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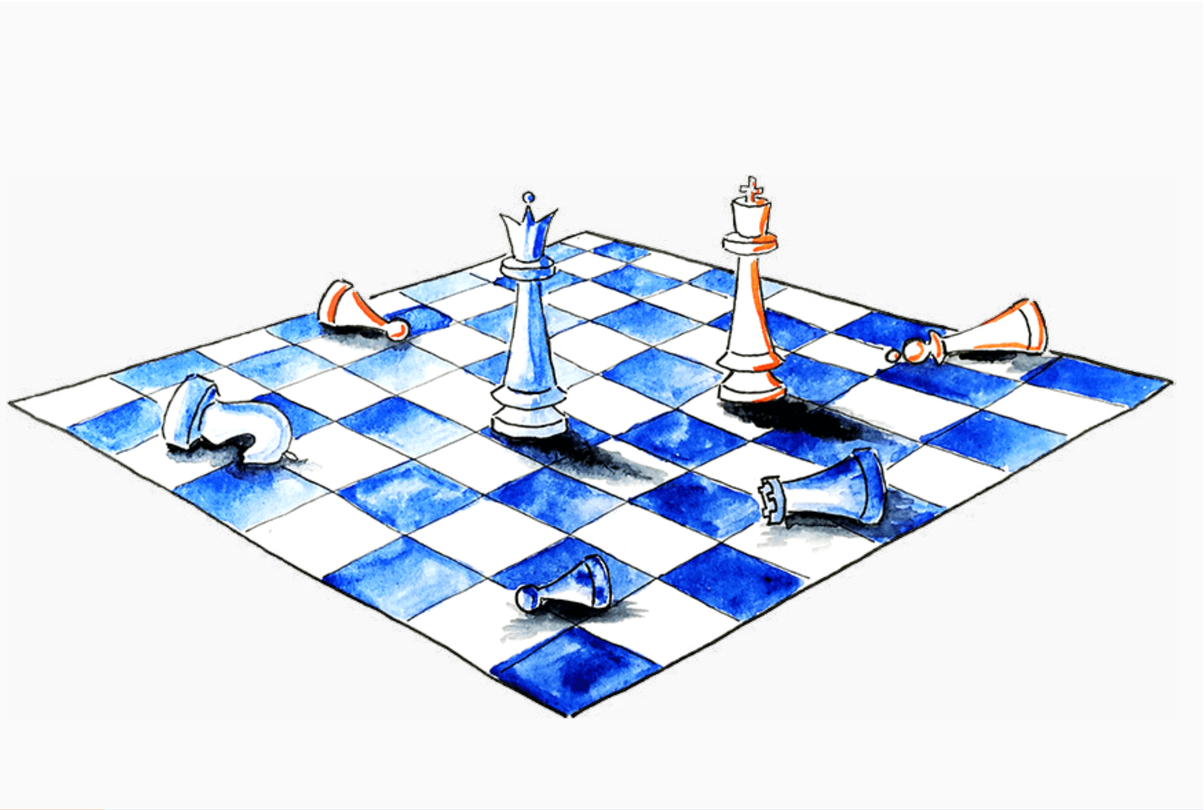

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THE GERMAN STANDARD OF REVIEW OF (EU) COMPETITION LAW ISSUES IN SETTING-ASIDE PROCEEDINGS

Written by Friederike Schäfer & Thomas Herbst

INTRODUCTION

In September 2022, the German Supreme Court ("**BGH**") rendered a decision addressing the standard of review of competition law in setting-aside proceedings (Decision of 27 September 2022, docket no. KZB 75/21). The BGH found that arbitral awards are subject to a full factual and legal review as far as the application of Sections 19 to 21 of the German Competition Act ("**GWB**") is concerned. It clarified that these provisions concerning the abuse of market dominance and other restrictive practices form part of the German public policy (*ordre public*). Thereby, the BGH refused to accept the reasoning of the Upper Regional Court of Frankfurt am Main ("**OLG**"), which took the view that the review of arbitral awards would be limited to an examination of whether the decision disregards fundamental value decisions of the legislator as expressed by provisions of antitrust law.

The decision of the BGH was broadly discussed in legal literature since it was understood by some arbitration practitioners as a departure from previous case law. Specifically, it was suggested that the decision abandoned the general requirement that the application of the public policy clause was limited to cases where the award caused a result which is *manifestly* incompatible with fundamental principles of German law.

Whether this is indeed the case and what impact the decision might have on future disputes before arbitral tribunals involving antitrust law, will be discussed in the following.

OVERVIEW OF THE DISPUTE AND PROCEEDINGS

The decision was issued in proceedings for the setting aside of an arbitral award rendered in a domestic arbitration. Subject matter of the arbitration was the termination of a lease contract between Claimant (the respondent party in the setting aside proceedings) and Respondent (applicant in setting aside proceedings) for a mine on Claimant's land. Claimant declared the termination of the contract with the intention to lease the mine to another party, which already held the lease for a second mine on Claimant's land. By leasing both mines to one lessee Claimant hoped to alleviate the price pressure of the mines and thus generate a higher lease (which was dependent on the mine's turnover).

In the arbitration, Claimant sought to enforce the termination of the lease and requested that Respondent vacate the mine. By way of a counterclaim, Respondent requested the arbitral tribunal to find that the termination was invalid, that Claimant be ordered to agree to an extension of the lease, and to cease and desist from making any threats in the future, in particular, from threatening the termination of the lease agreement.

The arbitral tribunal found that Claimant had validly terminated the contract (by way of a second declaration of termination issued during the arbitration) and that Respondent had to vacate the mine (except for a part being subject to a building lease). Respondent's counterclaim was denied.

In the meantime, Respondent also had turned to the German federal antitrust authority who fined Claimant for terminating the contract (by way of the first declaration of termination) in violation of the general prohibition of practices restricting competition (Section 21(2) no 1 and Section 21(3) no 2 GWB).

Further, the Respondent applied for the partial setting aside of the arbitral award before the OLG to the extent the award decided against it. The OLG rejected this application. In turn, the Respondent appealed this decision before the BGH.

DECISION OF THE BGH AND MAIN TAKEAWAY

The BGH granted the application in major parts: The court annulled the OLG's decision to the extent that it upheld the arbitral tribunal's finding that the termination was valid and that the lessee had to vacate the mine. To the extent the BGH annulled the OLG's decision it also set aside the arbitral award.

