need to improve. We may all like to see new legislation to clarify the current legal position, however with a crowded legislative agenda and with a general election due to take place in the next 14 months or so, we shouldn’t be holding our breath.

Now may be the time for a new regulatory body, truly independent from the litigation funders, properly empowered to manage the industry. However, if this required legislative input then, as stated above, that may not be happening any time soon. The industry may also be assisted by a development of a standard form LFA (or set of, for different circumstances) that is compliant with Paccar.

The Paccar case is a moment for the litigation finance industry to reflect. To be better than it is today, better for litigants, better for all stakeholders. It is an opportunity that should be grasped.

This note is not legal advice. It is the view only of the writer. Readers of this note should be taking their own independent legal advice to review the case findings and conclusions.

For more information, please contact the author(s) of this alert

STUART HILLS
CEO, Riverfleet Ltd
T +44 7967 441187
E stuart.hills@river-fleet.com

JOSHUA COLEMAN-PECHA
Senior Associate, HFW, Dubai
T +971 4 560 6624
E joshua.coleman-pecha@hfw.com

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INTERNATIONAL ARBITRATION

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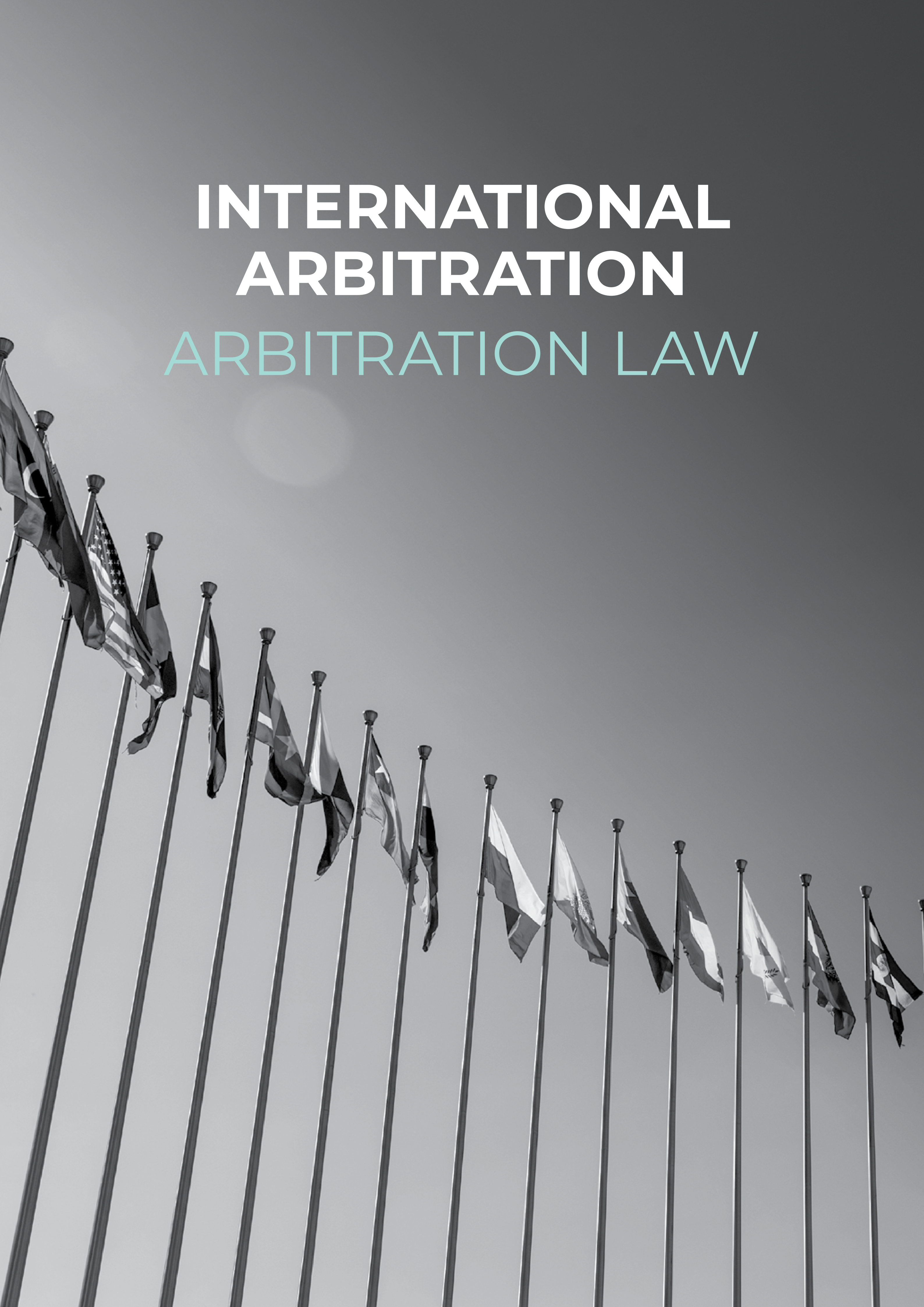

INTERNATIONAL ARBITRATION | SEPTEMBER 2023

THE UK SUPREME COURT PROVIDES ITS LONG-AWAITED RULING ON S.9 ARBITRATION ACT 1996 STAYS IN THE "TUNA BONDS" SCANDAL.

In a recent decision of the UK Supreme Court in *Republic of Mozambique (acting through its Attorney General) v Privinvest Shipbuilding SAL (Holding) and Others* [2023] UKSC 32, the Republic of Mozambique has won a long running battle on a preliminary issue concerning a stay under s.9 of the Arbitration Act 1996 (the 1996 Act). The win for Mozambique ends the stay and means the trial on the substantive issues can proceed.

This decision is the first in which the Supreme Court has interpreted s.9 of the 1996 Act and provides much needed clarity on the approach which courts must adopt when granting arbitration stays.

Notably, this decision was then immediately followed by the Privy Council judgment in *FamilyMart China Holding Co Ltd v Ting Chuan (Cayman Islands) Holding Corporation* [2023] UKPC 33 in which it confirmed and upheld the analysis set out in *Mozambique* (perhaps unsurprisingly as both decisions were delivered by Lord Hodge). The Supreme Court's analysis in *Mozambique* will therefore be binding on all Commonwealth countries whose final appeal court is the Privy Council.

<u>What's the "matter"?</u>

Also known as the "*tuna bonds*" or "*hidden debts*" scandal, the long-running dispute between the Republic of Mozambique and a group of defendants (the **PRIVINVEST DEFENDANTS**) concerned a US$2 billion fraud relating to the development of Mozambique's Exclusive Economic Zone. The claims brought by the Republic of Mozambique against the Privinvest Defendants included claims of bribery, unlawful means conspiracy, dishonest assistance and knowing receipt.

The Privinvest Defendants applied to stay the English court proceedings under s.9 of the 1996 Act on the basis that supply contracts entered into between the relevant parties contained Swiss-law arbitration agreements.

S.9 of the 1996 Act requires courts to stay proceedings "*in respect of a matter which…is to be referred to arbitration*" so long as the arbitration agreement is not null and void, inoperative or incapable of being performed. As Mrs Justice Carr observed in the Court of Appeal: "*the power to stay under s.9 is not discretionary: if the "matter" in question falls within the scope of the arbitration agreement, the court must grant the stay*" unless the arbitration agreement is null and void, inoperative or incapable of being performed.

The Privinvest Defendants alleged that all of the Republic's claims were "matters" falling within the scope of the arbitration agreements and, accordingly, a s. 9 stay of the proceedings should be given. The application failed at first instance before Mr Justice Waksman but the decision was overturned in the Court of Appeal.

<u>The Decision of the Supreme Court</u>

In a unanimous judgment given by Lord Hodge, the Supreme Court interpreted the word "matter" in s.9 of the 1996 Act and closely reviewed the leading authorities on the subject, leading it to overturn the Court of Appeal and rule that none of the Republic's claims in issue on appeal were "matters" in respect of which proceedings were brought within the terms of the arbitration agreements.

In coming to its decision, the Supreme Court said that, on any interpretation of s.9, the court must adopt a two-stage test:

1. first, the court must identify the matter or matters in respect of which the legal proceedings are brought; and

2. second, the court must ascertain whether the matter or matters fall within the scope of the arbitration agreement(s) on its true construction.

On this first issue, the Supreme Court confirmed that a "matter" is a substantial issue which is legally relevant to a claim or a defence, rather than an issue which is peripheral or tangential. Further, at paragraph 77 of the judgment, the Supreme Court stressed that ultimately any analysis of what a "matter" is will require a common-sense approach.

Conclusions and Key Takeaways

The Supreme Court's decision on what constitutes a "matter", and whether it falls within the scope of an arbitration agreement, is certainly helpful and provides important guidance to any party who wishes to issue, or has already issued, proceedings in circumstances where a valid arbitration agreement exists between the parties. That is particularly so in fraud-related claims in which defendants (and sometimes claimants) will no doubt prefer the private and confidential nature of arbitral proceedings.

The Supreme Court's analysis also helpfully confirms that, where a "matter" only has a tangential connection with an agreement containing an arbitration clause, or is not an essential element of the claim or of a relevant defence, the courts will be slow to grant a stay of the proceedings.

HFW are currently acting for clients in relation to an appeal in the Isle of Man due to be heard on 26 – 27 October 2023. The appeal directly concerns arbitration stays and the guidance set out in Mozambique *and* FamilyMart.

For more information, please contact the author(s) of this alert

RICK BROWN
Partner, London
T +44 (0)20 7264 846
E rick.brown@hfw.com

NEIL CHAUHAN
Associate, London
T +44 (0)20 7264 8376
E neil.chauhan@hfw.com

HFW

HIGHEST COURT IN HONG KONG CLARIFIES THE LIMITS OF JUDICIAL INTERVENTION IN THE ARBITRAL PROCESS

(*C v D* [2023] HKCFA 16)

The Court of Final Appeal (CFA) decided that the court did not have power to set aside an arbitral tribunal's decision on whether pre-arbitration conditions in an arbitration agreement were fulfilled. It concluded that upon the proper construction of the Agreement, both the main contractual dispute and the dispute as to the fulfilment of the pre-arbitration conditions under the Agreement fell within the parties' contemplation and intended submission to arbitration, such that the Appellant could not rely on Article 34(2)(a)(iii) of the Model Law to bring proceedings in the court to set aside the arbitral award.

Background

A contractual dispute arose between the Appellant (**C**) and the Respondent (**D**) in relation to the operation of a jointly-owned broadcasting satellite. The clause in question was an escalation clause, also known as a multi-tiered dispute resolution (**MDR**) clause, which provided for pre-arbitration conditions requiring the parties to conduct good faith negotiations for a period of 60 business days before referring the dispute to arbitration in Hong Kong. The clause also provides that "*either Party may, by written notice to the other, have such dispute referred to the Chief Executive Officers of the Parties for resolution*."

Invoking the escalation clause, D referred the dispute to arbitration at the Hong Kong International Arbitration Centre. C challenged the jurisdiction of the tribunal on the grounds that the pre-arbitration procedures had not been complied with, namely D's written notice for negotiations was not addressed to C's CEO but to its board of directors. The Tribunal rejected the challenge and a partial award was rendered against C for breach of contract.

C brought proceedings in the Court of First Instance (**CFI**) and relied on Article 34(2)(a)(iii) of the Model Law (which is incorporated in Section 81(2)(a)(iii) of the Arbitration Ordinance (Cap. 609)) to set aside the partial award, contending the arbitrators were wrong to decide that the pre-arbitration requirements had been complied with. Section 34(2)(a)(iii) of the Model Law provides that an arbitral award may be set aside by the court if the party making the application can proof that "*the award deals with a dispute not contemplated by or not falling within the terms of the submission to arbitration, or contains decisions on matters beyond the scope of submission to arbitration*."

Decisions of the lower courts

The CFI dismissed the application finding that non-compliance with a pre-condition to arbitration is a question of admissibility, not jurisdiction. It considered that C's objection was not that the Tribunal lacked jurisdiction to hear the claim, but simply that the claim itself was not yet ripe for determination as pre-arbitration requirements had not been met. The issue in question did not trigger Article 34 of the Model Law and so there was no basis for the court to set aside the Tribunal's decision. C then appealed to the Court of Appeal (**CA**).

The CA dismissed the appeal and upheld the CFI's decision. Both courts held that C's objection went to the admissibility of the claim and not the jurisdiction of the tribunal. The CA regarded the dispute falls "*within the terms of the submission to arbitration*" and therefore it did not provide a basis for judicial intervention to set aside the partial award under Article 34(2)(a)(ii) of the Model Law. C then appealed to the CFA.

Decision of the CFA

The CFA unanimously dismissed the appeal. It concluded that, upon the proper construction of the Agreement, both the main contractual dispute and the dispute as to the fulfilment of the pre-arbitration conditions under the agreement fell within the parties' contemplation and intended submission to arbitration and therefore did not give rise to grounds for the court to set aside the partial award under Article 34(2)(a)(iii) of the Model Law.

A majority of the CFA held that the distinction between "admissibility" and "jurisdiction" should be adopted as a helpful aid for determining whether judicial intervention in an arbitral process was permissible. It took note that the conceptual distinction was widely adopted by academic writers and in recent case law in Singapore, English and New South Wales which are, like Hong Kong, leading centres for arbitration. Further, the majority adopted a presumption that, in the absence of unequivocal language to the contrary, pre-arbitration conditions should be regarded as matters of admissibility and therefore would not be subject to judicial intervention.

In terms of defining "jurisdiction", the Court took the view that the jurisdiction of an arbitral tribunal is essentially agreement-based. Given the freedom of contract, in the context of arbitration, the "jurisdiction" of a tribunal has no fixed definition but is ultimately dependant on the parties' agreement, reflecting their consent to arbitration.

Mr. Justice Gummow NPJ agreed to the dismissal of the appeal but differed on the reasoning. The judge regarded the admissibility/jurisdiction distinction as an unnecessary distraction and held that the question is simply to consider whether C's objection falls within the scope of Article 34(2)(a)(iii), commenting that many decisions of courts in Model Law jurisdiction applied the Article without any attention to such a distinction.

Comments and practical implications

This is a key decision that clarifies the limits of judicial intervention in the arbitral process and gives certainty to parties in dispute who seek to invoke or rely on an escalation clause in their arbitration agreements. More importantly, the decision has practical implications to commercial parties in general who have mutually consent to refer their dispute to arbitration. Here are some relevant considerations:

- **Pre-contract considerations:** At the time of contracting, it is important to consider carefully in the event a dispute arises, whether the parties would like to go through mandatory steps to resolve the dispute before commencing arbitration proceedings under an escalation clause. Such a clause is particularly useful in preventing small disputes from snowballing, helping parties to preserve their commercial relationships and saving the parties' time and costs. However, the inclusion of an escalation clause in a contract would also mean that parties cannot have the flexibility to commence proceedings on their own timeline until they have proven to the Tribunal that all pre-arbitration conditions have been met. This poses challenges and risks to parties particularly in circumstances where the limitation period of a claim is close to its expiration.
- **Drafting of escalation clauses:** The decision lays down the presumption that pre-arbitration conditions should be regarded as matters of admissibility and therefore would not be subject to judicial intervention. However, this does not mean that parties are unable to make compliance with pre-arbitral steps a jurisdictional issue. As Chief Justice Cheung has pointed out in his judgment, the "jurisdiction" of a tribunal has no fixed definition but is ultimately dependent on the parties' agreement, reflecting their consent to arbitration. Therefore, if the parties wish to do so, they can rebut the presumption by clear language, agreeing that certain matters which would otherwise be classified as going to admissibility only under the distinction are matters going to “jurisdiction” affecting fundamentally their consent to arbitrate, such that the “jurisdiction” of the tribunal is circumscribed accordingly. In addition, words chosen should not be opened to much room for speculation and the parties should state specifically which part of the escalation mechanism is mandatory and which part is only optional to prevent future disputes on the compliance of the escalation clause.
- **Compliance with escalation clauses:** If there is an escalation clause in the arbitration agreement, parties will need to comply with the pre-arbitration conditions fully before formal proceedings are commenced. If the tribunal considers that the conditions are not fulfilled, it may stay the arbitration proceedings to allow time for compliance with the escalation clause or impose costs sanctions against the non-compliant party for failing to comply with the escalation clause, or even dismiss the claim as inadmissible. In the absence of unequivocal language to the contrary, any decisions to be made by the Tribunal in relation to matters going to admissibility are likely to be final and conclusive and is not subject to judicial intervention.
- **Proper identification of the nature of a dispute:** It is crucial for the parties to identify whether an issue is in fact jurisdictional or presumptively non-jurisdictional before asking the court to decide whether jurisdiction was correctly assumed. This could avoid giving rise to a lengthy and expensive dispute and an unfruitful outcome for the reason that the issue is not subject to judicial intervention.
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For more information, please contact the authors of this article:

LEANNE FOK
Associate, Hong Kong
T +852 3983 7641
E leanne.fok@hfw.com

KEVIN WARBURTON
Partner, Hong Kong
T +852 3983 7629
E kevin.warburton@hfw.com

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INTERNATIONAL ARBITRATION | OCTOBER 2023

FEDERAL DECREE LAW 15/2023 AMENDING THE UAE FEDERAL ARBITRATION LAW WILL AFFECT BOTH ARBITRATORS AND PARTIES TO ARBITRATION

Federal Decree law 15/2023 was issued on 4 September 2023 to amend the UAE Federal Arbitration Law (Law 6/2018).

