**Expert Witnesses? Expert Tribunals?**

**New Tools for Resolving Complex Financial Disputes**

By Hon. Elizabeth S. Stong and Camilla Perera-De Wit

Even the most casual observer of courts and financial marketplaces would have to note the growing number, and growing complexity, of financial market disputes since the global financial crisis. And if news reports and the volatility of markets are any guide, this situation is not likely to change anytime soon. All of these disputes are significant to the participants, and many may have systemic consequences as well. But many courts may lack the experience and expertise in financial matters that may be necessary to address the increasingly complex and technical questions that can arise in such cases in an effective way. What can courts and parties do in order to be prepared to deal with such matters when they arise? The answer to this question has several parts, and includes dispute resolution tools both within and outside the traditional court system.

Some background is helpful to understand the context of these issues. Since the collapse of Lehman Brothers in September 2008, there has been a significant increase in the number of complex financial product disputes that have been litigated or arbitrated. The numbers involved can be huge – it has been reported that outstanding over-the-counter derivatives contracts total hundreds of trillions of dollars. Tribunals, including courts and arbitration panels, charged with deciding disputes arising from these and other complex financial transactions may lack training in the legal issues and experience in the commercial realities implicated by these cases. As a result, decisions can be unpredictable and sometimes conflicting, can entail significant delays, and may even be unenforceable outside of the issuing jurisdiction.

Against this background, academics, lawyers, and judges have come together to consider how to improve the prospects for sound and effective decision-making and dispute resolution in these matters, wherever they arise. The result of their collaboration is a new entity, P.R.I.M.E. Finance, which is based at the Peace Palace in The Hague. P.R.I.M.E. Finance stands for Panel of Recognized International Market Experts in Finance, and P.R.I.M.E.’s activities include and dispute resolution services including arbitration and mediation, judicial capacity-building and education, and the compilation of a central database of international precedents and resources.

P.R.I.M.E. Finance is a specialized dispute resolution facility, dedicated to improving both processes and outcomes in financial market dispute settlement. With the support of the Dutch government, it officially opened its doors in The Hague in 2012. P.R.I.M.E. Finance has a particular focus on issues arising in connection with industry-standard documentation, as well as comparative law and market practices for derivatives and other complex financial products. P.R.I.M.E. Finance recently joined forces with the Permanent Court of Arbitration in The Hague, which makes it possible for parties to disputes involving complex financial transactions to have enhanced access to an expert roster of arbitrators, mediators and experts to resolve their disputes and an experienced and well equipped Secretariat to provide administrative support. And as specialized business and commercial courts are established in both the developed and the developing worlds, opportunities for judicial training and capacity-building have expanded as well.

**Increased Caseload**

How big is this caseload? Financial disputes in general have increased significantly since the global financial crisis. Disputes involving complex financial instruments, including over-the-counter (OTC) derivatives such as swaps, forwards and options, have similarly increased. And many of these disputes arise in transactions where industry-standard documents issued by the International Swaps and Derivatives Association, or “ISDA,” are at the core of the dispute. By way of example, while some 78 decisions involving ISDA standard documentation were handed down by the English courts during the period from January 1993 to August 2011 – more than 18 years – some 60 percent of these decisions were rendered between 2009 and 2011.[[1]](#endnote-1).In addition, in the past 20 years, several investment treaty arbitration awards have been issued relating to financial products such as loans, bonds, and derivatives. [[2]](#endnote-2)

The sheer size of this market is also of note, and the amounts involved in these instruments are large indeed. By one accounting, undertaken by the Bank for International Settlements, the total notional amounts outstanding of OTC derivatives contracts as of June 2015 is $553 trillion, and the vast majority of these contracts are understood to be defined by ISDA terms.[[3]](#endnote-3)