In its decision, the BGH took the position that the application of the provisions of German competition law by the arbitral tribunal was subject to a full factual and legal review. The result of such review was that the arbitral tribunal had misapplied the law. According to the BGH the termination declared by the lessor was invalid because it violated competition law. Therefore, the arbitral award had to be set aside to the extent it ordered the Respondent to vacate the mine and thus gave effect to the competition law violation.

The main takeaway from the decision is that the court confirmed in all clarity that arbitral awards are subject to a full factual and legal review insofar as the application of competition law is concerned that forms part of the German *ordre*

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public. While this has already been held by earlier decisions (e.g. BGH, decision of 25 October 1966, docket no. KZR 7/65), the possibility or necessity of such a full review appears not to have been commonly acknowledged in case law of lower courts. The OLG's decision makes that clear.

In its reasoning, the BGH stresses that such a full factual and legal review does not contradict the principle that the refusal of recognition or enforcement of an arbitral award under the public policy exception is limited to cases where said recognition would lead to a result that is **manifestly inconsistent** with fundamental principles of German law.

Whilst the BGH had stated in an earlier decision (BGH, decision of 28 January 2014, docket no. III ZB 40/13) that the criterion of "manifest inconsistency" is based on the prohibition of a *révision au fond* (i.e. the prohibition against fully reviewing an arbitral award on its merits), it now clarified that this principle would not prohibit the full legal and factual review of the tribunal's (mis)application of competition law forming part of German public policy.

This could be considered a contradiction in itself. But upon closer review this is not necessarily the case: the criterion of "manifest inconsistency" does not require that the arbitral tribunal made a manifest error in its application of the law. Where a specific provision forms part of the *ordre public*, any misapplication of that provision suffices because such error necessarily leads to a result which is manifestly inconsistent with the fundamental principles, the provision represents.

Against this background the question arises what remains of the "manifest inconsistency" criterion and its purpose of avoiding a *révision au fond* of arbitral awards at the setting aside and enforcement stages. The decision of the OLG suggests a certain dilemma.

As a starting point, the OLG applied the general consideration that the review of the award had to be restricted and could not become a *révision au fond*. It took the position that the fact that competition law forms part of the German *ordre public* could not justify that courts fully review the application of such competition law by arbitral tribunals or even subject the award to a plausibility control. Rather, the review should be restricted to the question whether the arbitral tribunal has disregarded a basic value decision of the legislator as expressed in the respective competition law provisions. While the OLG went on discussing the decision of the arbitral tribunal and arrived at the result that the award did not disregard a basic value decision of the legislator, it did explain how it could make such a determination. The OLG merely stated that the arbitral tribunal applied the competition law provisions, came to a certain result, and thereby did not disregard the basic value decision of the legislator. However, the OLG did not address the question why a misapplication of the competition law provisions would not (manifestly) violate the *ordre public* simply because the arbitral tribunal did not make any manifest error. Especially where a fundamental principle of law is expressed in a specific provision, the superficial review suggested by the OLG proves deficient. In such a case, it is difficult to imagine how a broad-brush review of the general method of application and eventual manifest errors could ensure that the outcome is in line with the essential principle expressed by the provision.

Thus, the criterion of "manifest inconsistency" is more pertinent in cases where the relevant fundamental principle of law is not enshrined in a particular provision. In addition, the prohibition of a *révision au fond* keeps its relevance: Even where the *ordre public* test may allow (or require) the factual and legal review of the application of a certain set of provisions, this does not necessarily mean that the entire award may be reviewed according to the same strict standard.

OUTLOOK FOR EU COMPETITION LAW

It is important to note at this stage that a related question, namely the standard of review in setting aside proceedings as far as alleged violations of **European competition law** are concerned, is the subject of an – so far – unresolved debate. The debate has been ongoing for many years.

It was kicked off by the CJEU's 1999 ruling in *Eco Swiss v Benetton* (C-126/97). The Court's central holding was that EU competition law qualified as public policy and courts of EU member states were obliged to set aside arbitral awards infringing EU competition law where their domestic procedural law would require them to do so in case of a violation of their domestic public policy.

The decision was significant. By qualifying EU competition law as public policy, the court made it clear that a review of an arbitral tribunal's (non-)application of EU competition law was generally permissible – even *ex officio,* where the parties had failed to raise the issue in the arbitration. But the CJEU's ruling also left many questions unanswered. In particular, the Court's reference to the member state's procedural law

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raised the question of the permissible scope of review, considering that procedural laws ordinarily limit the powers of the courts to review the reasoning of an award on public policy grounds.

The main issue with the ruling was that the CJEU seemed to be acknowledging equally two competing and effectively irreconcilable principles: the principle of procedural efficiency and the finality of arbitral awards on the one hand and the interest of uniform application of mandatory provisions of a particular legal order on the other. The disputed question to which extent courts are obliged to review the award and the tribunal's reasoning, is the culmination point of these two competing principles and the CJEU – regrettably – failed to give guidance how to resolve that issue.

Unsurprisingly, therefore, for almost 25 years, different views and approaches how to square this circle have been adopted by scholars and member state courts. The "minimalist" position adopted by some (French, Italian, some German, and (possibly) Austrian) courts and authors is that there is only one concept of a states' *ordre public* and that EU competition law does not require a standard of review different from the one stipulated by domestic procedural law for other public policy matters. Based on rules of domestic procedure, it is hence argued that only "obvious" infringements of EU competition law can be taken up by the courts in setting aside proceedings and that and a general review of the case on the merits (*révision au fond*) is prohibited, even if – upon review – the court would have applied EU competition law differently.

The opposing, "maximalist" position taken by other (Dutch and some German) courts and, notably, Advocate General Wathelet in the subsequent *Genentech* case (C-567/14) is that not only do courts enjoy the power to review an award's factual and legal analysis in full, but are required to do so when it comes to the assessment of the award's compliance with EU competition law. Proponents of this view stress that the effective and uniform application of EU law requires the domestic courts full review of the application of competition law and point to private tribunals' lack of power to make preliminary references to the CJEU (cf. *Nordsee*, C 102/82). And, of course, there are intermediary views as well, arguing in favour of a sliding scale approach depending, amongst others, on the severity and obviousness of the breach, and a mere review of the law but not the facts established by the tribunal.