We summarise the amendments here for the benefit of parties to arbitration proceedings and, also, for the benefit of arbitrators, as the amendments are of relevance to both.

The amendments are relatively light touch and do not have a major impact on the substance of the law. We set out the detailed amendments below and would like to highlight that:

- Pursuant to Article 10 Bis (2), an arbitrator and an arbitral institution can become liable for damages to the parties of an arbitration. The instances where this is a possibility are limited and specific. However, this amendment appears to remove the relative immunity of arbitrators afforded under numerous arbitration rules.
- Article 28 is updated to expressly allow hearings to be held virtually. Additionally, arbitration centres are now required to "*provide the necessary technologies to conduct arbitration proceedings through modern technical means or in technical communities in accordance with the necessary technical standards and controls.*"

While the amendments are unlikely to affect the majority of arbitration users, they are a sign that the UAE retains its intent to be a modern arbitration hub.

Relevant Article	Previous Position	Updated Position
Article 10 – **The Requirements to be met by an Arbitrator**	In addition to the requirements agreed upon by the Parties, under Article 10, the arbitrator was required to be a physical person, and was not permitted to be: • a minor, • incapacitated, • bankrupt (unless exonerated), • convicted of any felony or misdemeanour (even if exonerated), • a member of the Board of Trustees or the administrative branch of the competent Arbitration Institution administering the arbitration case in the State.	**Article 10** now expressly adds a further prohibition to the appointment of an arbitrator, namely that the arbitrator may not have a direct relationship with any of the parties to the arbitration that may prejudice the arbitrator's impartiality and independence.
Article 10 bis - **Conditions for Appointing an Arbitrator from Among Members of the Supervisory or Regulatory Authorities in the Competent Arbitration Institution**		**Article 10 bis** is a new article which has been added to the Federal Arbitration Law to provide an exemption to the prohibition in Article 10(2) on the appointment of an arbitrator who is also a member of the Board of Directors, the Board of Trustees, or the administrative branch of the competent Arbitration Institution administering the arbitration case. Under Article 10 bis such appointment may be made under certain conditions, which include:

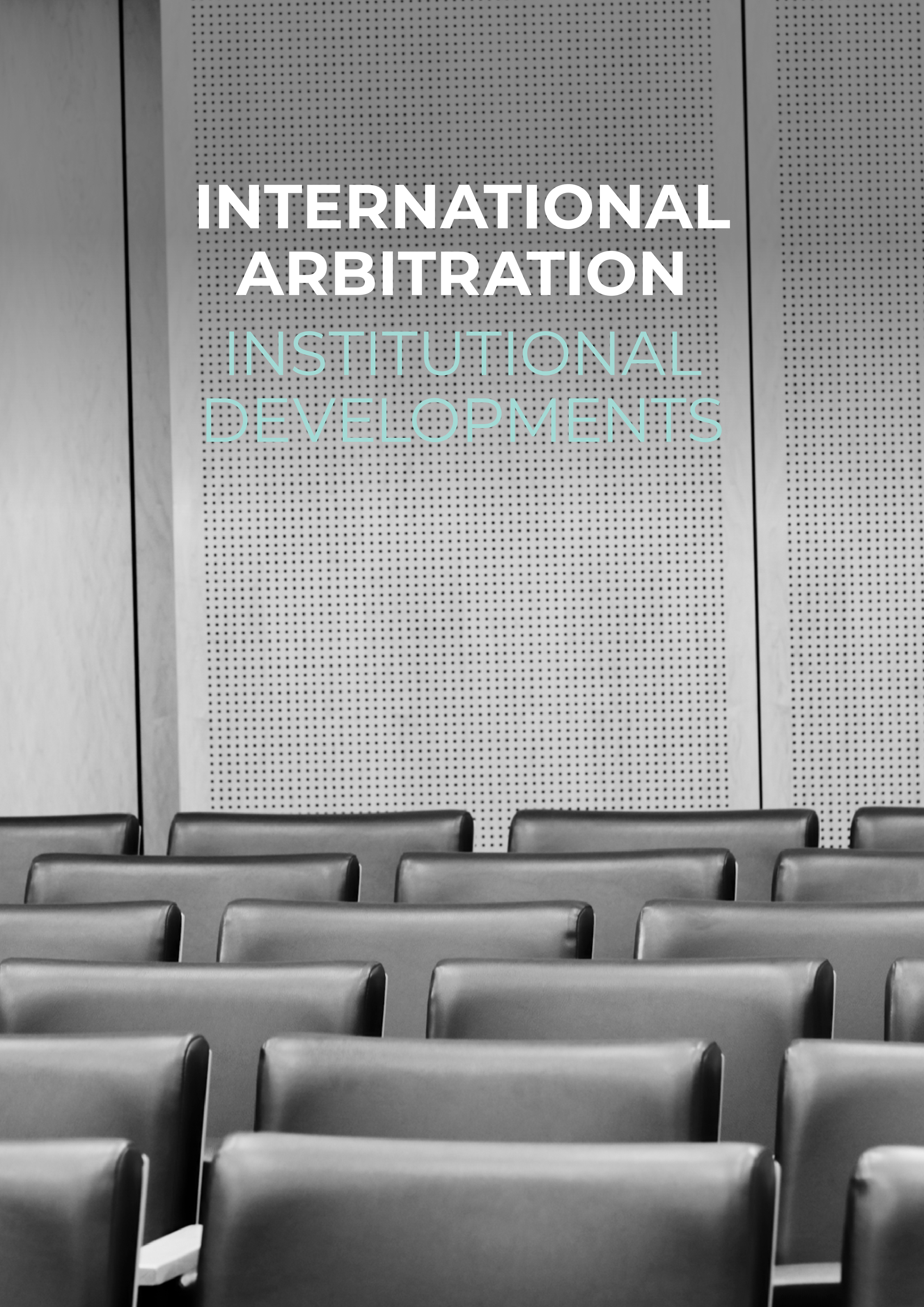
		- That the respective arbitrator may not act as Chair; - The parties shall acknowledge in writing the nature of the arbitrator's connection with the institution and confirm that there is no objection or reservation on their part to the appointment; and - The implementation of a governance system to avoid exploitation by the arbitrator of the connection with the institution in a way that may create a conflict of interest or which may influence the conduct of the arbitration case in any way. The aim of the new article is to enable arbitrators to act as co-arbitrators in proceedings administered by institutions in which they hold supervisory roles. The new article confirms that any violation of the conditions set out in Article 10 bis shall invalidate the award and give the parties the right to seek compensation from the institution and the arbitrator.
Article 23 - Determination of the applicable proceedings	1. Subject to the prohibition on a member of the Board of Trustees or the administrative branch of the competent Arbitration Institution administering the arbitration case in the State under Article 10(2), the Parties may agree on the procedures that the Arbitral Tribunal is required to follow in the arbitration. 2. If there is no agreement to follow certain procedures, the Tribunal may determine the procedures that it deems appropriate subject to the provisions of the procedural Law, and basic principles in litigation and international agreements to which the State is a party.	As a result of the addition of Article 10 bis (which provides an exemption to the prohibition in Article 10(2) on the appointment of an arbitrator who is also a member of the Board of Directors, the Board of Trustees, or the administrative branch of the competent Arbitration Institution administering the arbitration case under certain conditions), Article 23 has been amended to remove the reference to it being subject to Article 10(2).
Article 28 - Place and Proceedings of arbitration	1. The Parties may agree on the place of arbitration, failing which the Tribunal shall make such determination having regard to the circumstances of the case, and convenience of the Parties. 2. Unless otherwise agreed by the Parties, the Arbitral Tribunal may: a. Hold the arbitration hearings in person at any place as it deems appropriate. b. Hold the arbitration hearings by all means of communication and modern electronic technologies. The Arbitral Tribunal shall deliver or send the minutes of the hearing to the Parties.	Reflecting the increase in virtual hearings, revised Article 28 clarifies that both determination of the place of the arbitration and arbitration hearings may be conducted virtually, through modern technical means or in technical communities (as well as in-person). Further, the amendments to Article 23 require that arbitration centres in the UAE provide the necessary technology to conduct such virtual proceedings using modern technical means or within technical communities.
Article 33 - Arbitration Hearings and Proceedings	1. Unless otherwise provided by the Parties, the arbitration hearings shall be held at private meetings. 2. Unless otherwise agreed by the Parties, the Arbitral tribunal may decide whether to hold oral hearings for the production of evidence or for oral arguments, or whether to proceed with the proceedings	Article 33 has been amended to remove the reference to hearings held through modern means of communication which is now clarified under amended Article 28. Also, the Tribunal's discretion to determine the rules of evidence that shall be followed, in the event that the applicable law lacks

	on the basis of documents and other material evidence. The Arbitral Tribunal may decide to hold these hearings at an appropriate state of the proceedings at the request of a party. 3. The hearings may be held through modern means of communication which do not require the Parties to appear in person at the hearings. 4. The Arbitral Tribunal shall notify the Parties of the dates of the hearings, in sufficient time before said hearings as the Arbitral Tribunal may deem appropriate, and as the case may be. 5. The Parties may, on their own costs, seek the assistance of experts and legal representatives such as attorneys and others to represent them before the Arbitral Tribunal. The Arbitral Tribunal may request any party to submit a proof of the power granted to his representative in the form specified by the Tribunal. 6. A summary of the facts of each hearing held by the Arbitral Tribunal shall be inscribed in a minute, a copy of which is delivered to each party. 7. Unless otherwise agreed by the Parties, the statements of the witnesses including experts may be heard according to the applicable laws in the State. 8. The Arbitral Tribunal shall have a discretionary power to determine the applicable rules of evidence, and the extent of admissibility, relation or evaluation of the evidence submitted by any party on an incident or expertise; moreover, it may determine the time, method and form in which said evidence is exchanged between the Parties, and the method of its provision to the Tribunal.	evidence to rule on the dispute, is now subject to any alternative agreement of the parties regarding the rules of evidence that shall be followed.

For more information, please contact the author(s) of this alert

SLAVA KIRYUSHIN
Partner, Dubai
T +971 4 560 6623
E slava.kiryushin@hfw.com

MARIA DEUS
Legal Director, Abu Dhabi
T +971 2 235 4907
E maria.deus@hfw.com



INTERNATIONAL ARBITRATION

INSTITUTIONAL DEVELOPMENTS

New Draft SIAC Rules released for public consultation – the key themes and changes

Dan Perera

International Arbitration Partner at HFW Singapore. Solicitor Advocate (England & Wales); Attorney-at-law (New York); Lawyer (Australia). Energy; Resources; Carbon; Commodities; Crypto; Web3.
dan.perera@hfw.com

The Singapore International Arbitration Centre (**SIAC**) released a draft of its eagerly anticipated 7th Edition Arbitration Rules (the **Draft SIAC Rules**) on 22 August 2023, and has invited comments on the same via a public consultation. The Draft SIAC Rules may be accessed via the SIAC website, and may be downloaded here. We summarise our initial thoughts on the Draft SIAC Rules below.

A reputation for innovation

SIAC has, over the years, developed a strong reputation for being innovative and progressive in the advancement of arbitration practice and procedure – as you would come to expect, of a major international arbitration centre. The latest Draft SIAC Rules seek to build on that reputation with the introduction of several new and progressive concepts and constructs aimed, as confirmed by SIAC Registrar, Kevin Nash, in his Registrar's Report at, "*...enhancing the user experience and raising the bar on efficiency, expedition and cost-effectiveness...*".

Key themes and changes

The key changes to the Draft SIAC Rules summarised below can be grouped into several core themes, which include:

- a clear focus on efficiency and cost-effectiveness throughout;
- the increased adoption of technology to drive efficiency and cost-effectiveness;
- bringing greater clarity to the Rules relating to many applications in SIAC arbitration proceedings; and
- general modernisation, and the recognition of several developments in legislation, arbitration practice, and social and cultural change, since the time of the release of the current SIAC Rules in 2016.

We explore these themes, and the changes behind them, in greater detail below.

A. Focus on efficiency and cost-effectiveness.

***Increased focus on efficiency and cost-effectiveness*:** Rule 3.5 of the Draft SIAC Rules recognises that the various organs of the SIAC and the Tribunal, "...*shall endeavour to ensure*...", among other things, "...*the expeditious and cost-effective conduct of the arbitration proportionate to the complexity of the claim and the amount in dispute*...". This brings the Draft SIAC Rules into closer conformity with municipal civil litigation rules in jurisdictions such as Singapore, as well as in England and Wales, both of which expressly empower courts to deal with cases in an expeditious and cost-effective manner, with regard to the complexity of the case and the quantum in issue. An express reference to this imperative in Rule 3.5 may give tribunals additional impetus and confidence to conduct the arbitration proceedings, and to make procedural decisions in a manner that enables SIAC arbitrations to meet this imperative.

***Streamlined Procedure*:** The Draft SIAC Rules introduce a new Streamlined Procedure which applies to a SIAC Arbitration on the application of a party in circumstances where:

(i) the parties have agreed to the application of the Streamlined Procedure;

(ii) the amount in dispute does not exceed the equivalent amount of SGD $1m at the time of the application; or

(iii) the circumstances of the case warrant the application of such procedure.

This introduces an additional form of SIAC 'small claims' arbitration, complimenting the existing standard SIAC arbitration proceedings, and the SIAC Expedited Procedure. The Streamlined Procedure compresses the time frames for proceedings, including through the omission of hearings, document production, and fact and/or expert witness evidence, as well as the requirement for the tribunal to issue an award within three months from the date of its constitution. These proposals may make the SIAC Rules a more viable option for disputes which are presently conducted under the rules of various trade associations, which typically involve lower sums in dispute and truncated timelines, often aligned with parties' desire to achieve a more 'commercial' resolution of lower value claims.

***Changes to the requirements of the Expedited Procedure*:** The maximum value threshold for proceedings to be administered under the Expedited Procedure (absent parties' agreement to the contrary) has, in the Draft SIAC Rules, been raised to SGD $10m, from the presently applicable SGD $6m. This proposed change is a recognition of the fact that many claims involving larger sums may still be relatively straightforward, and may benefit from the application of the

Expedited Procedure; and that significant inflation has occurred globally since 2016. Many users of SIAC will welcome this change, as it should bring a greater degree of proportionality to the cost-benefit analysis of disputing smaller claims.

B. An increased adoption of technology to drive efficiency.

***Introduction of the SIAC Gateway*:** Rules 4.2 and 4.3 of the Draft SIAC Rules provide for an electronic "Gateway", maintained by the SIAC, to which all communications, pleadings and documents in the arbitration are to be uploaded. The introduction of such a gateway mirrors civil litigation practises in many jurisdictions such as Singapore, where the courts maintain a similar platform to which litigants are to upload all documents relevant to their case. Such platforms are already utilised by other major arbitral institutions, who have implemented such systems over the last few years. This is a welcome move towards modernisation that will likely enable more seamless case and document management. However, the extent of the Gateway's impact will ultimately depend on its user interface, and how easily the Parties, Tribunal and the SIAC are able to upload, view and store information relating to the arbitration.

C. Greater clarity on many applications in SIAC arbitration proceedings.

***Coordinated Proceedings*:** Rule 17 of the Draft SIAC Rules formalises a common practice for circumstances where parties agree for the same Tribunal constituted in two or more arbitrations to hear such arbitrations together, and clarifies the variety of options in which such coordinated proceedings can be conducted.