**Documentation, Complexity, and Systemic Risk**

What kinds of documents are used in these transactions? And why do they matter? Complex financial products are often documented by standardized market agreements, and this can make it all the more important that the decisions interpreting these agreements are sound. The best-known and most widely used industry-standard agreement may well be the ISDA Master Agreement, which exists in several editions for derivatives transactions. As one court noted, in *Lomas v JFB Firth Rixson Inc.*, the ISDA Master Agreement is “one of the most widely used forms of agreement in the world . . . [and] . . . probably the most important standard market agreement used in the financial world.”[[4]](#endnote-4) While there are many benefits to standardization, it can also bring about significant systemic risk – because a single erroneous interpretation of a particular term or phrase may have sweeping consequences that reach far beyond the case at issue.[[5]](#endnote-5)

International financial disputes have become more intricate from a procedural standpoint as well. Disputes may involve many parties, multiple contracts, technical terms, and legal relationships that cross jurisdictional borders.[[6]](#endnote-6) For these reasons too, the systemic consequences of decisions in these cases can be significant, particularly where standard forms of agreements such as the ISDA Master Agreement are used.

And even courts that are very accustomed to hearing and determining complex business and financial disputes may reach different conclusions about standard language. For example, courts in London and New York reached different conclusions as to the enforceability of a key provision in the ISDA Master Agreement to the effect that, following a default, the payment obligations of the non-defaulting party would be suspended, potentially indefinitely. A London court upheld its enforceability in *Lomas v JFB Firth Rixson Inc.*,[[7]](#endnote-7) while a New York federal bankruptcy court held that it was of limited or no enforceability in the *Metavante* ruling, a September 15, 2009 bench ruling in *In re Lehman Brothers Holdings, Inc.*, Case No. 08-13555.[[8]](#endnote-8)

The results from other courts can also vary. Across continental Europe, trial and appellate courts have decided disputes arising from derivatives or other complex financial product trading using approaches that range from administrative law to contract law to even criminal law. The issues may include the capacity of a party such as a municipal entity to enter into a derivatives transaction as well as the extent of the seller’s disclosure obligations to a professional money manager or a retail client. So far, only a fraction of cases have been the subject of appellate review, so there is little available controlling precedent.[[9]](#endnote-9)

Against this background of scope, scale, and complexity, what dispute settlement mechanism and tools best serve the parties’ interests in a particular case? How can the prospect of systemic risk be minimized? The forums and remedies in markets may differ – for example, the remedies available in the derivatives markets differ from those available in the loan and bond markets.[[10]](#endnote-10) Parties have the opportunity to consider alternatives to court proceedings, such as mediation and arbitration, at the time a transaction is entered into, and again after a dispute arises. Alternatives to court proceedings including arbitration and mediation may offer faster and more reliable determinations. And even courts have recognized a role for alternative paths to a resolution. As one English High Court Justice observed:

I therefore allow Credit Suisse's claim under the [ISDA] Master Agreement. The amount that they recover will depend upon the determination of the issues between the parties about the calculation of the Early Termination Amount. I ask that the parties consider how those issues can best be resolved (*and no doubt they will consider whether they are more efficiently and satisfactorily determined by an arbitrator or an expert rather than a court hearing*).[[11]](#endnote-11)

**Some Historical Context**

Some historical context may put these issues and questions in perspective. Traditionally, international financial transactions have been documented in agreements with choice of law terms providing for the application of English or New York law, and jurisdiction clauses conferring jurisdiction on the English or New York courts. These are, for example, the options contemplated in Section 13 (Governing Law and Jurisdiction) of the 1992 and 2002 ISDA Master Agreements. The law in these jurisdictions is well known to commercial parties and their counsel, and the courts in these jurisdictions regularly hear complex financial matters. But not every forum in these jurisdictions has had experience with adjudicating derivatives contract disputes, and not every such dispute is heard in these forums. Increasingly, parties to derivatives transactions may be found around the globe, including in emerging market jurisdictions. In addition, the participants and particularities of a case may change rapidly.