Indeed, proponents of both positions have good arguments to make: The minimalists point out that a full review of the award's application of competition law effectively devalues arbitration as an efficient method of dispute resolution in certain areas of the law. Similarly, there is some force in the argument questioning whether the nature of EU competition law requires a different approach than that afforded to other core principles of a domestic legal order, ordinarily understood as public policy. However, the maximalists correctly point out that competition law disputes are often fact sensitive and that a merely superficial review effectively excludes the CJEU's ultimate control in all but cases of the non-application of competition law or violations of "hardcore restrictions". In the practically important area of competition law violations by effect (e.g. violations through single branding obligations or abuses of dominant market positions) the CJEU would not be able to exercise its role as final arbiter of EU law, where the dispute was referred to a tribunal.

The BGH has now put down a marker with the present ruling, expressly adopting the "maximalist" position at least for domestic competition law. However, it does not take psychic powers to suggest that the BGH will adopt the same approach, allowing a more substantive review in setting aside proceedings regarding the application of EU competition law in the future. Indeed, the BGH made express reference to European competition law in its decision. The court noted that the public interest in the effective application of competition law required a comprehensive review of competition law issues, considering that *"as opposed to state courts, arbitral tribunals are generally not entitled to refer the question of the application of Art 101 and Art 102 TFEU to the CJEU in cases where aside from Sections 19, 20, 21 GWB, Art 101 or Art 102 TFEU would be applicable (cf. § 22 GWB)"*. Considering further that member states have widely adapted their domestic competition laws to comply with the standard of EU competition law and the fact that the standard of review at the annulment stage still is (primarily) a matter of domestic procedural law, mere consistency requires this outcome. Therefore, the relevance of this decision likely goes beyond the jurisdiction in which it was rendered as it would add Germany to the jurisdictions in which arbitral tribunal's application of EU competition law is reviewed in detail in setting aside proceedings.

Furthermore, one could speculate that the BGH's ruling might tip the scales and motivate the CJEU to make an express statement in a future reference concerning the issue. Whilst the CJEU dodged the question of the requisite standard of review in *Genentech* (C-567/14), the CJEU's case law after *Eco Swiss* suggests that the Court is amenable towards a more detailed review of arbitral awards at the annulment and even the enforcement stage. Although, the Court still upheld the finality of the award over EU competition law in *Eco Swiss* (the time for filing for an action for the setting aside had passed), in the subsequent rulings *Mostaza Claro* (C-168/05) and *Asturcom* (C-40/08) ultimately the Court obliged courts to leave preclusive provisions of domestic procedural law unapplied to achieve the effective application of mandatory EU law (in these cases: EU consumer protection law). What is more, the CJEU appears to have developed a strained relationship with arbitration, failing to recognize it

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as an equivalent system of dispute resolution within the EU. Clearly, the Court appears keen to ensure that the supremacy of EU law and its final say is preserved – even if that means disrupting the system of how courts and arbitral tribunals are designed to interact. By way of a recent example, in its *Prestige* ruling (C-900/20), the CJEU expressed its general skepticism towards arbitration by forcing members states to ignore domestic final awards in favor of subsequent decisions of another member state where the tribunal disregarded principles of EU law (that were undisputedly inapplicable in the arbitral proceedings).. That in mind, it seems fair to suggest that the CJEU will likely adopt the BGH's position when asked for the requisite standard of review the next time around.

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TO ARBITRATE OR NOT TO ARBITRATE ARBITRABILITY – ARE ICC RULES A SUFFICIENT DELEGATION OF THRESHOLD ISSUES TO ARBITRAL TRIBUNAL?

Written by Gerold Zeiler & Alexandra Kutschera

INTRODUCTION

Arbitrators are competent to decide a dispute if the parties submit that dispute to arbitration by concluding an arbitration agreement. Whether a particular dispute is covered by a particular arbitration agreement constitutes a threshold issue, referred to as (general) arbitrability.

In many jurisdictions this question is presumptively to be resolved by the arbitrators pursuant to the principle of competence-competence. Under US law, however, threshold questions of arbitrability are presumptively resolved by the courts, rather than the arbitrators (*DDK Hotels, LLC v. Williams-Sonoma, Inc.*, 6 F.4th 308, 316 (2d Cir. 2021) at 317). Parties may choose to refer the determination of the question of whether a particular dispute is covered by a particular arbitration agreement to the arbitrator. This requires an agreement to that effect, as well as clear and unmistakable evidence thereof (*Henry Schein, Inc. v. Archer & White Sales, Inc.*, 139 S. Ct. 524, 527 (2019) at 531).

With its recent decision *Lavvan, Inc. v. Amyris, Inc.*, No. 21-1819 (2d Cir. Sept. 15, 2022), the Second Circuit sheds further light on the issue whether the incorporation of the ICC Rules into the arbitration clause by reference sufficiently evidences the agreement to delegate threshold issues to the arbitral tribunal.

BACKGROUND AND FACTS OF THE CASE

Plaintiff Lavvan specializes in the creation of cannabinoid ingredients for a wide variety of industries. Defendant Amyris is a biotechnology company manufacturing various ingredients and products. In 2020, a dispute arose from their Research, Collaboration, and License Agreement ("**RCLA**"). Lavvan subsequently alleged misappropriation of trade secrets and patent infringement by Amyris.

The RCLA contained the following clauses addressing dispute resolution:

"All disputes that cannot be resolved by the management of both Parties pursuant to Section 3.2.4 will be finally settled under the Rules of Arbitration of the International Chamber of Commerce (the "ICC Rules") by an arbitration tribunal appointed in accordance with the said ICC Rules as modified hereby, and judgment upon the award rendered may be entered in any court having jurisdiction thereof. The decision of the arbitrator as to any claim or dispute shall be final, binding, and conclusive upon the Parties."

"In the event that a dispute arises with respect to the scope, ownership, validity, enforceability, revocation or infringement of any Intellectual Property, and such dispute cannot be resolved by the management of both Parties in accordance with Section 3.2.4., unless otherwise agreed by the Parties in writing, such

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dispute will not be submitted to arbitration and either Party may initiate litigation solely in a court or other tribunal of competent jurisdiction in the country of issuance, registration, application or other protection, as applicable, of the item of Intellectual Property that is the subject of the dispute."