***Challenge(s) to an Arbitrator*:** Rules 26 and 27 introduce more formality and structure to a process presently fraught with uncertainty. Rule 26.1 sets out far more detailed grounds on which an arbitration may be challenged whilst Rule 27 provides a procedure for challenging an arbitrator which now includes a filing fee.

***Additional requirement for consolidation*:** Rule 16.1(c) introduces the additional requirement that, "*...a common question of law or fact...",* must arise out of or in connection with the two or more arbitrations that a party seeks to consolidate. This addition recognises the presence of this requirement in the arbitration jurisprudence of many major jurisdictions globally.

***Preliminary Determination*:** Rule 46 similarly introduces more formality and structure to an application that is not infrequently made to tribunals in SIAC arbitrations. Rule 46.4, in particular, imposes a deadline of 45 days for the tribunal to make a decision on such application from the date of the filing of an application for preliminary determination. This timeline is a welcome clarification of the uncertainty as to the procedure and timelines of applications to the tribunal for the preliminary determination.

D. General modernisation, and the recognition of several developments in legislation, arbitration practice, and social and cultural change.

***General modernisation*:** While prevalent as a theme throughout the Draft SIAC Rules, this is perhaps most quickly apparent from the revised format of the Draft SIAC Rules, in their .pdf form. Containing considerably more comprehensive definitions and interpretations sections up front, the document immediately much more closely resembles a well-formatted contract. A number of current Rules have been re-drafted in a more modern drafting style, more clearly segregating principles, which significantly enhances the user experience.

***Third-party funding*:** The proposed Rule 38 of the Draft SIAC Rules now expressly refers to third-party funding and requires any Party to, among other things, "...*disclose the existence of any third-party funding agreement and the identity of the third-party funder in its Notice or Response or immediately upon concluding a third-party funding agreement...*" (Rule 38.1). These new rules reflect the increasing prevalence of third-party funding arrangements in the major jurisdictions of the parties involved in SIAC arbitrations.

***Recognition of the importance of tribunal secretaries in international arbitrations*:** Rule 24 governs the appointment of a tribunal secretary. It formalises a trend in international arbitration practice where tribunal secretaries are appointed to assist the tribunal in high-value and complex arbitrations. Rule 24.2 imposes the same requirements relating to disclosures regarding independence and impartiality, etc., imposed on arbitrators to the tribunal secretary. Rule 24.3 adopts international best practices on the conduct of tribunal secretaries by prohibiting, among other things, the delegation of the tribunal's, "... *decision-making or other essential functions to the Tribunal Secretary...*", and requires the tribunal to supervise the work of the Tribunal Secretary.

***Diversity and inclusion* (D&I):** Very positively, the Draft SIAC Rules have acknowledged the significant importance, and need for a greater degree, of D&I in international arbitration. Rule 19.5 requires the SIAC President to take into account, "...*principles of diversity and inclusion...*", in the appointment of an arbitrator under the Draft SIAC Rules. It may be of some assistance, and bring a further degree of clarity to the Draft SIAC Rules, if a recognised independent third-party standard for such principles may be referenced - although we appreciate that there may be challenges in achieving this, in a manner which may apply equally across all relevant jurisdictions. The Draft SIAC Rules generally incorporate a greater degree of transparency, relevant to a variety of procedural aspects, throughout.

We have noted a number of further positive changes and other noteworthy additions contained within the Draft SIAC Rules, which shall be the subject of a more detailed analysis in due course.

Initial Thoughts

As is highlighted by the words of the Registrar, Kevin Nash, the Draft SIAC Rules are an attempt to modernise – in some cases, to align with other arbitral institutions such as the International Chamber of Commerce, which have already adopted some of the new constructs contained herein since the last revision of the SIAC Rules in 2016 – and also to innovate, with clear and express regard to the critical issues of efficiency, expedition, cost-effectiveness, transparency, and D&I. SIAC has, quite correctly, recognised the significant threat to arbitration, as a dispute resolution mechanism, which the absence or lack of these critical factors poses, and is clearly keen to focus on an enhancement of the user experience. In doing so, SIAC is plainly mindful of the need to remain respectful of other critical first principles of arbitration, including the tenets of any just system of dispute resolution such as party autonomy, due process and natural justice.

The implementation of the Draft SIAC Rules, if eventually adopted in something akin to their present form and, critically, if executed by tribunals with reference to their express words, should go a long way towards boosting user confidence in arbitration, and ensure that the parties in dispute have express words and principles to point to, enshrined in the Rules, when seeking to rebalance any proceedings.

Public consultation

SIAC is inviting comments from all interested parties on its Draft SIAC Rules by 21 November 2023. Comments may be submitted by email through the link found on the SIAC website.

INTERNATIONAL ARBITRATION | NOVEMBER 2023

ICC PUBLISHES GUIDE ON DISABILITY INCLUSION IN INTERNATIONAL ARBITRATION AND ADR

As a leading Disputes firm with a global reputation in International Arbitration (IA) and Alternative Dispute Resolution (ADR), we are delighted that the International Chamber of Commerce (ICC) has published its Guide on Disability Inclusion in International Arbitration and ADR[1] (the Guide).

This briefing outlines the Guide's scope and the impact we hope it will make in advancing the arbitration industry by adopting a more inclusive approach, which recognises the needs of parties, lawyers, and arbitrators.

The Guide

The Guide, published in October 2023, seeks to promote greater accommodation of those with disabilities in IA and ADR by encouraging a more inclusive approach. The Guide also identifies the benefits that diversity and inclusion bring to the decision-making process and provides guidance on how to achieve it.

By addressing various points, including these often-sensitive issues, it is hoped that the IA and ADR industries will be able to open their doors to a greater pool of talent resulting in even higher quality decisions and outcomes.

The publication is timely. A recent report by Cortext Capital[2] identified that whilst the arbitration industry is generally aware of the need for diversity and inclusion for race and age when looking to appoint arbitrators, many other characteristics including disability are generally not considered.

What does the Guide include?

The Guide is split into three sections, namely:-

1. Recommendations and disability inclusion toolkit;
2. Understanding disability; and
3. Disability inclusion in International Arbitration and ADR.

Section 1 Recommendations and disability inclusion toolkit

Section 1 includes a suggested CMC wording for use by the parties and also guidance for Tribunals when considering requests for making accommodations.

The section also contains a helpful list of recommendations focussed on the roles of the Tribunals, Practitioners, and Institutions, and how they might best address issues around the inclusion of those with disabilities.

Section 2 Understanding disability

An issue around understanding disability is the language associated with it. Section 2 seeks to overcome this by discussing the language used and focusses on the World Health Organisation's (**WHO**) 2001 International Classification of Functioning, Disability and Health (ICF), which has been adopted by all 191 WHO members, and which provides a standard linguistic and conceptual basis for the definition and measurement of disability.

The section also helpfully sets out the various and varying definitions of disability, including that used by the United Nation's Convention on Rights of Persons with Disabilities, which defines persons with disabilities as including "*those who have long-term physical, mental, intellectual or sensory impairments which in interaction with various barriers may hinder their full and effective participation in society on an equal basis with others*."

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[1] 2023_ICC-Guide-on-Disability-Inclusion-in-International-Arbitration-and-ADR-902.pdf (iccwbo.org)

[2] The Usual Suspects 2023 (cortexcapital.org)

This is a welcome addition and will assist in the adoption of the correct terminology and provide confidence in an area where a fear of offending may lead to a tendency to avoid a discussion.

Section 3 Disability inclusion in International Arbitration and ADR

Section 3 differentiates between disabilities, which can be self-managed, and those in IA and ADR proceedings where the participants whether the party, legal team, or Tribunal need to take responsibility for making reasonable accommodations to enable participation by those with disabilities.

The section lists examples and references case studies where manageable accommodations can and have been made. For example, awareness of the access issues of a visually impaired participant in one matter led the Tribunal to relocate the hearing to enable their involvement.

The examples and practical steps taken are a helpful resource.

Conclusion

The Guide is to be welcomed in increasing awareness and understanding of the need for more inclusive practices and the benefits that will flow from us all making greater accommodations to enable a more diverse industry.

It encourages arbitral Tribunals, practitioners, and Institutions to take more responsibility for promoting training, and implementing policies that encourage an inclusive environment.

The Guide's recommendations, toolkit, and guidance are a helpful and valuable resource for practitioners, Institutions, and arbitrators.

We certainly hope that inclusive policies will become commonplace, and encourage a cultural shift embracing diversity and inclusion leading to full participation for all those interested in careers in IA and ADR.

For more information, please contact the author(s) of this alert

NICOLA GARE
Knowledge Counsel, London
T +44 (0)20 7264 8158
E nicola.gare@hfw.com

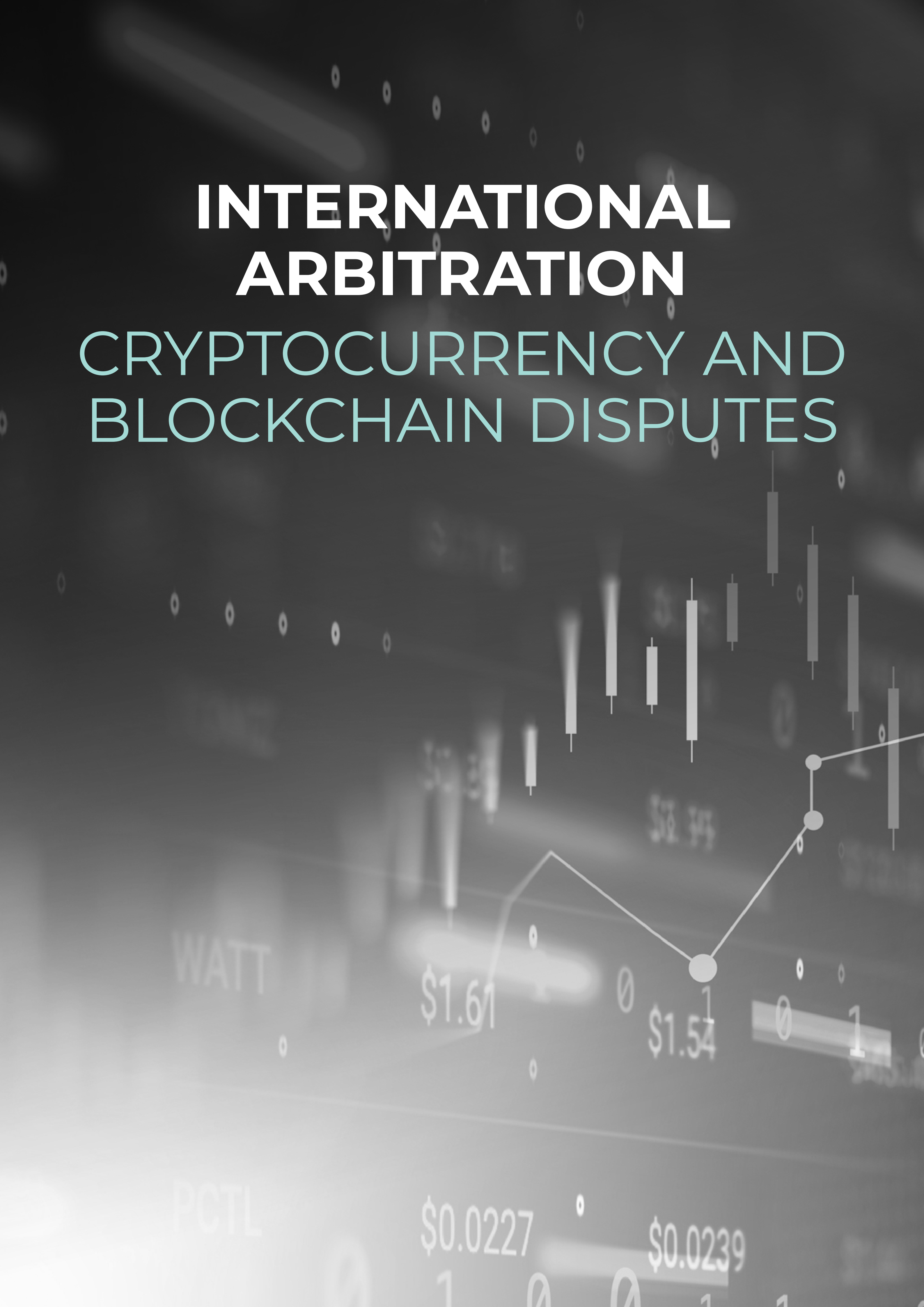
DAMIAN HONEY
Partner, London
T +44 (0)20 7264 8354
E damian.honey@hfw.com

SLAVA KIRYUSHIN
Partner, Dubai
T +971 4 560 6623
E slava.kiryushin@hfw.com

HANIA CORBETT
Trainee Solicitor, London
T +44 (0)20 7264 8804
E hania.corbett@hfw.com

INTERNATIONAL ARBITRATION

CRYPTOCURRENCY AND BLOCKCHAIN DISPUTES



THE ARBITRABILITY OF WEB3 DISPUTES: AN EFFECTIVE COURT OF FIRST WORLD PROBLEMS?

This article explores the arbitrability of blockchain, cryptocurrency, NFT and metaverse disputes and considers the issue of what arbitration and its supporting ecosystem must do, in order to remain an effective forum for the resolution of such disputes.

> "At the heart of a tremendous number of Web3 disputes lies private law. In most cases, given the internet-based global nature of Web3, this means private international law."

What are blockchain, cryptocurrency, NFT and metaverse disputes?

For the sake of simplicity, we shall refer to all such disputes within this article as, "Web3 disputes". Web3 disputes are disputes which are connected with the rapidly-growing range of decentralised technologies which utilise blockchain and smart contracts to record transactions, and to automate particular functions. These technologies include those powering cryptocurrencies and non-fungible tokens (NFTs), the records of transfer of which are stored on blockchains and are publicly viewable. Web3 disputes may also encompass disputes connected with the metaverse, a virtual-reality (VR) 'world', accessible through VR headsets, within which participants may engage with each other and interact in a computer-generated environment.

Disputes in the Web3 space may arise in a multitude of different ways and may fall within a number of categories of law (or within multiple categories). There may, for example, be disputes arising from criminal acts, such as hacks or exploits, or the theft or unauthorised movement of cryptocurrencies or NFTs. There may be tortious actions which give rise to liabilities and claims, either within or outside of the context of contractual relationships. Alternatively, disputes pertaining to Web3 may fall within the category of regulatory disputes, such as issues falling within the remit of the Securities and Exchange Commission or the Commodity Futures Trading Commission in the U.S., or within the regulatory scope of the Monetary Authority of Singapore – the question of whether particular cryptocurrencies are securities, for example.

However, at the heart of a tremendous number of Web3 disputes lies private law. In most cases, given the internet-based global nature of Web3, this means private international law. While the above description of Web3 sounds – and is - incredibly tech-driven, what is not always immediately apparent is that there is a raft of considerably more traditional legal contractual relationships and structures at play behind a significant amount of this technology. Those legal relationships are formed of bilateral and multilateral private contracts, most commonly written in plain language (as opposed to code), and which refer disputes between their various participants to a range of traditional forums for dispute resolution, pursuant to their chosen governing laws. It is those contracts, and the disputes which arise thereunder, which form the primary focus of this article.

How do Web3 disputes arise?

Web3 disputes may arise in a vast number of different ways – the majority of which have most likely not even been contemplated yet, such is the rapid pace at which the relevant technology is developing.

Taking a few examples which have already occurred, we have seen examples of each of the following:

- Disputes between users and operators of centralised cryptocurrency exchanges (CEXs) pertaining to the trading, deposit and withdrawal of their cryptoassets; platform hacks; blackouts; exploits or bugs, which may have caused losses for users.
- Disputes arising out of Simple Agreements for Future Tokens (SAFTs) or similar contracts, entered into between investors and intended future issuers of tokens, in the event that promises made under such contracts do not materialise.
- Disputes arising from interactions with smart contracts which do not proceed as intended, possibly for reason of errors in code or vulnerabilities, giving rise to losses.
- Disputes between participants in Decentralised Autonomous Organisations (DAOs) regarding issues relating to the DAO's governance or administration.

- Users of the metaverse suffering grievances, such as disagreements relating to the 'ownership' and transferability of virtual metaverse 'real estate', which have a tangible impact on them in the real world.

Are Web3 disputes arbitrable?

By and large, Web3 disputes are not only arbitrable but in many cases, arbitration would be the most suitable forum for their resolution.