In August 2020, Lavvan filed a request for arbitration with the International Chamber of Commerce ("**ICC**") against Amyris. In September 2020, Lavvan also brought an action in the US District Court, S.D. New York against Amyris. Amyris then moved to compel arbitration, arguing *inter alia* that the threshold question of arbitrability was for the arbitrators to decide.

FIRST INSTANCE DECISION

The district court held that *"[T]he issue of arbitrability may only be referred to the arbitrator if there is clear and unmistakable evidence from the arbitration agreement, as construed by the relevant state law, that the parties intended that the question of arbitrability shall be decided by the arbitrator."* (quoting *Bell v. Cendant Corp*., 293 F.3d 563, 566 (2d Cir. 2002)). It found that in this case, there was clear and *"unmistakable evidence […] that the parties explicitly agreed that intellectual property disputes would be determined* ***by a court****"* (*Lavvan, Inc. v. Amyris, Inc.*, No. 20-CV-7386 (JPO) (S.D.N.Y. July 26, 2021), emphasis added). Consequently, it denied Amyris' motion to compel arbitration.

DECISION ON APPEAL

Amyris appealed the decision arguing *inter alia* that the parties had delegated the question of arbitrability to an arbitrator to decide. The Second Circuit dismissed the Appeal, affirmed the judgement of the district court and remanded the case for further proceedings based on the following reasoning:

While parties may agree to delegate the decision on the threshold issue of arbitrability from the court to the arbitrator, this requires clear and unmistakable evidence of such agreement. Courts *"should not assume that the parties agreed to arbitrate arbitrability unless there is clear and unmistakable evidence that they did so."* (quoting *Henry Schein, Inc. v. Archer & White Sales, Inc.,* 139 S. Ct. 524, 527 (2019)).

The Second Circuit recognized that in previous cases, *"[b]road language expressing an intention to arbitrate all aspects of all disputes"* relating to an agreement was held to be sufficient indication of the parties' agreement to arbitrate arbitrability (quoting *Metro. Life Ins. Co. v. Bucsek,* 919 F.3d 184, 191 (2d Cir. 2019)). Further, according to case law, the incorporation of procedural rules, such as the ICC Rules, empowering arbitrators to decide arbitrability may constitute clear and unmistakable evidence of intent to arbitrate arbitrability.

However, the RCLA contained a dispute resolution agreement committing certain types of disputes to litigation and the rest to arbitration. The Second Circuit found that this does not express broad intent to arbitrate all aspects of all disputes and thus cannot refer the decision on arbitrability to an arbitrator. This result was not altered by the incorporation of the ICC Rules, because only one subsection of the RCLA's dispute resolution mechanism incorporated the ICC Rules, while the other, pertaining to disputes submitted to litigation, did not.

The court found that the decisive factor in this case was the carve-out clause generally referring disputes to arbitration but a certain category of disputes to litigation. It held that absent clear and unequivocal wording indicating parties' agreement to arbitrate arbitrability despite this dichotomy of dispute resolution forums, the power to decide questions of arbitrability remained with the court.

CONCLUSION

With this decision the Second Circuit added another layer to the discussion of who decides questions of arbitrability under the Federal Arbitration Act – the court or the arbitrator. It follows from *Lavvan v. Amyris* that the rules under the Federal Arbitration Act regarding who makes the decision on gateway questions of arbitrability currently stand as follows:

By default and absent clear and unmistakable evidence of parties' intent to arbitrate questions of arbitrability, the gateway issue of arbitrability is for the courts to decide. Such clear and unmistakable evidence of parties' intent to arbitrate arbitrability can be demonstrated by (i) an express clause to that effect but also by (ii) broad wording of the arbitration clause expressing intent to arbitrate all aspects of all disputes or by (iii) incorporating procedural rules empowering arbitrators to decide gateway issues of arbitrability. However, a carve-out provision exempting certain claims from arbitration negates the otherwise clear and unmistakable delegations of questions of arbitrability to an arbitrator regardless of whether the arbitration clause is otherwise broadly worded or incorporates procedural rules empowering arbitrators to decide arbitrability or both.

TAKEAWAYS

For many European arbitration practitioners this is an unusual issue to consider when drafting arbitration clauses, as the general principle in most European countries is the opposite. By default, the gateway question of arbitrability

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is for the arbitrators to resolve under the principle of competence-competence. However, under US law, the question of arbitrability must be separately referred to the arbitrators. As a result, when contemplating the incorporation of a dispute resolution clause featuring arbitration in the US, practitioners should be mindful that the power to arbitrate arbitrability must be delegated to the arbitrators by parties' agreement.

The standard of clear and unmistakable evidence of parties' intent to arbitrate arbitrability is a high one to meet. Any ambiguity in the arbitration clause, including carve-out clauses referring certain matters to litigation, may destroy clear and unmistakable evidence of parties' intent to arbitrate arbitrability and leave this question for determination by the courts. This of course provides an additional, potentially undesirable layer of court intervention regarding arbitration proceedings. In any case, it adds length and cost to the proceedings. Arbitration clauses involving a US party or US law should therefore be drafted with a view to this issue such as not to run into unexpected court proceedings regarding arbitrability.

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Additional content on this topic:

FLASHBIRD'S TAIL: PLANTING THE FEATHER OF MATERIAL PREJUDICE IN SECTION 67 ARBITRATION ACT 1996

Written by Joe Gosden & Alexandra Tompson

Fifteen months ago, the Privy Council gave judgment in Flashbird (*Flashbird Ltd v Compagnie de Sécurité Privée et Industrielle SARL* [2021]). An exotic visitor from the Supreme Court of Mauritius, Flashbird was a bid to set aside an arbitration award under Section 39(2)(a)(iv) of Mauritius' International Arbitration Act 2008.

The 'hybrid' arbitration clause in the Flashbird contract was a poorly drafted nightmare. From it, parallel arbitrations, appeals to the Permanent Court of Arbitration at the Hague and endless challenges took flight. However, when the clause eventually landed before the Supreme Court of Mauritius, it found it unnecessary to rule on the question of the proper interpretation of the clause *per se* and the Privy Council agreed it was right to have done so.

It sidestepped the linguistic contortions and found that, even if the appellant was correct, firstly it had failed to show that the appointment of a sole arbitrator was not in accordance with the agreement of the parties and, secondly, even if not in accordance, that prejudice sufficient to justify the exercise of the Court's power to set aside the award under Section 39(2)(a)(iv) had not been made out.