The reasons for this being so are in many cases down to the very same set of fundamental reasons why arbitration is so popular as a dispute resolution forum in international contracts generally. In brief summary, such reasons include:

- Privacy and confidentiality – which may be particularly relevant where, for example, confidential code under development is the subject matter of the dispute.
- Enforceability of arbitral awards (in contrast with court judgments), pursuant to the New York Convention[1] – of particular significance, given the inherently decentralised and international nature of Web3 disputes, and the fact that participants in ventures such as token issuers; CEXs; network verifiers or node operators; and sellers and buyers, may all be located in different geographies and legal jurisdictions.
- The ability of parties to select subject-matter experts as arbitrators to determine the disputes between them, rather than finding themselves before a judge who is not familiar with the subject matter.
- The flexibility in rules and procedure which may be adopted at the contracting stage and which may result in the rapid resolution of disputes, in comparison with court proceedings.
- The potential, subject to the applicable procedural laws of the seat, for arbitration proceedings to be final and binding in nature, and incapable of appeal.

There already exist a very significant range of Web3-related contractual relationships which incorporate traditional arbitration agreements, and which refer disputes to arbitration under a variety of institutional rules. Some examples of such contractual relationships are set out below:

- The terms of use or service of a number of the world's most popular CEXs, such as Binance, KuCoin and Coinbase, refer disputes to arbitration in jurisdictions such as Hong Kong and Singapore, and there have been proceedings initiated under such arbitration agreements.
- The terms of use for front-end user interfaces of decentralised exchanges (DEXs) such as those operated by Uniswap Labs, which may be used for interaction with smart contracts on the relevant blockchain, also refer disputes to arbitration.
- NFT trading platforms such as OpenSea and Nifty Gateway LLC include arbitration provisions in their terms of use, and the latter was successfully able to obtain a stay English court proceedings at first instance in favour of such reference[2] (more of which, later).
- Metaverse platforms, such as those operated by metaverse creator The Decentraland Foundation, and the auction house, Sotheby's, Inc., refer disputes to arbitration in Panama and New York respectively.
- Bilateral and multilateral Web3-related agreements, such as SAFTs; Multisig participation or administration agreements; and DAO governance agreements and terms of service, all commonly refer disputes to arbitration. The Maker Ecosystem Growth Foundation and others associated with the decentralised finance (DeFi) protocol, MakerDAO, were successful in compelling arbitration, following the commencement of a class action lawsuit against them by purported users in the Northern District Court of California[3]. The claim was referred to arbitration on an individual basis, pursuant to the rules of the American Arbitration Association, further to the inclusion of an arbitration agreement in MakerDAO's terms of service.
- The documentation underpinning the on-chain tokenisation of real-world assets (e.g. as collateral or security, or for fractionalisation purposes) commonly refers disputes to arbitration, most frequently aligning with other pre-existing contractual arrangements pertaining to the underlying physical asset.
- E-Sports participation agreements frequently refer disputes amongst operators and participants, or between participants, to arbitration.
- Arbitration agreements (as well as a choice of governing law) may now be 'baked in' to code in relation to new token issuances, referring disputes to traditional or on-chain arbitration. In some cases, determination of disputes may take place on-chain, with the decentralised pseudonymous 'arbitrators' being asked to vote on the issue and, in some cases, with direct execution of the 'award' through the use of smart contracts.

What are the limits to the arbitrability of Web3 disputes?

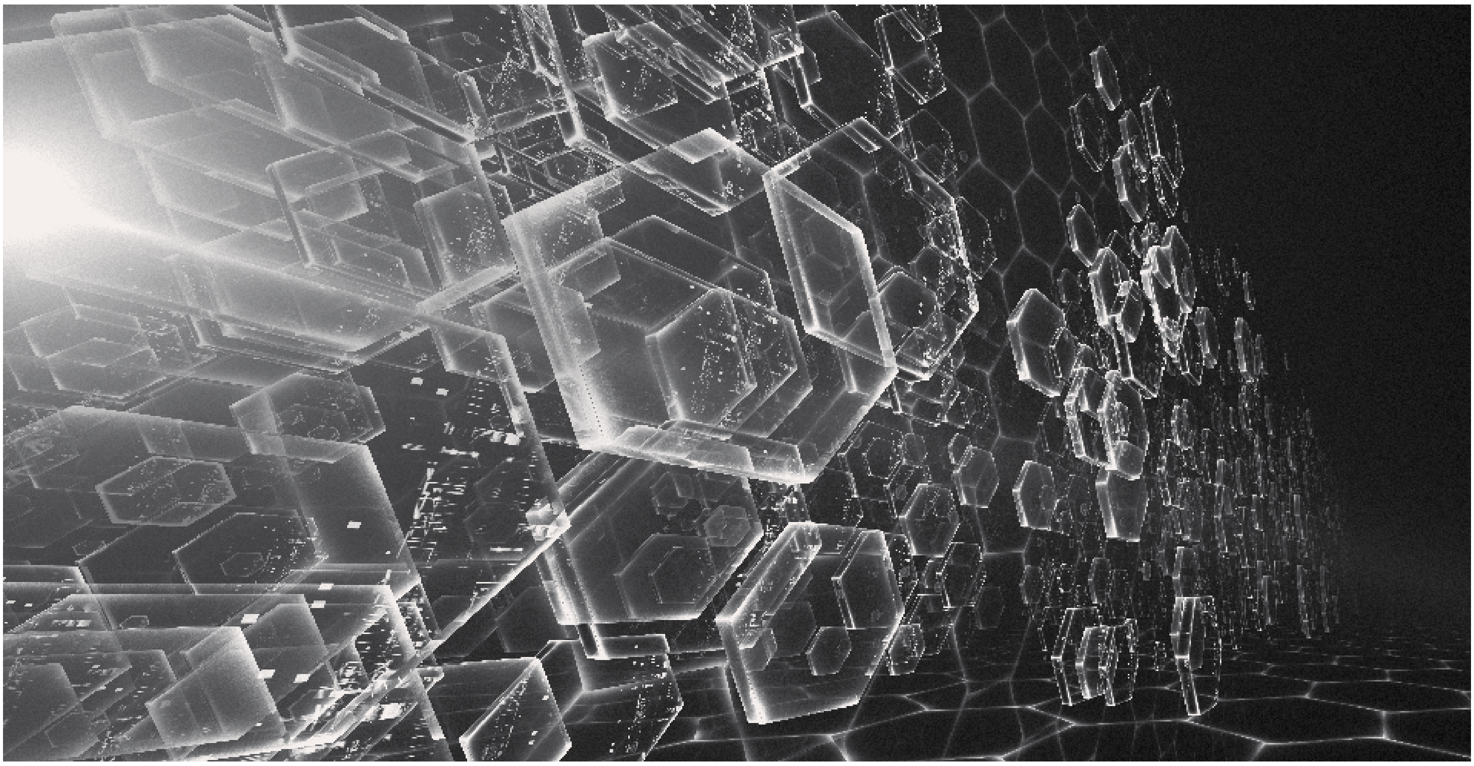
There are, however, limits to the use of arbitration as a dispute resolution tool in the Web3 space. We discuss a number of the relevant issues below.

- **Disputes involving consumers:** In relation to consumer-facing products or services, such as (for example) CEXs and NFT marketplaces, consumer protection laws may come into play in particular jurisdictions. In the English case of *Nifty Gateway v Soleymani* referenced above, and in contrast with the position taken in California pertaining to MakerDAO, the Court of Appeal overturned the first instance stay granted by the High Court, taking the view that there was, at least, a valid question to be tried over the validity of a consumer-facing

1 The Convention on the Recognition and Enforcement of Foreign Arbitral Awards of New York, USA, 10 June 1958

2 *Nifty Gateway v Soleymani* [2022] EWHC 733 (Comm)

3 *20-2569 - Johnson v. Maker Ecosystem Growth Holdings, Inc. et al*, United States District Court Northern District of California, 9th Circuit;



arbitration agreement, for reason of unfairness to the consumer[4]. A similar position was also adopted in the case of *Chechetkin v. Payward Ltd & Others*[5], where the English High Court determined that the existence of an arbitral award in relation to the subject matter of the dispute - while potentially highly relevant to the outcome of the case - did not impact on the fact that still it had jurisdiction to hear a claim commenced by a consumer of services.

- **Impact of local law:** Do the laws of the chosen seat support both arbitration and the arbitration of Web3 disputes? For example, do the national laws of the seat recognise smart contracts as binding legal relations? Or do they recognise cryptoassets as a specie of property? Is code considered to be a writing? And, at its most basic level, is holding, trading or otherwise interacting with cryptoassets lawful? In certain jurisdictions, it is not, or not entirely. It may therefore be legally or practically impossible to hold an arbitration seated in such jurisdictions, and the enforcement of awards in such jurisdictions is unlikely to be supported by the national courts, for reasons of public policy or illegality.
- **Intellectual property disputes:** In certain jurisdictions, disputes pertaining to intellectual property are incapable of being arbitrated, or limits are placed on their arbitrability. As such, in circumstances where intellectual property may be in dispute, the parties' choice of both governing law and seat is critical to their ability to resolve such disputes at arbitration.
- **Arbitration agreements contained in underlying code:** In relation to arbitration agreements baked into the underlying code attaching to cryptoassets, there exists a valid question as to whether or not such code may qualify as a writing, so as to be comparable with the terms of Article II of the New York Convention, and whether it may be said to be binding on persons who cannot easily read and understand such code on a plain reading – not least, where relevant, on the basis of the consumer protection principles mentioned above.
- **"On-chain arbitration":** There are significant questions as to whether decentralised pseudonymous "on-chain arbitration" may constitute arbitration in a traditional sense at all, and whether it may possibly meet all of the necessary requirements for enforceability pursuant to the New York Convention and national law. Whether that really matters, in circumstances where execution against the 'award' may be effected immediately by the 'arbitrators', is debatable – but, as a minimum, this may give rise to challenges before national courts, for reason of failures of due process or public policy.

These limitations give rise to the need to consider a range of factors when determining whether to refer Web3 disputes to arbitration.

How may these limits to arbitrability be mitigated?

While arbitration may be an excellent forum for the resolution of many Web3 disputes, the adoption of arbitration must still be carefully considered by the parties at the contracting stage, to ensure its suitability for the particular circumstances. The current limits of, or impediments to, the arbitrability of Web3 disputes are broad-ranging and for this reason, it is necessary to give specific consideration to the question of whether an arbitration agreement is suitable in each instance, as well as to the choice of institutional rules, and the seat of the arbitration.

4 *Soleymani v. Nifty Gateway LLC (Competition And Markets Authority intervening)* [2022] EWCA CIV 1297

5 [2022] EWHC 3057 (Ch)

- Choosing a Web3-favourable, progressive seat, with laws which appropriately recognise, categorise and support the development of cryptoassets and Web3 technology, may be critical to the successful arbitrability of Web3 disputes, and enforceability of arbitral awards.
- Adopting procedural rules which permit the granting of interim emergency reliefs may be a distinct advantage, in relation to disputes pertaining to digital assets which may fluctuate wildly in value in a short time frame.
- The application, from the very outset of contracting, of bespoke dispute resolution rules such as the Digital Dispute Resolution Rules developed by the UK Jurisdiction Taskforce[6], may also be advisable. As Web3 technology develops further, we would expect to see more tailored procedural rules being developed by a greater range of interested parties.
- Consumer-facing service providers may wish to adopt specific procedural rules such as the Consumer Arbitration Rules of the American Arbitration Association[7] which permit mass arbitration, or for batches of arbitration claims to grouped, which may offer a better chance of withstanding jurisdictional challenges and remaining compliant with consumer protection laws in certain jurisdictions.

How can arbitration remain the forum of choice for Web3 disputes?

There will be constant developments in the Web3 space over the coming years, both in terms of technological and legal advances. It will be critical for arbitration, and the national laws and international conventions which underpin it, to continue to adapt, in order to embrace technology as it develops and to remain relevant to, and suitable for, the resolution of Web3 disputes.

Adapting to developing technology may involve pushing the existing boundaries of international arbitration, and the fundamental norms which we associate with it. For example, could parties' mutual contractual agreement as to what constitutes due process, and their submission to directly enforceable decentralised on-chain arbitration, be capable of recognition and enforcement without challenge? Could parties in the Web3 space freely agree at the contracting stage that ex parte applications for interim reliefs shall be permissible, in the context of arbitration? May we see arbitration commenced by or against pseudonymous persons who wish to retain entire anonymity, even within the confidential confines of arbitration, or against persons unknown, in the manner which court action in certain jurisdictions may be? Could we potentially see the development of Web3-specific arbitration rules within a particular metaverse, and agree to seat our arbitrations there, in an effective private 'bubble', removed from the complexities of conflicts of often outdated national laws, and the vagaries of "public policy"?

While some of these concepts may seem far-fetched and outlandish, as both technology and law continue to develop, we may see issues of this nature being considered in all seriousness in years to come. The resolution of some of these legal issues may indeed bring greater confidence to the development of Web3 projects, and ultimately aid the adoption of the underlying technology, which presently suffers from a significant degree of legal uncertainty in many jurisdictions. The resolution of issues of this nature will be necessary, in order for arbitration to remain the most relevant and effective court of First World problems.

For more information, please contact the authors of this briefing:

DAN PERERA
Partner, Singapore
T +65 6411 5347
E dan.perera@hfw.com

JUSTINE BARTHE-DEJEAN
Senior Associate, Singapore
T +65 6411 5344
E justine.barthe-dejean@hfw.com

Additional research conducted by Missba Nizami, Trainee Solicitor.

6 https://resources.lawtechuk.io/files/2.%20UKJT%20Digital%20Disupte%20Rules.pdf
7 https://www.adr.org/sites/default/files/Consumer-Rules-Web.pdf

ARBITRATING DAO DISPUTES

A DELECTABLE CAN OF WORMS?

This article examines some of the relatively novel issues which may arise, when arbitrating (in the traditional sense, rather than on-chain) disputes relating to a Decentralised Autonomous Organisation (DAO).

Due to the broad range of jurisdiction – and issue-specific variables at play, it is only possible to scratch the surface of the multitude of potential issues which arbitrating DAO disputes may give rise to. It is, however, entirely apparent that there exist many complex and fascinating questions of law in this space, which remain to be resolved across key jurisdictions globally – many of which we shall see play out before tribunals (and, no doubt, courts), over the coming months and years.

What is a DAO?

A *Decentralised Autonomous Organisation*, more commonly referred to by its acronym, DAO, is a fairly new and novel form of association and is constructed through the use of computer code, and deployed on a blockchain. DAOs may be used to automatically process transactions or functions, through the use of smart contracts. The operations of a DAO are commonly directed through decentralised governance, and without any centralised management function. They are typically managed communally by their members, who hold tokens in a manner similar to members holding shares in a company, which permit them to direct the DAO's governance. Typically, some members in DAOs will exercise their governance rights and vote on proposals as to actions the DAO should take; others may remain largely passive; and another category of core members may hold administration keys, permitting them to effect alterations of the underlying code through which the DAO operates.

Levels of sophistication around DAO governance vary wildly. The DAO structure (or, commonly, the absence thereof) is not infrequently described as being akin to a, *"group chat with a bank account"* [1], or in similar parlance. More organised DAOs can, however, certainly rival highly professional corporations, with regard to their adoption of structure, management and governance practices.

There are a variety of categories of DAOs in existence, each with a particular nature or purpose, such as DAOs for service provision; DAOs established for social or charitable purposes; and DAO investment vehicles, to name but a few. Service DAOs use automation to fulfil a significant number of common corporate service functions, such as the routine payment of employee wages, or regular supplier invoices; or the automatic generation of outgoing invoices. As all data relating to a DAO's operations is stored on a blockchain, information relating to payments to employees, contractors or suppliers, or payments received from third parties, can be rapidly collated and categorised, for example, for accounting purposes, or to facilitate the filing of tax returns. The development of reliable recognised on-chain sanctions and compliance checks and "Know Your Client" identity verification services is likely to follow, as the technology in this space continues its rapid development. The automation of functions in this manner has the potential to result in significant cost savings for businesses, who may utilise service DAOs to perform traditionally labour-intensive corporate tasks. Elsewhere, investment DAOs have also been utilised as acquisition vehicles, giving rise to the acronym, "SPAD", as a variation of the special purpose acquisition company, or "SPAC", structure.

Since gaining initial popularity in around 2020, DAOs have grown rapidly in their adoption and there has been a significant increase in the total dollar value of funds locked into DAO contracts[2]. As their utility and technological functionality increases, it is anticipated that we shall see significant continued growth in DAOs going forward, leading to the establishment of a greater number of both independent stand-alone DAOs, created for the fulfilment of specific defined tasks; and the adoption of service DAOs within existing corporate structures, enabling a significant number of existing routine back-office business functions to be automated, at a fraction of the existing operating cost.

How will disputes relating to DAOs arise?

There exist myriad circumstances in which the operations of DAOs may give rise to disputes. DAOs have become the subject of regulatory enforcement actions – particularly in the U.S., where the Securities and Exchange Commission (SEC) has concluded that tokens offered and sold by a particular DAO constituted investment contracts, rendering them subject to federal securities laws[3]. Most recently, the SEC has turned its attention to the operator of the SushiSwap decentralised exchange, Sushi DAO, which has confirmed that it is now the subject of an SEC investigation, and issued a proposal to members to, *"Establish a legal defense fund to cover legal costs for core contributors and multisig participants"*[4]. Further, the U.S. Commodity Futures Trading Commission (CFTC), the body charged with regulation of the U.S. derivatives market, has also been active in taking enforcement action against Ooki DAO and its members for (*inter alia*) allegedly failing to ensure the conclusion of transactions on designated contract markets, in accordance with the U.S. Commodity Exchange Act[5].

Aside from the regulatory landscape and matters of public law, which will vary wildly across jurisdictions, disputes pertaining to DAOs may also arise in other ways, such as with regard to their operations vis-à-vis consumers, and the terms and conditions they impose on any users of their services; disputes as between members of the DAO, relating to (for example) the exercise of rights of governance, or multi-signature participation in the disbursement of treasury funds, for example; or disputes as between the DAO and other third parties, such as business partners, in relation to the performance (or the absence thereof) of contractual obligations. Disputes of this nature often arise under bilateral or multilateral private contracts which, given the inherently international and decentralised nature of Web3, commonly refer disputes to arbitration.

For a variety of reasons which we have previously considered in a broader Web3 context[6], arbitration may well be an excellent choice for the resolution of private disputes

1 The New York Times, *"The Latecomer's Guide to Crypto"*, Kevin Roose, 18 March 2022

2 **https://cointelegraph.com/news/dao-treasuries-top-25-billion-for-the-first-time-deepdao**

3 Securities and Exchange Commission Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO, 25 July 2017 (**https://www.sec.gov/litigation/investreport/34-81207.pdf**);

4 **https://forum.sushi.com/t/establish-sushi-legal-defense-fund/11813**

5 **https://www.cftc.gov/media/7681/enfookicomplaint092222/download**

6 **https://www.hfw.com/The-arbitrability-of-Web3-disputes-An-effective-court-of-First-World-problems-March-2023**

"It is of interest to note that both the SEC and the CFTC considered it appropriate (albeit in the context of the exercise of their regulatory powers) to take steps against unwrapped DAOs with no place or address of incorporation, and whose legal status is, perhaps, unclear."

relating to DAOs. However, whether this is in fact the case in each particular circumstance will require careful consideration, in order to ensure the best prospects of avoiding any unintended consequences, or thorny legal problems.

Can a DAO be a proper party to arbitration proceedings?

An significant initial consideration, at the outset of any potential arbitration involving a DAO, is the question of whether DAOs can themselves validly be the subject of arbitration proceedings. This will require careful analysis, in particular to determine whether the DAO in question has its own legal capacity and persona (to permit it to enter into an arbitration agreement), or whether it is ultimately merely an unorganised association of its individual members.

The answer to this question may very well differ from jurisdiction to jurisdiction. The law in many countries is languishing well behind the speed of technological development, and many have not yet reached the stage of having formally acknowledged the existence of DAOs, let alone considered their legal status. In the United Kingdom, the Law Commission is currently seeking evidence in advance of a public consultation in relation to the future legal status and characterisation of DAOs in England and Wales[7]; the Registration Authority of the Abu Dhabi Global Market (ADGM) free trade zone is also presently seeking feedback on its proposed legislative regime for distributed ledger technology and DAOs; in Singapore, DAOs are not automatically recognised as legal entities under existing legislation and, as in many other jurisdictions, they may therefore require a legal "wrapper" in order to obtain their own distinct legal persona, and to be capable of entry into contracts and arbitration agreements. In other jurisdictions, the legal status of DAOs is uncertain. As things stand, they may be treated very differently across different jurisdictions.

It is of interest to note that both the SEC and the CFTC considered it appropriate (albeit in the context of the exercise of their regulatory powers) to take steps against unwrapped DAOs[8] with no place or address of incorporation, and whose legal status is, perhaps, unclear. In a similar manner, could an unincorporated DAO which, for example, publishes terms of service incorporating an arbitration agreement on its public website, by which users of its services may be bound (which has validly been found to be the case previously[9]), open the door to arbitration against unincorporated associations? Or, by taking such actions, would individual members of the DAO be deemed to be entering into arbitration agreements in their personal capacities? Many questions of this nature are yet to be fully tested in the courts of major jurisdictions globally.

In order to address some of these issues of legal uncertainty, many DAOs have chosen to operate – and to contract – through a recognised legal entity, such as a Cayman Islands foundation; a British Virgin Islands limited company; a Swiss Association; a Singapore Public Company Limited By Guarantee; or a Wyoming "DAO LLC", or elsewhere. A number of jurisdictions globally have existing corporate structures which are considered suitable for the needs of a DAO, whereas others have adopted specific legislation that supports the legal incorporation and recognition of DAOs, and which aims to attract DAOs to incorporate there. We understand that other jurisdictions are considering enacting such legislation, or creating new corporate structures which would be particularly suitable for DAOs.

7 https://www.lawcom.gov.uk/project/decentralised-autonomous-organisations-daos/

8 Sushi DAO and Ooki Dao respectively, see 3, 4 and 5 above

9 *Johnson v. Maker Ecosystem Growth Holdings, Inc. et al*, United States District Court Northern District of California, 9th Circuit, Case No. 20-cv-02569-MMC

Incorporation of a legal entity with which to wrap the activities of a DAO and its assets, liabilities and contractual obligations also may bring with it other benefits, some of which are touched upon below.

In contrast, the risk of not legally wrapping a DAO in a disputes context arises as a result of the fact that the legal status of an unwrapped DAO is, in many jurisdictions, unclear. As has previously been argued, *"…if you don't formalize a legal structure for a human-created entity, courts will impose one for you…"* [10]. This statement is equally valid in relation to the potential arbitrability of DAO disputes. Certain jurisdictions may determine, through court judgments or new legislation, that unincorporated DAOs do nonetheless exhibit sufficient characteristics of an existing recognised legal structure, so as to have their own legal persona, and to validly enter into contracts and be a participant in arbitral proceedings. There already exist proforma best practice governance standards for DAOs, including those set out within the Model Law for Decentralised Autonomous Organisations published by the Coalition of Automated Legal Applications (COALA)[11] which, if adopted by states, may result in unwrapped DAOs being granted independent legal personality.

How can a DAO be notified of the commencement of proceedings?

If it is considered, for whatever reasons, that a DAO - whether legally wrapped or not – is a valid party to an arbitration agreement and proceedings arising under it, another potentially thorny issue concerns how best to validly serve the DAO with a notice of arbitration, and to ensure ongoing compliance with recognised standards of arbitral due process throughout the proceedings. To offer but one example of a prevalent issue in the world of Web3, locating information relating to the applicable registered address or physical, or even email, address of a range of market participants, is often something of a challenge. Identifying individual members of a DAO, at least beyond adopted pseudonyms, may be an incredibly difficult task.

Effecting service so as to comply with national laws or institutional arbitration rules may be considerably simpler in the context of legally wrapped DAOs, which will have a registered office address somewhere in the world. Similarly so, perhaps, when the DAO or its members are publicly being actively represented by legal counsel of record. A careful case-by-case analysis of how service can be effected should be considered, prior to the attempted commencement of any arbitration proceedings.

Outside of the sphere of arbitration, it is of interest that the CFTC opted to serve its recent Complaint against the unincorporated Ooki DAO through a *"Help Chat Box"* and *"an online discussion forum"* on the Ooki Dao public website. The CFTC claimed these to be the channels which Ooki DAO itself held out as means through which it may be contacted. The receipt of the Complaint was in fact confirmed by Ooki Dao via its official Twitter account, which assisted a California court to uphold these non-traditional methods of service as valid[12].

This potential complexities around this, ordinarily, relatively simple procedural task are reflective of the broader challenges with ensuring that DAO, and possibly also its members, are afforded what must amount to fairness and due process, in all aspects of the arbitration proceedings. A failure to do so may result in any award eventually being challenged at the time of enforcement. Achieving this standard may however, in certain cases, prove incredibly complex. Similarly, from a DAO's perspective, ordinarily simple tasks, such as obtaining legal advice, may require careful planning and consideration, and possibly even the establishment of a legal engagement and response entity, in order to avoid inadvertently waiving privilege over advice disseminated to all members globally. In all, a plethora of interesting legal issues for consideration.

Enforcement of arbitral awards against DAOs

Assuming one is able to obtain an arbitral award against a DAO, how would enforcement against the DAO take place, in light of its decentralised nature, and taking account of the fact that it may not even be capable of legally owning assets directly? Once again, this will require very careful consideration on a case-by-case basis. Much may depend on whether the DAO is legally wrapped, and the jurisdiction of incorporation of the legal entity through which it operates – and, of course, the location of any assets which may be enforced against. In circumstances where the DAO has a legal wrapper, more 'traditional' considerations relating to the enforcement of arbitral awards are likely to apply. Nonetheless, issues such as public policy of the jurisdiction of enforcement – and its attitude towards, and the legality of, participation in Web3 projects - should also be carefully considered.

If a DAO is not legally incorporated, or otherwise cannot legally own assets, it is certainly possible that there exists the potential to attack the assets of the members of the DAO, who have caused it to act in the manner complained of. Without a legal wrapper, members may, in particular jurisdictions, be treated as general partners or similar, and bear unlimited joint and several liability – and there will not exist any corporate veil to be pierced, in order to protect them.

However, in order to seek enforcement against DAO members' assets, it may be considered necessary to have an arbitral award against such members directly, in their personal capacities. If their identity is known or discoverable (once again, not always a simple task), it may be argued that they are valid parties to the arbitration agreement.

10 "How to Sue A Decentralized Autonomous Organization", Stephen D Palley, **https://www.coindesk.com/markets/2016/03/20/how-to-sue-a-decentralized-autonomous-organization/**

11 Coalition of Automated Legal Applications, Model Law for Decentralised Autonomous Organisations (DAOs), 2021: **https://coala.global/wp-content/uploads/2021/06/DAO-Model-Law.pdf**

12 Commodity Futures Trading Commission v Ooki Dao, United States District Court, Northern District of California, Case No. 3:22-cv-05416-WHO, Order concluding that service has been achieved: **https://storage.courtlistener.com/recap/gov.uscourts.cand.400807/gov.uscourts.cand.400807.63.0.pdf**

They may, perhaps, be the only valid parties to an arbitration agreement, from the side of the DAO, if the DAO is unincorporated.

As such, prior to the commencement of any arbitration proceedings against a DAO, early consideration should be given to the question of whether: (a) a DAO; (b) some or all of its members; or (c) any combination of such parties, may validly be Respondent(s) in arbitration proceedings. This determination may be critical to a Claimant's prospects of eventual recovery. Similar considerations of legal persona and standing are, of course, equally valid and relevant in the context of considering the commencement of claims at arbitration by, or on behalf of, a DAO or its members, or any class thereof.

The future of DAO disputes

As jurisdictions slowly develop their own settled positions relating to the extent of their recognition of DAOs, and their corresponding legal status and persona, many of the issues considered in this article will become clearer. However, that is unlikely to occur in short order and there will, for many years, remain a very significant disparity between jurisdictions globally, as to their treatment of both incorporated and unincorporated DAOs, and a great deal of legal uncertainty attaching to their status and capacity.

Considering the (once again now, growing) value of funds flowing through the crypto markets, and the tremendous range of potential uses of DAOs and the continuing increase in their adoption, it is clear that disputes will arise, and will need to be fought over. The manner in which DAOs are formed and structured, and any legal wrappers which they may adopt, should be carefully considered from the very outset, in order to address some of the complexities set out herein. How these issues will be resolved by courts and arbitral tribunals over the coming years is, presently, something of a delectable can of worms, waiting to be opened.

For further information, please contact the author of this briefing:

DAN PERERA
Partner, Singapore
T +65 6411 5347
E dan perera@hfw.com

JUSTINE BARTHE-DEJEAN
Senior Associate, Singapore
T +65 6411 5344
E justine.barthe-dejean@hfw.com

HFW

INTERNATIONAL ARBITRATION | SEPTEMBER 2023

HOW CRYPTO EXCHANGE DISPUTES ARE SHAPING THE FUTURE OF CONSUMER ARBITRATION AGREEMENTS: A GLOBAL PERSPECTIVE

As cryptocurrencies and non-fungible tokens (NFTs) gain in popularity and adoption globally, it is inevitable that we will see a corresponding increase in disputes arising between consumers, and major exchanges facilitating the sale and purchase of cryptocurrencies and NFTs. Cryptocurrency and NFT exchanges (collectively, Exchanges) are largely unregulated in many jurisdictions. These Exchanges do not solely offer services to a limited group of sophisticated investors but make their services available to retail consumers (Consumers) from multiple global jurisdictions – often with very limited, or no, "Know Your Customer" due diligence.

Exchanges commonly adopt arbitration agreements in their standard terms to protect their interests, not least in order to avoid the potential for class actions against them, by groups of Consumers who allege they have suffered similar losses arising out of the same cause of action. Many Exchanges go further, specifically adopting institutional arbitration rules which make no concessions for Consumers.

The use of arbitration agreements in these circumstances has resulted in challenges for courts, regulators, and the Exchanges. For the courts and regulators in jurisdictions concerned with maintaining an "arbitration-friendly" reputation, there is tension between holding parties to their bargain by enforcing such arbitration agreements, and ensuring that Consumers, who are often less resourced and experienced than Exchanges, are not unduly disadvantaged in the arbitrations. For Exchanges, the advantages of adopting arbitration as an enforceable, predictable, expeditious and confidential means of resolving disputes with Consumers must be balanced against the risk: (i) that the agreements may be held by regulators and courts to be void and of no legal effect; (ii) of facing expensive and time-consuming satellite litigation concerning the validity of their arbitration agreements; and (iii) the bad publicity resulting from the enforcement of these agreements against Consumers.

In this article, we examine the criticisms associated with using arbitration agreements in contracts between businesses and Consumers, which are based on the business' standard terms, including those of various Exchanges (B2C Arbitration Agreements); and the measures that regulators, arbitral institutions, as well as the Exchanges have taken to address these criticisms. We also examine the effectiveness of these measures, recent developments, and the road ahead.

The role of cryptocurrency and NFT exchanges

Cryptocurrency exchanges generally fall within one of two categories:
a) centralised exchanges (**CEXs**), which permit consumers to on-ramp and exchange fiat currency (e.g., US dollars or British Pounds Sterling) for a range of cryptocurrencies, which are held by the exchange until withdrawn to a private 'wallet' – well-known examples being Binance and Coinbase; or
b) decentralised exchanges (**DEXs**) - essentially, smart contract protocols that permit parties to exchange one cryptocurrency for another directly, via decentralised applications (**DAPPs**) linked to private cryptocurrency 'wallets'. These smart contracts are commonly accessed via a recognised front-end user interface, an example being the DEX user interface operated by Uniswap Labs.

NTFs are commonly traded via NFT trading platforms, such as those operated by OpenSea[1], which allows consumers to browse and trade NFTs via an online marketplace – essentially a user interface which permits interaction with smart contracts on the relevant blockchains.

The services offered by all such Exchanges are often subject to specific geographical restrictions and, particularly in the context of CEXs, relevant "Know Your Client" regulations. However, many Exchanges (and particularly DEXs) are generally available to, and accessible by, Consumers irrespective of location and domicile. Many of the major Exchanges publish their standard terms of use on their website and/or during an enrolment process where Consumers are deemed to have agreed to by using the services offered by these Exchanges.