Flashbird was an alternative argument derived from the New York Convention enforcement regime, being applied to the identically worded grounds for annulment under the Mauritian Act. It was, on the face of it, nothing to do with the common or garden Section 67 Arbitration Act 1996 at all. Nevertheless, Flashbird has a long tail and arguments inspired by it are starting to be run on challenges to the jurisdiction of tribunals in confidential fora.

FLASHBIRD – A HYBRID OF NO MATERIAL PREJUDICES

Flashbird was, really, a decision about hybrid arbitration clauses.

Hybrid arbitration clauses are notoriously fiddly and come in two broad forms. The first is a mutual or unilateral option clause, by which one (or both parties) have the right choose between arbitration and litigation. The second are the one song to the tune of another type - providing for arbitration administered by one arbitral institution, but conducted under the arbitration rules of another.

Flashbird was the second sort of clause. Translated into English, it provided:

> *"14. The law applicable and the settlement of disputes*
> *Mauritius has a permanent Court of arbitration at the Chamber of commerce and industry. (http://www.jurisint.org/fr/ctr/75.html).*
> *All disputes arising out of this Contract or in connection with it, such as with regard to additional clauses, shall be finally determined according to the arbitration Rules of the international Chamber of commerce by one or more arbitrators appointed in accordance with those Rules.*
> *The applicable law shall be malagasy law.*
> *The arbitration shall be held at Port Louis, Mauritius."*

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The clause led to a long and convoluted procedural fight. CSPI commenced arbitration before the Mauritius Chamber of Commerce and Industry's Arbitration and Mediation Centre ("**MARC**"), which appointed a sole arbitrator.

Flashbird protested, arguing that the arbitration should be governed by the Rules of Arbitration of the International Chamber of Commerce ("**ICC**", "**ICC Rules**"). Specifically, Flashbird alleged the tribunal should have been constituted by a panel of three arbitrators under the ICC Rules.

The Permanent Court of Arbitration at the Hague, which acts as the default appointing authority under the Mauritian International Arbitration Act subsequently rejected Flashbird's objection and the arbitration proceeded without Flashbird participating. Then, towards the end of the MARC proceedings, Flashbird commenced a parallel arbitration against CSPI before the ICC.

Ultimately, the sole arbitrator appointed by MARC issued an award holding Flashbird liable to CSPI and so Flashbird brought proceedings before the Supreme Court of Mauritius, seeking an order to set aside the award.

The Supreme Court dismissed Flashbird's appeal. The Supreme Court did not consider that it was necessary to rule on the question of the proper interpretation of the arbitration clause, holding that Flashbird failed to demonstrate that the alleged irregularity had caused "*substantial prejudice*".

Finally, Flashbird appealed to the Judicial Committee of the Privy Council on four grounds. Two were not raised prior and so cursorily dismissed. The other two were that the Supreme Court of Mauritius erred in, firstly, failing to find that the arbitrator erred in his interpretation of the arbitration clause in applying MARC rules instead of the ICC Rules and, secondly, in failing to find that the arbitration should have been governed by the ICC Rules even though the tribunal was one appointed by MARC.

The Privy Council noted that the remaining grounds essentially concerned the contention that the arbitration, in particular the constitution of the tribunal, should have been conducted in accordance with ICC Rules and addressed them together.

On that question, the Supreme Court held it was unnecessary to rule on the question of the proper interpretation of the arbitration clause because, even if Flashbird was correct, it had not demonstrated that, firstly, the appointment of a sole arbitrator was not in accordance with the agreement of the parties and, secondly, that if it was not, it had suffered "*substantial prejudice*" as a consequence.

The Privy Council agreed with the Supreme Court of Mauritius' findings on both of these points.

On the first, such finding was that the only material failure to act in accordance with the parties' agreement as to arbitral procedure alleged by the applicant related to the constitution of the arbitral tribunal as consisting of a sole arbitrator rather than a panel of three arbitrators – because no complaint was made before them as to the identity of that sole arbitrator.

In order for Flashbird to make good its case, it therefore needed to show that following the ICC arbitral procedure would be likely to have led to the appointment of three arbitrators rather than a sole arbitrator. On the basis of the ICC Rules and the nature of the dispute, this had not been established. Flashbird could not show that the appointment of a sole arbitrator was not in accordance with the parties' agreement as to arbitral procedure.

On the second, such finding was born out of New York Convention jurisprudence from enforcement courts globally and recent English case law. Notably, Section 39(2)(a)(iv) of the Mauritian Act essentially adopts the language of Article V(1)(d) of the New York Convention as a ground for annulment, which provides:

> *"1. Recognition and enforcement of the award may be refused, at the request of the party against whom it is invoked, only if that party furnishes to the competent authority where the recognition and enforcement is sought, proof that:*
> *...*
> *(d) The composition of the arbitral authority or the arbitral procedure was not in accordance with the agreement of the parties, or, failing such agreement, was not in accordance with the law of the country where the arbitration took place;"*

This provision has been tested around the world and, recently, that jurisprudence has been confirmed as falling within English law in Eastern European Engineering Ltd v Vijay Construction (Proprietary) Ltd [2018] EWHC 2713 (Comm); [2019] 1 Lloyd's Rep 1. Cockerill J noted that: "it is not in issue that in order to succeed on this ground the applicant must show a material breach of the arbitration agreement that was not an inconsequential irregularity".

Where the only material failure alleged by Flashbird related to the constitution of the tribunal as a sole arbitrator rather than a panel of three arbitrators, and Flashbird could not show that following the correct rules would be likely to have made any difference, the Privy Council found the Supreme Court was justified in concluding that Flashbird had to establish material prejudice if the Court's discretion under Section 39(2)(a)(iv) was going to be used to set aside the award. Flashbird could show no such prejudice.

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FLASHBIRD FLIES AGAIN?

In a novel approach to Section 67 challenges, Flashbird is making a comeback. It has been argued recently in confidential proceedings to set aside an arbitration award under Section 67 on grounds that the tribunal lacked substantive jurisdiction because it was not properly constituted.

Section 67 of the 1996 Act

To recap, an award made by an arbitral tribunal as to its own substantive jurisdiction can be challenged under Section 67 of the English Arbitration Act 1996 (the "**1996 Act**"). The law on Section 67, as it stands, provides as follows:

> *"(1) A party to arbitral proceedings may (upon notice to the other parties and to the tribunal)*
> *apply to the court—*
> *(a) challenging any award of the arbitral tribunal as to its substantive jurisdiction; or*
> *(b) for an order declaring an award made by the tribunal on the merits to be of no effect, in*
> *whole or in part, because the tribunal did not have substantive jurisdiction. A party may lose*
> *the right to object (see section 73) and the right to apply is subject to the restrictions in section*
> *70(2) and (3).*
> *(3) On an application under this section challenging an award of the arbitral tribunal as to its*
> *substantive jurisdiction, the court may by order—*
> *(a) confirm the award,*
> *(b) vary the award, or*
> *(c) set aside the award in whole or in part"*

In other words, Section 67 deals with challenges to an arbitral award on the grounds of want of "*substantive jurisdiction*", defined by Section 82(1) of the 1996 Act.

> *"Substantive jurisdiction, in relation to an arbitral tribunal, refers to the matters specified in section 30(1)(a) to (c), and references to the tribunal exceeding its substantive jurisdiction shall be construed accordingly".*

Section 30 of the 1996 Act gives power to an arbitral tribunal to rule on its own substantive jurisdiction. This encompasses any decision as to: (i) whether there is a valid agreement to arbitrate; (ii) whether the tribunal is properly constituted; and (iii) what matters have been submitted to arbitration in accordance with the arbitration agreement.

Section 67 permits a party to apply to the Court to challenge an award made by an arbitral tribunal in respect of these three matters. The Court has the power to either confirm, vary or set aside the award in whole or in part (see Section 67(3)(a) to (c) of the 1996 Act). Section 67 applications are notoriously hard to win and somewhere around 1 in 10 are thought to succeed.

Importantly in respect of this case, the 1996 Act is not based on the UNCITRAL Model Law and its Section 67 – other than Section 39(2)(a)(iv) of the Mauritian Act – hence not based on the wording of Article V(1)(d) of the New York Convention.

Arguing Flashbird under Section 67

In a recent hearing on a borderline challenge, the party maintaining the Tribunal had been validly constituted tried to run the 'Flashbird argument' – i.e. that any alleged defect in the process for appointment of the Tribunal was inconsequential and/or caused no prejudice to the Claimant. The argument went that, in a case concerning a comparatively minor or technical breach of procedure for appointment of an arbitral tribunal, a Section 67 applicant should have the burden of demonstrating that the breach has caused it material prejudice.

Such an argument seeks to elide the approach under a Section 68 application where (an Award can be challenged for 'serious irregularity' and) it is necessary to show that serious irregularity has caused or will cause substantial injustice to the claimant.

Moving Section 67 in the direction of Section 68 by the backdoor is a novel twist. Section 67 is sometimes seen as the preserve of 'arid and technical' arguments about formalities of the Tribunal's constitution – without real regard for the consequences thereof.

The argument run was that, since Flashbird, this should no longer be the case – the Court could now have regard to whether or not the alleged error caused prejudice to one party of another under Section 67. This was on the basis that the relevant part of the Mauritian Act did not express any requirement that substantial, material or any other kind of prejudice be suffered, either. Nevertheless, the Supreme Court of Mauritius had lifted the material prejudice argument out of the New York Convention jurisprudence and the Privy Council found that it was right to have done so. Therefore: why not Section 67, too?

Predictably, a strong counter argument was run to the effect that the importation of Section 68, which enables a challenge to an arbitral award on the basis of a *"serious irregularity affecting the tribunal, the proceedings or the award"* into Section 67 was out of place. Put simply, Section 68 is irrelevant to Section 67 - the logic was not transferable.

The decision took the simple approach and held there was no reason to imply words from Section 68 to Section 67, if they did not appear in Section 67. The hearing turned on ot-

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her matters. However – it is hard not to see a kernel of possibility in the Flashbird argument and that, argued skilfully before a more understanding tribunal, the point might just take off.

CONCLUDING COMMENTS

On a purely practical level, Flashbird serves as a reminder to be meticulous when drafting arbitration clauses. Poorly drafted, ambiguous clauses can lead to years of litigation and pain. But recent attempts to apply Flashbird more widely may bear fruit and should be watched closely by arbitration practitioners. Initial attempts to run the material prejudice argument under Section 67 have failed, but there is no reported authority and so the point remains open. In the hands of a skilful advocate, Flashbird might yet take flight again.

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STATUS OF EUROPEAN INVESTMENT ARBITRATION AFTER *KOMSTROY* AND *PL HOLDINGS*

Written by Ondrej Cech & Christian Weisgram

INTRODUCTION

In late 2021, we have seen two landmark decisions of the Court of Justice of the European Union ("**CJEU**") addressing intra-EU investment arbitration. In September, the CJEU decided to extend the reach of its previous *Achmea* ruling to Energy Charter Treaty ("**ECT**") cases in *Komstroy*. Shortly thereafter, in October, the CJEU ruled in PL Holdings that EU member states cannot get around the *Achmea* decision by concluding *ad hoc* arbitration agreements with the investors. In the following, we will briefly revisit these two rulings, seeking to summarize the current status of European investment arbitration.

INTRA-EU ISDS AFTER *ACHMEA*

The investment arbitration in EU has not been in a great shape for quite some time now. The above-mentioned *Achmea* judgment rendered in March 2018 famously declared that the arbitration clauses based on intra-EU Bilateral investment Treaties ("**BITs**") are inconsistent with Articles 267 and 344 of the Treaty on Functioning of the European Union ("**TFEU**") (Judgment of the CJEU of 6 March 2018, *Slovak Republic v Achmea*, C-284/16). In its reasoning, the Court explained that an arbitral tribunal constituted under an arbitration agreement contained in a BIT cannot be considered a "*court or tribunal of a Member State*" in the meaning of Article 267 TFEU and as such cannot submit references for preliminary rulings to the CJEU. Furthermore, decisions of the investment arbitral tribunals are subject only to a limited court review, which is dependent on domestic law. Since arbitral tribunals are likely to interpret EU law but at the same time are (for the most part) out of reach of CJEU, they have adverse effect on the autonomy and uniformity of EU law enshrined, in particular, in Article 344 TFEU. Therefore, according to the Court, arbitration agreements in BITs concluded between EU member states are contrary to EU law.