Common criticisms of arbitration agreements in consumer contracts

The use of B2C Arbitration Agreements pre-dates the existence of Exchanges, for example. B2C Arbitration Agreements have been present in the securities industry in the United States since the 1990s, and more recently, in the standard terms of various Web2 service providers such as DoorDash, Amazon, and Uber.[2]

The use of B2C Arbitration Agreements has been criticised by consumer protection groups, the media, academics, and politicians. Criticisms include:

The use of B2C Arbitration Agreements has been criticised by consumer protection groups, the media, academics, and politicians. Criticisms include:
a) Awareness of consent: consumers are often unaware that they have consented to binding arbitration. B2C Arbitration Agreements are frequently found in lengthy standard terms, which consumers will not generally read or understand before using the services provided. For example, consumers who used wayfair.com, an online housewares vendor, were deemed to have consented to arbitration by simply accessing the wayfair.com website, each page of which contained a link to the arbitration agreement that was "*two-thirds of the way through* [the] *4,600 word-long terms of use*".[3]
b) Arbitration is typically more expensive for Consumers than equivalent proceedings in court. Under various institutional rules that make no concessions or differentiations for Consumers, consumers are liable for paying not only their legal fees, but also the costs of arbitration which include filing, case management, and arbitrator fees, which in total could be considerably more expensive for Consumers than equivalent proceedings in their local courts, in which they may also avoid an adverse costs order if unsuccessful.
c) The chosen seat of arbitration or location for hearings may unfairly prejudice a Consumer. Arbitration agreements have been challenged on the basis of prejudice to the Consumer, where the seat of the arbitration proceedings is inconvenient for the Consumer. It may, for example, be considered prejudicial to a Consumer located in Singapore to be required to arbitrate disputes in a far-flung jurisdiction such as Panama, against a business offering its services globally.
d) Arbitration may result in less favourable outcomes for Consumers. Research has suggested that, at least in the securities industry, "*securities firms hold information and selection advantages over consumers that result in more industry-friendly arbitration outcomes*."[4]
e) Arbitration restricts Consumers' ability to commence class action lawsuits. The rules of arbitral institutions commonly contain restrictions on joinder and consolidation- meaning that individual Consumers are prevented form grouping together to consolidate their arbitration proceedings arising out of the same set of facts (such as an Exchange service outage) against businesses. At least in the United States, this is the primary way for Consumers to hold large businesses to account, as class actions lower the otherwise often prohibitive legal costs for each Consumer and, in jurisdictions which so permit, such costs may only be payable by such Consumers upon the condition of successful recovery of damages in the proceedings.

[1] Ozone Networks, Inc. doing business as OpenSea, https://opensea.io/tos
[2] Legal | Uber
[3] Forced Arbitration: A Clause for Concern - Consumer Reports
[4] https://siepr.stanford.edu/publications/tipping-scales-balancing-consumer-arbitration-cases

Key global legislative and institutional responses to arbitration agreements in consumer contracts

Several jurisdictions have responded to these criticisms by regulating the terms of B2C Arbitration Agreements, regardless of the seat and/or applicable institutional rules. These regulations similarly apply to arbitration agreements between Consumers and Exchanges. For example:

a) The European Union Council Directive 93/13/EEC on Unfair Terms in Consumer Contracts creates a presumption that arbitration clauses contained in contracts concluded between a seller or a supplier and a Consumer are not binding on the latter.

b) The Unfair Contract Terms in Consumer Contracts Regulations 1999 Regulation 1(q) of Schedule 2 of the UK Unfair Terms in Consumer Contracts Regulations 1999 expressly states that terms, "...*excluding or hindering the consumer's right to take legal action or exercise any other legal remedy, particularly by requiring the consumer to take disputes exclusively to arbitration not covered by legal provisions* [...] *may be regarded as unfair...*".

c) Further, Sections 89 to 91 of the English Arbitration Act 1996 provides that Part 2 of the Consumer Rights Act 2015 (**CRA**) applies to an arbitration agreement, "...*whatever the law applicable to the arbitration agreement is...*". Accordingly, for consumer claims under GBP 5,000, arbitration clauses are automatically unfair and foreign law clauses are automatically disapplied, whilst consumer claims over GBP 5,000 are to be disregarded if the consumer has a close connection with the United Kingdom.

d) In Australia, the Federal Court ruled that the country's "fairness" requirements under the Australian Consumer Law, "...*encompass, but are not limited to, whether or not a term grants one party an additional right, protects them from consequences to which the other party is subject, or creates a significant imbalance between the parties...*" This has not been specifically applied to arbitration agreements yet, but the Australian legislation bears the hallmarks of the EU and UK approach, as exhibited by Section 25(k) of the Australian Consumer Law, which states that a type of clause that may be unfair would be one that, "...*limits, or has the effect of limiting, one party's right to sue another party...*".[5]

By contrast, jurisdictions including Singapore and the United States have traditionally adopted a more liberal approach towards B2C Arbitration Agreements.

a) The Singapore Unfair Contract Terms 1977 (**UCTA**) expressly states that, "...*an agreement in writing to submit present or future differences to arbitration is not to be treated under this Part as excluding or restricting any liability...*".

b) There is similarly no prohibition on the ability of a company to enter into arbitration agreements with Consumers in the United States. Congress voted against the Consumer Financial Protection Bureau promulgation of a rule in 2016 that would have prohibited consumer financial service providers (including Exchanges) from including class action waivers in their arbitration agreements.

Arbitral institutions have also attempted to mitigate the perceived unfairness of B2C Arbitration Agreements. For example, JAMS provides for minimum standards in arbitrations in circumstances where a business has, "...*an arbitration clause in its agreements with individual consumers and there is minimal, if any, negotiation between the parties as to the procedures or other terms of the arbitration clause...*" – which would very likely be the case for arbitration agreements that are typically found in the standard terms of Exchanges. These minimum standards address many of the criticisms outlined above.

They include, among other things:

a) requirements that the consumer must be provided with written notice of the arbitration agreement and that its existence, terms, conditions and implications must be clear;
b) limiting the arbitration fees paid by the consumer to US $250 and obliging the business to bear all the costs of the arbitration such as the JAMS Case Management Fee and all professional fees for the arbitrator's services;
c) giving consumers the right to an in-person hearing in his or her hometown area;
d) entitling either the business or the consumer to seek remedies in, "...*small claims court for disputes or claims within the scope of its jurisdiction...*"; and[6]

[5] Is arbitration innately unfair? - Contracts and Commercial Law - Australia (mondaq.com)

[6] Consumer Arbitration Minimum Standards | JAMS Mediation, Arbitration, ADR Services (jamsadr.com)

e) providing for the possibility of bringing a class action arbitration, unless the relevant arbitration agreement, "*contains a class preclusion clause or its equivalent, unless a court orders the matter or claim to arbitration as a class action.*"

The American Arbitration Association (**AAA**) has also formulated a set of Consumer Arbitration Rules and a Consumer Due Process Protocol Statement of Principles which together seek to strike an appropriate balance in fairness between the Consumer and the business. By way of example, under these Rules, if not agreed by the parties, the location of any physical hearing which may be required shall be determined by the AAA, and shall be one which is reasonably convenient for the parties, taking account of, "*...their ability to travel and other pertinent circumstances...*"[7].

However, not all arbitral institutions have rules specifically catered toward arbitrations with Consumers. Unlike JAMS and AAA, three of the dominant institutions for arbitration in Asia: the Singapore International Arbitration Centre (**SIAC**), Hong Kong International Arbitration Centre (**HKIAC**), and the International Chamber of Commerce (**ICC**) do not have consumer-focused arbitration rules, nor do they provide for class action arbitration. As such, subject to any municipal legislation providing otherwise, Consumers who consent to an arbitration agreement providing for an arbitration administered by the aforementioned Institutions will not benefit from those additional provisions. Conversely this might make those Institutions appealing to businesses. who may actively seek to adopt the rules of these Institutions.

Exchanges and arbitration agreements

Being relatively late entrants to the world of B2C Arbitration Agreements, Exchanges have had the benefit of learning from various financial services and other Web2 service providers' experiences with arbitration agreements in determining: (i) whether to include arbitration agreements in their standard terms; and (ii) the Institution and applicable rules of such arbitration. Perhaps unsurprisingly, Exchanges located in Asia tend also to favour arbitral Institutions with a significant presence in Asia, such as the SIAC, HKIAC, and ICC, whilst Exchanges located in North America tend to favour arbitral institutions located in North America, such as JAMS and AAA which, as explained above, include concessions for Consumers. Regardless of the seat or the rules, many Exchanges expressly or impliedly exclude Consumer rights to commence class action proceedings against them. For example:

CEXs
a) Binance's applicable Terms of Use[8] refer disputes to arbitration under the rules of the HKIAC, seated in Hong Kong, and include an express waiver of class or representative actions, and the consolidation of proceedings is expressly specified as being impermissible, without the consent of all parties, "*including Binance*";
b) Similarly, Crypto.com's non-U.S. terms also require disputes to be arbitrated, "*...solely through individual action, and will not be brought as a class arbitration, class action or any other type of representative proceeding....*", seated in Hong Kong, under the administration of the HKIAC[9];
c) Bybit refers disputes to arbitration in Singapore under the Arbitration Rules of the SIAC[10], whose rules do not presently specifically cater for class arbitration proceedings;
d) Another major CEX, KuCoin, requires that disputes, "*...shall be submitted to the Singapore International Arbitration Commission for arbitration...*"[11] [sic]. No express choice of seat is specified; and
e) Gate.io's User Agreement[12] refers disputes to arbitration in Panama, in accordance with the Arbitration Rules of the ICC.

[7] Pursuant to R-11 of the AAA's Consumer Arbitration Rules (https://adr.org/sites/default/files/Consumer%20Rules.pdf), the place of any in-person arbitration hearing shall, if not agreed by the parties in dispute, be determined by the AAA, with reference to the underlying principle that, "*...the proceedings should be conducted at a location which is reasonably convenient to both parties with due consideration of their ability to travel and other pertinent circumstances...*".

[8] Binance Terms of Use, 12 April 2023, Article X: https://www.binance.com/en/terms

[9] Crypto.com Exchange Terms and Conditions published by CRO DAX Limited, 14 February 2023, Clause 26.10: https://crypto.com/exchange/document/tnc

[10] Bybit Fintech Limited Terms and Conditions, August 4, 2021: https://www.bybit.com/app/terms-service/information

[11] Terms of Use, 2019/08/13 16:20:35, Article 100: https://www.kucoin.com/news/en-terms-of-use

[12] https://www.gate.io/docs/agreement.pdf

f)	United States based CEX such as Kraken (the trading name of Payward, Inc.), require users to agree to arbitration in San Francisco, California, administered by JAMS, with the state or federal courts of San Francisco having exclusive jurisdiction over any appeals of an arbitration award.

DEXs	
a)	The operator of the front-end user interface of one of the most popular DEXs, Uniswap Labs, refers disputes to arbitration in New York under the JAMS Optional Expedited Arbitration Procedures under its Terms of Service. Uniswap Labs' terms expressly specify that, "...[u]*nless we agree otherwise, the arbitrator may not consolidate your claims with those of any other party...You must bring any and all Disputes against us in your individual capacity and not as a plaintiff in or member of any purported class action, collective action, private attorney general action, or other representative proceeding. This provision applies to class arbitration. You and we both agree to waive the right to demand a trial by jury...*"[13];
b)	Another popular DEX user interface, operated by dYdX, also refers disputes between users and itself to JAMS arbitration, on an individual basis and, "...*will not be brought as a class arbitration, class action, or any other type of representative proceedings...*" this time in San Francisco, and under the JAMS Streamlined Arbitration Rules and Procedures[14]; and
c)	Popular DEX PancakeSwap's Terms of Service refer disputes to HKIAC arbitration in Hong Kong, and also include an express waiver of both class action and, "*class arbitration*"[15].

It is apparent from the above that many major Exchanges remain keen to avoid any potential for multiple or consolidated claims against them. In the absence of the adoption of arbitral rules which permit multiple arbitrations to be consolidated or batched, taking such action would not ordinarily be a viable option for groups of users of an Exchange's service, and claims would need to be brought individually. Similarly, absent any agreement to consolidate more than one set of arbitral proceedings, achieving consolidation of multiple arbitrations arising out of similar facts would be difficult at best, and more likely, impossible in these circumstances, as we have explored previously in our previous comparative analysis of consolidation requirements, across key arbitral rules globally[16].

Challenges to and effectiveness of such measures

Notwithstanding the criticisms above, the courts in the United States (where many challenges to B2C Arbitration Agreements have been brought), have traditionally adopted a strict approach towards the enforcement of B2C Arbitration Agreements. No distinctions are generally made between arbitration agreements between businesses (who often have equal bargaining power) and B2C Arbitration Agreements (who involve parties that do not). The United States courts have held that challenges to B2C Arbitration Agreements are generally limited to the same grounds as any arbitration agreement such as assent, unconscionability, lack of consideration, or fraud.[17]

Despite the limited scope for Consumers to challenge B2C Arbitration Agreements, businesses must still ensure that B2C Arbitration Agreements meet certain minimum standards of fairness and any changes to such terms are communicated timely and unambiguously to Consumers. The United States District Court in California recently denied Live Nation Entertainment and Ticketmaster's (ticket sales and distribution companies) motion to compel arbitration against users who complained that they were compelled to pay uncompetitive fees to purchase tickets on Live Nation Entertainment and Ticketmaster's online platforms. The court avoided the relevant B2C Arbitration Agreement as, among others, Live Nation Entertainment and Ticketmaster had unilaterally changed the arbitration provider in the B2C Arbitration Agreement from JAMS to a relatively new institution, New Era, whose rules the court held to contain several objectionable elements including: (i) a mass arbitration protocol allowing New Era's affiliated neutrals to make determinations on bellwether cases which would bind subsequent cases; (ii) the lack of a right to discovery; and (iii) the limited right of appeal.[18]

The court arrived at this decision even though Live Nation Entertainment and Ticketmaster had an express right under the relevant B2C Arbitration Agreement to unilaterally amend the terms of the B2C Arbitration Agreement.

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[13] Clauses 8.2 and 8.3, Uniswap Labs Terms of Service, March 3, 2023: https://uniswap.org/terms-of-service
[14] dYdX Trading Limited Terms of Use, April 18, 2023, Section 15:
[15] PancakeSwap Terms of Service, 28 February 2023: https://pancakeswap.finance/terms-of-service
[16] https://www.hfw.com/downloads/003468-Core-issues-in-international-arbitration.pdf
[17] Amy J. Schmitz, American Exceptionalism in Consumer Arbitration, 10 Loy. U. Chi. Int'l L. Rev. 81 (2012) (https://core.ac.uk/reader/217048190)
[18] Skot Heckman, et al. v. Live Nation Entertainment, Inc., et al (Case No. CV 22-0047-GW-GJSx), page 27

The court described such changes as involving an "*extreme amount of procedural unconscionability*" for, among other reasons: (i) that for the users to discover that he/she had agreed to resolve his/her dispute under a novel mass arbitration procedure, the users, "*would need to parse through New Era's separately posted Rules and comprehend their implications*";[19] and (ii) these changes were made whilst Live Nation Entertainment and Ticketmaster were engaged in several JAMS administered arbitrations against other users (which, as explained above, provide several protections to Consumers).

Further, the court held that the class arbitration procedure in the New Era rules was substantively unconscionable as such rules, "*contain a substantial amount of ambiguity*", as to how the bellwether cases are to be applied to the subsequent cases and provide no guidance on how the New Era affiliated neutral is to exercise his/her discretion on whether and how to apply the bellwether cases.[20]

The above decision underscores the importance of ensuring that the terms of B2C Arbitration Agreements meet the minimum standards good faith and fair dealing, and any changes thereof are communicated to Consumers in an unambiguous and easy to understand manner. Additionally, whilst the inclusion of class arbitration provisions in B2C Arbitration Agreements may be seen as a boon for Consumers, the contents of such provisions will not escape scrutiny and the entire B2C Arbitration Agreement risks being avoided, should it be found to be substantively unconscionable, as was the case for Live Nation Entertainment and Ticketmaster.