In the *Komstroy* judgment (Judgment of the CJEU of 2 September 2021, *Republic of Moldova v Komstroy*, C-741/19), the CJEU went further and, relying on the *Achmea* ruling, decided that also intra-EU arbitration agreements based on the ECT are contrary to the TFEU. Interestingly, the case itself did not concern an intra-EU dispute as it concerned investment arbitration between a Ukrainian investor and Moldova. The relevant EU element was a seat of arbitration in France. The reference for a preliminary ruling was made by a French court in setting aside proceedings. The CJEU first opined that it is entitled to interpret the ECT because the EU is a signatory and the CJEU is entitled to interpret acts of EU bodies. From there, the CJEU reiterated the *Achmea* reasoning concerning the autonomy of EU law and concluded that arbitration agreements based on the ECT are contrary to the TFEU.

In the *PL Holdings* ruling (Judgment of the CJEU of 26 October 2021, *Republic of Poland v PL Holdings*, C-109/20), the CJEU addressed a different matter. The case concerned an investment arbitration between a Luxembourg investor and Poland, where the final award had been rendered prior to the *Achmea* judgment. Poland attempted to raise a jurisdic-

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tional objection based on the inconsistency between the arbitration agreement based on the BIT and the TFEU but did so belatedly and its continuation in the proceedings was interpreted as a tacit agreement to arbitrate. This created interesting factual circumstances before the courts of Sweden in the following setting aside proceedings. The court had to consider – in light of the *Achmea* reasoning – whether Poland could enter into this *ad hoc* arbitration agreement with the investor, which was distinct from the BIT, but had identical content to the arbitration clause of the BIT. The CJEU argued that permitting member states to enter such agreements would in effect amount to a circumvention of their obligations under the TFEU as interpreted in the *Achmea* judgment. Therefore, even such subsequent *ad hoc* arbitration agreements are contrary to the TFEU.

These cases demonstrate that the CJEU is dedicated to enforce its position that intra-EU investment arbitration is contrary to the legal framework as provided by the TFEU and thus must be prevented in any form. Nevertheless, while the courts of EU member states have been generally ruling in line with the CJEU, investment tribunals have been less eager to abide by the CJEU's position.

A good example for this tendency is the jurisdictional decision of the tribunal in the *Fynerdale case* (Award dated 29 April 2021, *Fynerdale Holdings BV v The Czech Republic*, PCA Case No. 2018-18). Incidentally, the tribunal was constituted under the same BIT that was addressed in *Achmea* itself and the case concerned a Dutch investor claiming damages against the Czech Republic. ZFZ represented the Czech Republic and raised several jurisdictional objections, including arguments based on *Achmea* and the inconsistence between the arbitration agreement under the BIT and the TFEU. However, the tribunal opined that it was not bound by *Achmea* and adopted a different interpretation of the relevant provisions of the TFEU. Whilst, ultimately, the Czech Republic prevailed on the basis on another jurisdictional objection, the tribunal's approach is illustrative of a larger trend.

CONCLUSION AND OUTLOOK

In the years since *Achmea*, investors and arbitral tribunals have been engaged a cat and mouse game with the CJEU and the courts of (most) EU members states. Investors are attempting to avoid any contact with the European courts and try to structure the claims and proceedings to eliminate any intra-EU elements. The member states, in turn, are actively seeking contact with EU courts and take various steps to benefit from the CJEU's position on the admissibility of Intra-EU-investment arbitration. The most significant of such steps is the BIT termination treaty, which was signed by 23 out of 27 EU member states in 2020. Although the CJEU did not go so far as to explicitly declare *ad hoc* arbitration agreements in intra-EU investor-state arbitrations invalid *per se*, based on this treaty and in light of *Komstroy* and *PL Holdings,* it seems likely that any intra-EU investment arbitration is slowly coming to an end. Both the CJEU and the EU members states have made it clear that there are no exceptions to the *Achmea* findings and once the BITs are terminated, even tribunals will have to accept that the era of Intra-EU-investment arbitration has come to an end.

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Additional content on this topic:

IURA NOVIT ARBITER – AN OVERVIEW

Written by Gaudenz Küenburg

INTRODUCTION

The defining element of arbitral proceedings is the importance prescribed to the will of the disputing parties. In principle, they can shape and structure the proceedings to their needs and wishes and determine the scope in which arbitral tribunals are authorised to issue enforceable awards. To some extent, the function of arbitrators appointed by the parties may be regarded as that of service providers. This characterisation, without doubt, raises questions about the power of arbitral tribunals to act autonomously, hence, without the parties' express application or authorization, and, subsequently whether – and to what extent – the doctrine of *iura novit* curia applies in international arbitration.

DEFINING THE "BEAST"

The doctrine of *iura novit curia* – "the court knows the law" has its origin in the Roman law tradition and is – despite lacking an express legal provision – widely accepted as a core principle in civil law jurisdictions. It forms an integral part of law traditions with an inquisitorial approach, where courts are – in principle – actively involved in investigating the facts and legal questions of the case. In its most literal application, *iura novit curia* would not require the parties to make any legal submissions before a court. In practice, however, even in jurisdictions that formally prescribe to this

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doctrine it is not applied rigorously. Rather, in Germany and Austria, for example, it is common practice for parties to submit their views on the legal qualification of the merits of the matter. Indeed, the mere assertion of a conclusive claim implies and requires taking a legal position. Importantly, however, the doctrine of *iura novit curia* prevents the court from being bound by the Parties' legal arguments.

Whereas *iura novit curia* is a widely uncontested feature of civil law jurisdictions, the doctrine is considered somewhat alien – or less relevant – to common law traditions which apply a more adversarial approach. Very generally speaking, adversarial systems are characterised by the fact that the parties are required present all their factual and legal arguments before a court which then renders a judgment solely on this basis.

In view of these different approaches to the doctrine of *iura novit curia* in different legal traditions, the question arises whether such principle applies in international arbitration and whether the existing systemic divide between civil law and common law jurisdictions extends to the realm of international arbitration.

IURA NOVIT ARBITER IN INTERNATIONAL ARBITRATION

The quest for determining the existence or the application of the doctrine of *iura novit curia* in international arbitration is characterized by the notable lack of express provisions on the issue in arbitration laws around the world.

Nevertheless, some provisions hint at – or better suggest – the application of the principle of *iura novit arbiter*. Surprisingly enough, a frequently cited example in this regard is Section 34 of the 1996 English Arbitration Act ("**Act**"). By some scholars this provision is referred to as evidence that doctrine of *iura novit curia* applies in arbitration. They point to the seemingly broad discretion of arbitral tribunals to ascertain the facts and the law suggested by the provision. Section 34(2)(g) of the Act stipulates that *"it shall be for the tribunal to decide (…) whether and to what extent the tribunal should itself take the initiative in ascertaining the facts and the law."*

However, despite the wording of this provision, the existing case law suggests the apparently broad power of arbitral tribunals to be limited by the Parties' right to be heard. Arbitral tribunals therefore enjoy wide discretion to determine the applicable law if they have "*briefly raised*" the point and give the Parties the opportunity to comment on every legal point (*Terna Bahrain Holding Co WLL v Al Shamsi* [2012] EWHC 3283 (Comm) 106). Otherwise, the arbitral tribunal might risk the challenge of its award.

Given the lack of an express regulation of the application of the doctrine of *iura novit arbiter*, a reasonable approach for assessing its relevance in international arbitration is to analyse to what extent an application can result in a successful challenge of the award. Accordingly, scholars have devoted considerable attention to the question of the extent to which an award may be annulled, or its recognition or enforcement refused under the 1958 New York Convention (the "**Convention**") due to a challenge based on *iura novit arbiter*. Most commonly, the question of *iura novit arbiter* is raised in the context of Article V(1)(b) of the Convention, under which the recognition and enforcement of the award may be refused where a party was "*unable to present his case*" – hence, due to a violation of the right to be heard.

In Austria, the discussion on the issue revolves around the admissibility and consequences of so-called "surprise decisions", which tend to be frowned upon in the arbitration community (Ferrari F and Cordero-Moss G, *Iura Novit Curia in International Arbitration* (Juris 2018) 26). In 2016, by reference to German case law, the Austrian Supreme Court adopted the view that there was no general obligation of an arbitral tribunal share or discuss its legal views with the parties before rendering the award. However, where the tribunal choose to do so and intends to deviate from its initial views, it was held to be obliged to raise this point with the parties (OGH 23 February 2016, docket no. 18 OCg 3/15p; Ferrari et al, 29f).

From the English perspective, the High Court's ruling in *Terna* indicates that a party's right to be heard is not infringed where "*a point is raised only briefly*" because this gives the party the opportunity to address it.

What is more, a general reluctance to refuse the recognition of awards due to the application of previously unmentioned legal theories can be observed in U.S. court decisions as well. For example, in 2011, a U.S. District Court refused to deny recognition based on Article V(1)(b) of the Convention even though legal theories referred to by the tribunal were not raised by or even presented to the parties before rendering the award. According to the court, the parties' mere opportunity to present its interpretation of facts and legal theories during the proceedings was sufficient to satisfy its right to be heard. Also, this decision appears to confirm wide discretionary powers of arbitral tribunals (Ferrari et al, 411).

In summary, even this limited selection of international case law suggests that state courts tend to be reluctant to interfere with arbitral awards, where a challenge is based on a violation of the right to be heard following the application of the principle of *iura novit arbiter*. Arguably, this reluctance is evidence of the application of *iura novit curia* in international arbitration. However, the theoretical possibility of challenges based on violation of the right to be heard following an

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application of the principle of *iura novit arbiter* may prevent arbitral tribunals from applying this principle rigorously.

CONCLUSION

Based on this brief overview, one might conclude that the existing cultural divide between common law and civil law concerning the issue of *iura novit arbiter* is less relevant in international arbitration than in proceedings before state courts. However, it is worth paying attention to the legal background of arbitrators, which will – albeit subconsciously – influence their approach. As to possible challenges of awards on the basis of *iura novit arbiter*, selected decisions from various jurisdictions suggest a picture of *iura novit arbiter* – light: by and large, state courts are rather reluctant to refuse the recognition of awards unless parties were completely unable to comment on a legal point on which the decision in based. Still, arbitral tribunals can be expected to be more cautious than state courts and more inclined to raise legal issues they consider relevant with the parties, even if they might actually have wider discretion in this regard. That is because arbitrators will ordinarily make every effort to ensure that they render binding and enforceable awar

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NEWS

TEAM

Our **London** and **Chicago** offices have been seeing some serious growth over the past couple months!

| Our **London** office welcomed in April new partner **Jonathan Webb**, joining with a wealth of over 20 years' arbitration and litigation experience as partner at a leading international maritime and commodities firm. Read Tradewinds' coverage on Jonathan's joining here.

The team welcomed two associates in May. First to join is **Zoé Pajot**, a French qualified lawyer with experience both working in France and New Zealand based firms specializing in dispute resolution and litigation in maritime and shipping matters. Second to join is **Anastasiia Demidova**, a Russia and New York qualified associate pursuing a third qualification as an England and Wales Solicitor, specializing in arbitration & dispute resolution.

| Our **Chicago** office recently welcomed two new associates. First to join was **Wafeek Elafifi**, joining with arbitration, litigation and advisory work experience within the shipping and logistics sectors. The Chicago team's second addition is **Rowland Edwards**, bringing litigation experience, joining from the Illinois Cook County State's Attorney's Office.

EVENTS

DISPUTES FOR TEA | ARBITRATION

News from Hong Kong: Questions to Dr. Mariel Dimsey, the Secretary General of the Hong Kong International Arbitration Centre

On 22 May 2023, **Dr. Mariel Dimsey** was joined by ZFZ Partner **Friederike Schäfer** and ZFZ Barrister **Jakob Reckhenrich** for an overview of the work of the HKIAC. She presented the institution and guided us through the most important features of its rules. The three discussed the constitution of the arbitral tribunal, the role and involvement of the Secretariat in the arbitral proceedings, the duration of proceedings, as well as how costs are dealt with under the HKIAC Rules. We also covered some background information on Hong Kong as a place of arbitration and the role of the courts in a Hong Kong seated matter, in particular regarding interim measures. Finally, Mariel outlined the institution's wealth of experience in specific, globalized business sectors, like maritime and shipping matters.

VIDEO **Length 47 min.**

Disputes for Tea | Arbitration

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