Aside from challenges on these limited and grounds, the traditionally strict approach has been recently re-emphasised by the United States Supreme Court in a case involving Coinbase, who had filed a motion to compel arbitration and moved to stay class action proceedings in the United States District Court commenced by several users who alleged that Coinbase failed to replace funds fraudulently taken from Coinbase users' accounts. A narrow majority held that the CEX's appeal against the denial of a motion to compel arbitration automatically stays the users' proceedings in the district court.[21] This decision (which is of general application, not just in relation to B2C Arbitration Agreements) is a re-affirmation of the Griggs principle under United States Federal law (i.e., a district court must stay its proceedings while the interlocutory appeal on arbitrability is ongoing) and a further indicator that the United States federal courts are unwilling to make any special exceptions to the general principles on the enforcement of arbitration agreements in B2C Arbitration Agreements.

In light of the above, most of the successful challenges to the enforcement of B2C Arbitration Agreements are either: (i) the result of a decision by the business themselves, from either the negative publicity of enforcing such provisions against Consumers, or being faced with the unintended prospect of having to pay millions in arbitration filing fees in circumstances where mass arbitrations have been commenced against them; or (ii) the result of certain mandatory rules of municipal law. Businesses must therefore be mindful of the full range of potential implications of inserting arbitration clauses in their standard terms of use, including the reputational risks arising therefrom.

In relation to the former, RushCard (an online financial services provider) was compelled to waive its rights to arbitration in 2015, due to public pressure, in disputes with 132,000 consumers who lost access to their accounts for several days. Similarly, in 2021, Amazon informed its customers in the United States that they could resolve disputes with Amazon in the United States. federal court system, notwithstanding the presence of an arbitration agreement in its applicable standard terms of use. Observers have suggested that this change was the result of Amazon facing more than 75,000 mass arbitration claims commenced by users of products which, under the applicable arbitration rules, would entail Amazon paying "*tens of millions of dollars*" in arbitration fees.[22]

More recently, DoorDash (a food delivery service) found itself in the uncanny position of attempting and failing to set aside an arbitration agreement in *its own* standard terms of use. A US District Court upheld the arbitration clause in its standard terms of use and found DoorDash liable to pay US $12 million in arbitration fees to the AAA to administer mass arbitration proceedings commenced by 5,879 DoorDash couriers who each independently asserted in individual arbitrations that they were improperly classified as independent contractors instead of employees.[23]

In relation to the latter, Consumers in England have had some success in relying on municipal consumer protection legislation to challenge arbitration agreements with Exchanges. In the case of *Soleymani v Nifty Gateway LLC* [2022] EWCA Civ 1297 (***Soleymani***), the English Court of Appeal allowed part of an appeal by an English-domiciled user of an NFT trading platform whom, among other things, sought declaratory relief that the New York seated arbitration agreement was "*unfair and not binding on him*". Whilst the Court of Appeal disagreed with the assertion that the English courts had the jurisdiction to hear the application under section 15(B) of the Civil Jurisdiction and Judgments Act 1982 (**CJJA**) on the grounds that where arbitration is the subject matter of proceedings, such proceedings are excluded from the application of the Brussels Recast Regulation, the Court of Appeal observed that under changes

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[19] Skot Heckman, et al. v. Live Nation Entertainment, Inc., et al (Case No. CV 22-0047-GW-GJSx), page 14

[20] Skot Heckman, et al. v. Live Nation Entertainment, Inc., et al (Case No. CV 22-0047-GW-GJSx), page 20

[21] *Coinbase v Bielski* (599 U.S. ___ (2023)

[22] https://www.nytimes.com/2021/07/22/business/amazon-arbitration-customer-disputes.html

[23] *Abernathy v. DoorDash* 438 F. Supp. 3d 1062 (N.D. Cal. 2020)

to the court rules governing the jurisdiction of the English courts taking effect on 1 October 2022, the English Courts would have jurisdiction to hear the claim.[24]

The Court of Appeal nonetheless directed that there should be a trial to determine if the arbitration agreement with Nifty Gateway was, "...*null and void, inoperative, or incapable of being performed...*", on the grounds that the English court is better placed to determine whether Soleymani's rights as a consumer had been vindicated.

Many of the Court of Appeal's observations in *Soleymani* on the applicability of consumer protections under the CJJA were subsequently affirmed in the case of *Payward, Inc. and others v Chechetkin* [2023] EWHC 1780, which is the subject of another HFW briefing[25]. where the English High Court refused to enforce a final award issued by a Tribunal in a New York seated JAMS Arbitration in a dispute between Payward (a group of companies which run the Kraken Exchange) and a user domiciled in the UK, on the grounds that, among others, the enforcement of the final award would be contrary to public policy, as so doing would enable Payward to bypass the protections in the CRA for consumers such as the defendant , who had a close connection with the UK.

What this means for the direction of travel

As cryptocurrencies and NFTs increase in popularity and adoption globally, it is likely that more Consumers will attempt to set aside arbitration agreements contained in an Exchange's standard terms. Exchanges must therefore be aware of and alive to the risks, both legal and reputational, of including arbitration agreements in their standard terms, particularly in jurisdictions with robust consumer protection laws such as, the United Kingdom, European Union, and Australia, and increasingly, in the United States - where there is a real risk that B2C Arbitration Agreements may be found to be void and of no legal effect, regardless of how they are drafted. Businesses also risk being faced with lengthy satellite litigation when Consumers seek to challenge the validity of their arbitration agreements.

Mitigation of risks

There may be ways in which Exchanges can mitigate these risks, whilst maintaining arbitration as the sole, or majority, forum for dispute resolution in B2C contracts, these include:

- The adoption of specific Consumer-friendly arbitration rules;
- The inclusion of an opt-out of arbitration provision, triggered by notice by the Consumer within a specified period of acceptance (as has been adopted by Crypto.com in the terms applicable to the use of its U.S. application[26]); or
- Applying different sets of terms and conditions, with bespoke and jurisdiction-specific arbitration provisions for Consumers located in different global jurisdictions.

However, the present direction of travel demonstrates that these approaches may not succeed in all jurisdictions, and may be the subject of court challenges from Consumers. As such, broad consideration of all relevant factors, and the careful, appropriate and balanced tailoring of bespoke arbitration agreements or other dispute resolution clauses, as well as careful consideration if and when a business wishes to make changes to them, should be considered imperative for any such businesses engaged in offering Consumer-facing goods or services across multiple jurisdictions.

For more information, please contact the authors of this alert

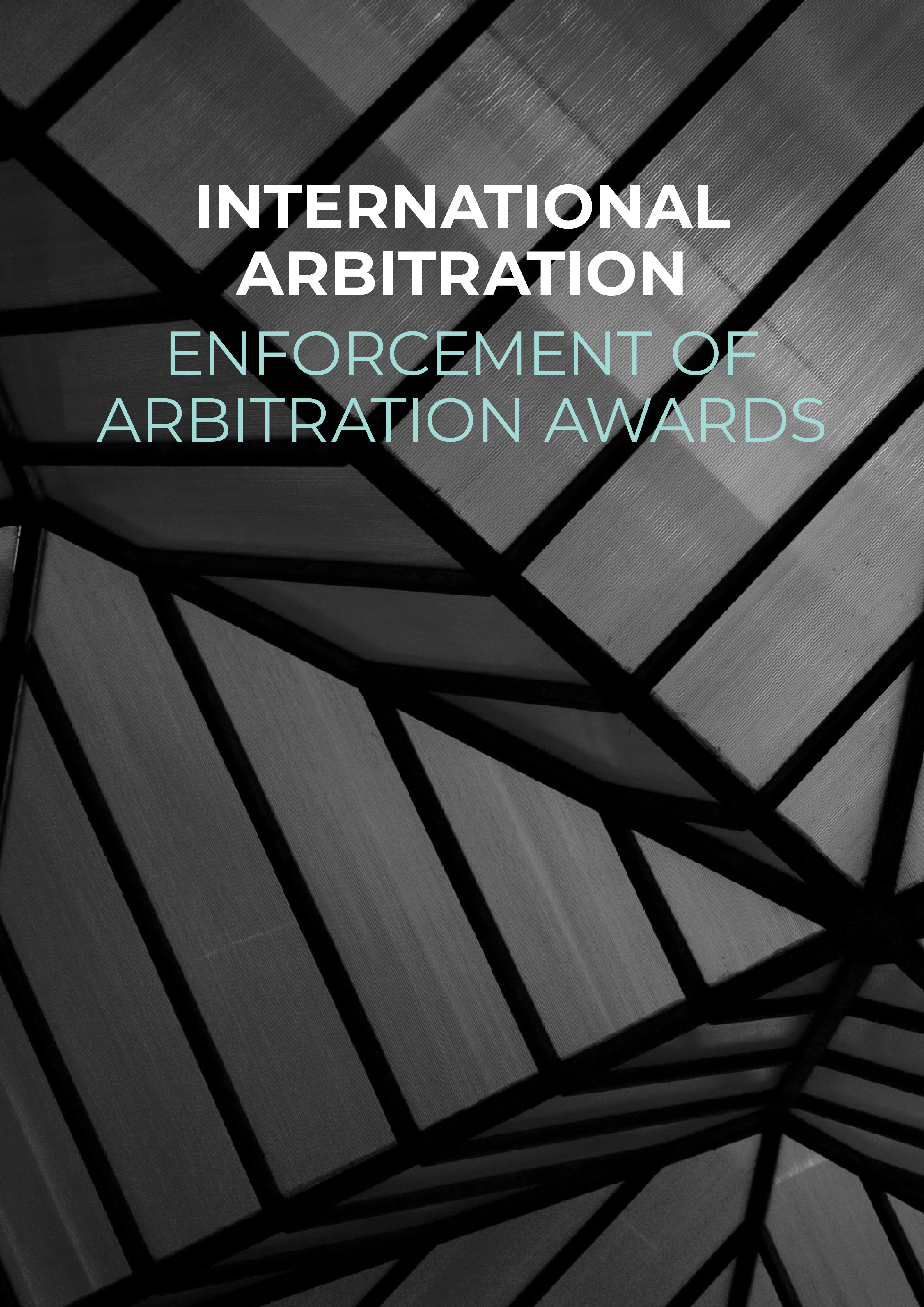
DAN PERERA
Partner, Singapore
T +65 6411 5347
E dan.perera@hfw.com

JOHNSON TEO
Associate, Singapore
T +65 6411 5313
E johnson.teo@hfw.com

[24] *Soleymani v Nifty Gateway LLC* [2022] EWCA Civ 1297, paragraph 94

[25] https://www.hfw.com/downloads/005188-HFW-A-Warning-To-Non-UK-B2C-Businesses-UK-Commercial-Court-Refuses-To-Enforce-Foreign-Arbitration-Award-On-Public-Policy-Grounds.pdf

[26] Crypto.com App U.S. Terms & Conditions, Last Update: July 24, 2023: https://crypto.com/document/entity_us.pdf



INTERNATIONAL ARBITRATION

ENFORCEMENT OF ARBITRATION AWARDS

DISPUTE RESOLUTION | AUGUST 2023

A WARNING TO NON-UK B2C BUSINESSES: UK COMMERCIAL COURT REFUSES TO ENFORCE FOREIGN ARBITRATION AWARD ON PUBLIC POLICY GROUNDS

(PAYWARD INC V CHECHETKIN)

The UK Commercial Court has declined to enforce a foreign arbitration award on public policy grounds, ruling that the underlying business-to-consumer ("B2C") contract was subject to UK Consumer legislation, despite its terms providing for foreign law and arbitration. This decision is highly relevant to any non-UK B2C business providing services to UK consumers, especially via online platforms.

In *Payward Inc v Chechetkin*[1], the English Commercial Court declined to enforce a foreign-seated arbitration award on the basis that to do so would be contrary to UK public policy under section 103 of the UK Arbitration Act 1996 (the "**Act**"). The court saw issues with both: (1) consumer protection provided under the Consumer Rights Act 2015 ("**CRA**"); and (2) the regulatory objectives of the Financial Services and Markets Act 2000 ("**FSMA**"). The court also found that where the underlying B2C contract has a close connection to the UK, the CRA would apply regardless of whether the consumer and the company have contractually agreed to non-UK governing law and jurisdiction under the applicable terms.

The case concerned a dispute between: (1) the Payward group (which operates the Kraken global online cryptocurrency exchange); and (2) one of its UK customers, Mr Chechetkin. Payward was in possession of a favourable Californian arbitration award, which it sought to enforce in the UK.

This case is of interest to non-UK companies in general, particularly those running international web-based businesses: (1) with UK-based consumer customers; and (2) using terms which are governed by non-UK law and provide for a dispute resolution forum outside UK. The decision means that claims could potentially be brought against such companies before the English Courts rather than through the dispute resolution forum provided for under the applicable terms. This is regardless of whether a final arbitration award or court judgment has been made in relation to the same dispute in the overseas jurisdiction. It also means that the underlying contract may be subject to the CRA and other applicable English statutes.

Background

The Claimants were UK and US corporate entities within the same group ("**Payward**"). Payward runs the Kraken global digital online cryptocurrency exchange. Payward brought a claim pursuant to section 101 of the Act for enforcement of a Californian arbitration award (the "**Final Award**") against the UK-domiciled Defendant ("**Mr Chechetkin**"). Mr Chechetkin had undertaken various trading activities on Payward's trading exchange and lost more than £600,000. Before trading on the exchange, Mr. Chechetkin had accepted the online terms and conditions containing an arbitration clause referring disputes to arbitration seated in California pursuant to the exclusive jurisdiction of the Judicial Arbitration and Mediation Services ("**JAMS**").

[1] [2023] EWHC 1780 (Comm)

The Final Award confirmed Payward's assertion that the arbitration should be under the JAMS procedure in California and that the laws of California should apply. It further concluded that Payward was under no liability to Mr. Chechetkin.

The FSMA Proceedings

Prior to these proceedings and in parallel to the JAMS arbitration, on 23 February 2022, Mr Chechetkin commenced a claim in the English High Court. Claiming repayment of the sums lost, he alleged that Payward had breached FSMA on the grounds that it did not have the necessary authorisation. Payward contested the jurisdiction of the English court and made an application for a declaration that the court lacked jurisdiction.

The court dismissed Payward's challenge to jurisdiction and found that it was not bound by the decision in the JAMS arbitration such that the Final Award did not deprive the English court of jurisdiction. This was despite: (1) Mr Chechetkin having accepted the online terms and conditions; and (2) the Final Award stating that Payward owed no liability to Mr Chechetkin.

It follows that the FSMA proceedings would continue unless the outcome of the Commercial Court proceedings was in favour of enforcing the Final Award. The court also provided guidance on the definition of 'consumer' for the purposes of section 15B of the Civil Jurisdiction and Judgments Act 1982 ("**CJJA**"), reaching a clear view that Mr Chechetkin was a consumer within the definition contained in the CJJA.

The Commercial Court proceedings

In these proceedings, Payward sought enforcement of the Final Award before the English Commercial Court. Mr Chechetkin contended that the Final Award should not be enforced by the court, relying on the following exceptions provided for in section 103 of the Act:

1. Recognition or enforcement may be refused if it would be contrary to public policy (section 103(3)), based on both the CRA and FSMA.

2. Recognition or enforcement may be refused if the award deals with matters beyond the scope of the submission to arbitration (section 103(2)(d)).

Decision

Was Mr Chechetkin a consumer under the CRA?

The court held that Mr Chechetkin was a consumer under the CRA because his sole profession was as a lawyer and he had made it clear when he applied for his account with Payward that his employment as a lawyer was his source of income. In addition, he was assessed as a customer by Payward on the basis that he did not work in crypto or fintech, and he was acting on this own behalf with no intention to resell.

Should the FSMA proceedings have been brought pursuant to JAMS arbitration?

Payward asserted that Mr Chechetkin should have brought his FSMA claim under the JAMS arbitration and the Final Award prevented him from raising the issue again. However, the court found that as the arbitration was against the application of any law other than the laws of California from the outset, there was no scope for Mr Chechetkin to bring a counterclaim in the JAMS arbitration under the FSMA.

Was the English court bound by the Final Award when applying section 103 of the Arbitration Act?

The court held that it was not bound by any of the tribunal's determinations when applying section 103 of the Act because a tribunal's decision on its own jurisdiction does not bind a different enforcement court.[2] The court further held that an English court should not be obliged to enforce an award that is contrary to UK public policy merely because the arbitrator's decision was said to mean that the Final Award was not contrary to public policy.

Were the CRA and FSMA expressions of UK public policy?

The court held that both the CRA ad FSMA are expressions of UK public policy.

The CRA was in part the UK's enactment of EU Directive 93/13 on unfair terms in consumer contracts, which has been authoritatively established as public policy by several decisions of the Court of Justice of the European Union (the "**CJEU**"). These decisions have the status of retained CJEU case law, which binds the English Court.

[2] Dallah Co v Ministry of Religious Affairs of Pakistan [2011] AC 763

FSMA is a UK statute making provisions regarding the regulation of financial services and appointing the Financial Conduct Authority (the "**FCA**") as the regulatory body for financial services. Accordingly, it too is part of UK public policy.

Would enforcement be contrary to the public policy objectives of the CRA and FSMA?

Public policy objective of section 74 CRA

Section 74 of the CRA provides that where a consumer contract has a close connection with the UK, the CRA applies regardless of whether the parties have chosen a non-UK governing law. The court held that the contract in question had a close connection with the UK as it was:

- between a UK national domiciled in England and a company incorporated in England;
- for services that were paid for in UK currency; and
- paid for under transactions to and from English bank accounts.

The court concluded that the enforcement of the Final Award would be contrary to the public policy objective of section 74 because the JAMS tribunal took no account of the CRA or any other elements of English law. This alone was sufficient to make the Final Award unenforceable. The court's rationale was that questions that should have been answered under the CRA have instead been answered under the laws of California which in itself was contrary to UK public policy.

The public policy objective of section 62 CRA

Under section 62(4), a term in a consumer contract is unfair if, contrary to the requirement of good faith, it causes a significant imbalance in the parties' rights and obligations to the detriment of the consumer. The issue here was whether the contract was unfair because it required disputes to be resolved by arbitration in California under JAMS Rules.

The judge made reference to Schedule 2 to the CRA, which sets out sample consumer contract terms that may be regarded as unfair (the so-called 'grey list'). Paragraph 20 refers to: "*A term which has the object or effect of excluding or hindering the consumer's right to take legal action or exercise any other legal remedy, in particular by…(a) requiring the consumer to take disputes exclusively to arbitration not covered by legal provisions…*"

The terms on the grey list are not automatically unfair but may be used to assist a court when considering the application of the fairness test to a case. The court made it clear that the mere fact that a consumer contract provides for disputes to be resolved in arbitration did not make the contract terms unfair. The test was whether a reasonable consumer in the position of Mr Chechetkin would have agreed to the contract. The court concluded that a reasonable consumer would have agreed to arbitration in the UK (subject to the Act) and would not have agreed to arbitration in California (under JAMS rules) and subject to the US Federal Arbitration Act. This reasoning was based on some significant disadvantages for Mr Chechetkin noted by the court:

- there cannot be an appeal on the basis of an error of (English) law;
- the US federal courts are legally not competent to supervise disputes that are concerned with English law and UK statues. The US Federal Arbitration Act is neither an appropriate statutory framework nor one that a reasonable consumer would have selected;
- due to geographical location of the seat of the arbitration in San Francisco, an arbitrator would have difficulty providing for hearings to take place remotely at mutually convenient times;
- Mr Chechetkin had to instruct US attorneys, which was both expensive and inconvenient (by contrast, San Francisco is the headquarters of Payward); and
- a US arbitrator would have no experience of English law and English regulation of financial services markets and would not be receptive to submissions in this area. Therefore, US tribunal would not be appropriate to determine the issues raised in Mr Chechetkin's case.

Public policy and FSMA

The court found that enforcement of the Final Award would have the effect of stopping the FSMA proceedings and leaving that claim undetermined. That in itself was a further reason why the arbitration clause in question was considered unfair within the meaning of the CRA and contrary to public policy considerations of the CRA. Further, the court held that the prevention of Mr Chechetkin's claim under FSMA would be contrary to the public policy considerations under FSMA itself, on the ground that investigation and prosecution of offences is far less likely to occur if customers with grievances are obliged to pursue them in confidential arbitration proceedings overseas and customer complaints are therefore less likely to come to the FCA's attention.

Comment and practical tips

While the English court generally seeks to give effect to arbitration awards as required under the New York Convention, this case is an important example of a situation where the English court refused to enforce a foreign arbitration award on the grounds that to do so would be contrary to UK public policy and consumer legislation.

The decision certainly has wider implications for non-UK companies in general and particularly those running an international web-based business with UK-based consumers, many of which offer standard terms and conditions governed by non-UK laws and providing for a dispute resolution forum outside UK:

- the underlying terms may potentially be considered as having a close connection to the UK and hence UK consumer legislation would apply regardless of whether the parties have contractually agreed a non-UK governing law and a foreign dispute resolution forum;
- UK-based consumers could rely on the protection provided under the CRA and any terms failing the 'fairness' test would not be binding upon consumers;
- provisions in the terms that attempt to bind UK consumers to an arbitration process that puts them at a disadvantage would be vulnerable to challenge as unfair;
- companies could potentially face separate English court claims brought by UK consumers in relation to disputes arising from the services or products offered, regardless of whether a final arbitration award or court judgment has been made in favour of these companies in relation to the same dispute in the overseas jurisdiction specified in the terms; and
- companies engaging in financial services (such as cryptoasset exchange platforms) may find their terms subject to FSMA and therefore regulated by the FCA. This would increase the company's exposure to risks such as facing criminal charges for carrying on regulated activities without authorisation (as in this case if Mr Chechetkin succeeds in the FSMA proceedings).
- The decision is an important reminder of the need for entities servicing customers across the globe to customise their terms. That includes giving careful thought to the dispute resolution provisions in consumer contracts and to the specific circumstances of the entity's type / scope of services, products and potential customer base. In addition to careful drafting and constant review of their terms, detailed consideration of potentially applicable foreign public policies and consumer legislation should be carried out in order to reduce the risk of contravention of the same, as well as mitigating the risk of unfairness in consumer contract terms.

For more information, please contact the authors of this alert

LEANNE FOK
Associate, Hong Kong
T +852 3983 7641
E leanne.fok@hfw.com

KEVIN WARBURTON
Partner, Hong Kong
T +852 3983 7629
E kevin.warburton@hfw.com

INTERNATIONAL ARBITRATION | NOVEMBER 2023

HONG KONG COURT REFUSES ENFORCEMENT OF MAINLAND AWARD ON PUBLIC POLICY GROUNDS

Is the ability to multitask something to be embraced by arbitrators? In *Song Lihua v Lee Chee Hon* [2023] HKCFI 2540, the Hong Kong Court of First Instance (HKCFI) refused enforcement of a Chengdu Arbitration Commission (CAC) award on public policy grounds, as the failure of an arbitrator to give his full attention to the hearing was a "serious irregularity" where justice was not "seen to be done".

Background

Section 95(3)(b) of the Hong Kong Arbitration Ordinance (Cap, 609, **Arbitration Ordinance**) provides that enforcement of a Mainland award can be refused when it would be contrary to public policy to enforce the award.

The CAC arbitration (the **Arbitration**) arose out of a share dispute between Song and Lee. A CAC award was made on 11 October 2021 (the **Award**), in which Lee was required to pay Song RMB 337,222,219.90 with interest and costs.

Pursuant to Song's application, on 12 January 2023, the HKCFI granted leave to Song to enforce the Award in Hong Kong (the **Enforcement Order**). Lee then applied to set aside the Enforcement Order based on section 95 of the Arbitration Ordinance. Lee raised six grounds as follows:

1. **Contact Methods Complaint** – Lee had not been given proper notice of the Arbitration, as Song had failed to disclose to the tribunal Lee's contact methods as known to Song;
2. **Service Complaint** – Lee had not been properly served with notice of the Arbitration;
3. **Nomination Complaint** – Lee was deprived of the opportunity to nominate an arbitrator because of the Service Complaint;
4. **Arbitrator Complaint** – the conduct of one of the arbitrators (**Arbitrator Q**) deprived Lee of the right to a fair hearing and the opportunity to present his case, which was contrary to public policy;
5. **Supplemental Submissions Complaint** – Lee was not given a copy of the Supplemental Submissions by Song and was therefore unable to address the matters raised therein; and
6. **Invalidity Complaint** – the underlying contract and arbitration agreement was invalid and unenforceable under Mainland law.

The Arbitrator Complaint

The Arbitrator Complaint was the central complaint of the six made by Lee:

1. By way of background, Lee did not participate in the first Arbitration hearing as he was not informed of the arbitration. By the time Lee knew about the arbitration, he instructed his lawyer to attend the second hearing.
2. At the second hearing, the parties' lawyers and two of the three arbitrators attended the hearing in person, while the third arbitrator, Arbitrator Q, attended remotely by video.
3. During the presentation, challenges, and questioning by the tribunal in the second hearing, Arbitrator Q was noted as not concentrating on the hearing – he was moving from one location to another without using headphones or any earpiece, occasionally talking or gesturing to others, or looking into the distance instead of watching the proceedings, before eventually travelling in a private car.
4. There were also numerous occasions where Arbitrator Q was disconnected from the network and was unable to respond when other members of the tribunal were asking whether he could hear them.

It was clear to the court that Arbitrator Q was not concentrating during the Second Hearing.

In deciding whether to refuse enforcement of the Award as a result of the failure of Arbitrator Q to pay full attention to the hearing, Mimmie Chan J revisited the earlier authorities and helpfully summarised the principles for refusing to enforce an arbitral award in Hong Kong when it is deemed to be "contrary to public policy":

1. Before an arbitral award can be recognised and enforced in Hong Kong, natural justice must be observed and the award must be made as a result of due process.
2. When evaluating notions of due process and natural justice, the Hong Kong court will apply its own standards. This is because the Hong Kong court, as a court of enforcement, plays a distinct role when compared to a court of the supervisory jurisdiction.
3. Even though an award has been upheld by the court of the supervisory jurisdiction, Hong Kong courts may still refuse enforcement if the making of the award is contrary to the notions of justice in Hong Kong.
4. In Hong Kong, merely complying with natural justice and due process is not sufficient, as set out in the aphorism *'not only must justice be done, but it must also be seen to be* done', and as seen by a reasonable observer. This maintains public confidence in the arbitration system.
5. Moreover, the right to be heard is an important procedural right under the rules of natural justice in Hong Kong. Not only does the right to be heard encompass the litigant's right of access to the courts, but also that the court actually hears the litigant.
6. If an arbitrator is not concentrating on or not hearing the parties' submissions, a fair and reasonable observer would doubt whether this arbitrator was keeping an open mind as he was not properly hearing the parties, or that his decision was supported by the evidence. Consequently, there will be no apparent justice or fairness as a result. This is analogous to the situation where an employment tribunal member fell asleep during a hearing, as in the English authority of *Stansbury v Datapulse plc & another*[1].

Taking into account the facts and applicable principles, the court held that the second hearing lacked due process and failed to meet the standard of a fair and impartial hearing. In Mimmie Chan J's words, "*It would be shocking to the conscience of the Court to give recognition to the Award*"[2].

Further, the court rejected the arguments that consideration should be given to the fact that the Award had not been set aside in Mainland China or that the failure of Lee's lawyers to raise objections during the second hearing constituted a waiver of the irregularities. The irregularities owing to Arbitrator Q's conduct were too serious to be fully waived during the second hearing, and, in any event, the ground of public policy under section 95(3) of the Arbitration Ordinance enabled the court to refuse enforcement.

The Other Complaints

Since the court had already ruled that the Award should be set aside on grounds of public policy, the court rejected or decided not to make further findings on the other complaints:

1. **Contact Methods Complaint** – The court was satisfied that Song had supplied the CAC with the methods of contacting Lee as known to her and the Commission had succeeded in contacting Lee.
2. **Service Complaint** – Since the CAC rules provided for deemed service of documents and the rules had been fully complied with, service was deemed valid, alternatively Lee had waived any irregularity on service.
3. **Nomination Complaint** – As the PRC Arbitration Law provided that the Commission could appoint an arbitrator when a party fails to, the constitution of the tribunal was valid, alternatively Lee had waived any irregularity on the composition of the tribunal.
4. **Supplemental Submissions Complaint** and **Invalidity Complaint** – The court did not make findings on these two grounds.

Conclusion

The decision in *Song Lihua v Lee Chee Hon* is to be welcomed as highlighting the independence of the Hong Kong courts, and shows that they will not simply defer and follow decisions made by courts or tribunals in other jurisdictions.

The Hong Kong courts are capable and ready to refuse the enforcement of a non-Hong Kong award, when the underlying arbitral proceedings have not met the high threshold of natural justice and due process as maintained by Hong Kong courts.

This judgment also serves as a practical reminder to practitioners in the arbitration arena, as well as parties to an arbitration, that it is of paramount importance for arbitrators to uphold a high degree of professionalism and that

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[1] *Stansbury v Datapulse plc & Another* [2003] EWCA Civ 1951

[2] *Song Lihua v Lee Chee Hon* [2023] HKCFI 2540, [53]

their conduct will be scrutinised by the court. The same also applies to the parties and the parties' lawyers, as highlighted by the very recent case of *Federal Republic of Nigeria v Process & Industrial Development Ltd*[3], where the English High Court set aside an award obtained by fraud and conduct contrary to public policy, including knowingly using false evidence, committing bribery, and improperly retaining the opponent's legal documents, which represented the "*most severe abuses of the arbitral process*"[4]. Therefore, when a party to an arbitration feels that it has been prejudiced in the arbitral proceedings owing to misconduct, the party should carefully consider the need to seek assistance from the court by challenging the award. This decision supports the importance of properly conducted international arbitrations as an attractive and important method of resolving disputes.

For more information, please contact the authors of this alert

KEVIN WARBURTON
Partner, Hong Kong
T +852 3983 7629
E kevin.warburton@hfw.com

LEANNE FOK
Associate, Hong Kong
T +852 3983 7641
E leanne.fok@hfw.com

CURTIS PAK
Paralegal, Hong Kong
T +852 3983 7659
E curtis.pak@hfw.com

[3] *Federal Republic of Nigeria v Process & Industrial Development Ltd* [2023] EWHC 2638 (Comm)

[4] *Federal Republic of Nigeria v Process & Industrial Development Ltd* [2023] EWHC 2638 (Comm), [516]

Contributing Authors

NICK BRAGANZA
Partner, Dubai
T +971 4 423 0587
E nick.braganza@hfw.com

SCOTT CRUICKSHANK
Partner, BVI
T +1 (284) 494 4722
E scott.cruickshank@hfw.com

DAMIAN HONEY
Partner, London
T +44 (0)20 7264 8354
E damian.honey@hfw.com

DAN PERERA
Partner, Singapore
T +65 6411 5347
E dan.perera@hfw.com

ANDREW WILLIAMS
Partner, London
T +44 (0)20 7264 8364
E andrew.williams@hfw.com

NICOLA GARE
Knowledge Counsel
(Dispute Resolution) London
T +44 (0)20 7264 8158
E nicola.gare@hfw.com

JOSHUA COLEMAN-PECHA
Senior Associate, Dubai
T +971 4 560 6624
E joshua.coleman-pecha@hfw.com

PANSY WU
Senior Associate, Hong Kong
T +852 3983 7671
E pansy.wu@hfw.com

LEANNE FOK
Associate, Hong Kong
T +852 3983 7641
E leanne.fok@hfw.com

JOHNSON TEO
Associate, Singapore
T +65 6411 5313
E johnson.teo@hfw.com

RICK BROWN
Partner, London
T +44 (0)20 7264 8461
E rick.brown@hfw.com

HENRY FUNG
Partner, Hong Kong
T +852 3983 7777 / +86 21 2080 1111
E henry.fung@hfw.com

SLAVA KIRYUSHIN
Partner, Dubai
T +971 4 560 6623
E slava.kiryushin@hfw.com

KEVIN WARBURTON
Partner, Hong Kong
T +852 3983 7629
E kevin.warburton@hfw.com

MARIA DEUS
Legal Director, Abu Dhabi
T +971 2 235 4907
E maria.deus@hfw.com

JUSTINE BARTHE-DEJAN
Senior Associate, Singapore
T +65 6411 5344
E justine.barthe-dejean@hfw.com

JAMES HENSON
Senior Associate, BVI
T +1 (284) 494 5098
E james.henson@hfw.com

NEIL CHAUHAN
Associate, London
T +44 (0)20 7264 8376
E neil.chauhan@hfw.com

TANISHA SAXENA
Associate, Dubai
T +971 4 423 0582
E tanisha.saxena@hfw.com

CATRIONA HUNTER
Professional Support Lawyer,
Hong Kong
T +852 3983 7675
E catriona.hunter@hfw.com