Arbitration has long been a part of the landscape in the resolution of complex financial disputes among sophisticated parties, and this use is increasing. In September 2013, ISDA published its first Arbitration Guide, following a period of extensive consultations with ISDA members.[[12]](#endnote-12) [[13]](#endnote-13) The ISDA working group responsible for preparing the Arbitration Guide noted the increase in the use of pre-dispute arbitration clauses in derivatives contracts and more generally, in international financial transactions, and observed that this increase may be related to the perceived challenges associated with litigating such disputes in the courts of many jurisdictions, particularly in emerging markets. The Working Group also noted the wide acceptance and advantages of international enforcement of arbitral awards under the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards, also known as the New York Convention.[[14]](#endnote-14) The assets against which awards or decisions may need to be enforced are increasingly located in multiple jurisdictions where the enforcement of a court decision issued outside the jurisdiction may be difficult. By contrast, the New York Convention defers to local law in relation to the recognition and enforcement of international arbitral awards, and in practice, there are generally few procedural obstacles to the enforcement of an international arbitral award in any of the approximately 155 contracting states.[[15]](#endnote-15)

 Parties may mitigate the risk of an unenforceable court decision by agreeing to litigate disputes in the courts of the place where its counterparty has its assets. This approach has obvious advantages and disadvantages – while it may resolve some problems, it may create others including the potential lack of experience and expertise of local courts and local counsel in addressing complex financial disputes, as well as language barriers, lack of familiarity in dealing with foreign law and more. These challenges may result in delays, uncertainty, and other obstacles to an efficient dispute resolution process.

One response to this situation is the Convention of 30 June 2005 on Choice of Court Agreements.[[16]](#endnote-16) This Convention aims to promote international trade and investment by encouraging judicial cooperation in the field of jurisdiction and the recognition and enforcement of judgments. The Convention generally only applies to exclusive choice of court agreements. Some 30 countries have agreed to be bound by the Convention, but at this stage, it is far removed from offering the generalized protections and enforceability of the New York Convention.

**The Need for Expertise and the Birth of P.R.I.M.E. Finance**

So what should be the role for experts in the resolution of complex financial markets disputes? The challenges in the current financial and legal context are clear: litigation offers all of the benefits of a judicial process and resolution, but few courts have experience in these kinds of disputes, and inconsistent interpretations of standard documents including the ISDA Master Agreement could have significant adverse consequences – and not only for the parties, but also for the financial markets. Arbitration is often viewed as a more efficient, less costly, and better process for some kinds of disputes, but not every arbitration forum is well-equipped to address the complex issues that can arise in these matters. The need for a reliable path to sound decisions that can easily and effectively be enforced, a settled body of law, and speed of determination have led to innovative thinking with several notable developments as a result.

These matters were the focus of international attention by academics, lawyers, and judges when raised by Professor Jeffrey Golden,[[17]](#endnote-17) now Chairman of the P.R.I.M.E. Finance Foundation, at a conference in The Hague in 2007. Three years later, in 2010, an experts’ roundtable was convened at the Peace Palace in The Hague. That roundtable was chaired by the Right Honorable Lord Woolf of Barnes, CH, for former Lord Chief Justice of England and Wales, and attended by some 60 finance and legal experts including lawyers, judges, market representatives, chief legal officers, regulators and central bank officials, as well as many of the founders of the derivatives and structured finance industries Similar gatherings of local experts took place with lenders, dealers, “buy-side” market participants, judges, and regulators in global financial centers including London and New York. These experts considered the feasibility of creating a specialized dispute resolution institute that could provide an expert forum for arbitrations, expert witnesses to assist parties, judges, and arbitrators, and expert technical assistance and training to judges who may hear such disputes. Two years later, in 2012, P.R.I.M.E. Finance formally opened its doors in The Hague.

**Expert Dispute Resolution – P.R.I.M.E. Finance and the Permanent Court of Arbitration**

Today, P.R.I.M.E. Finance is based at the Peace Palace in The Hague. It offers dispute resolution services, including an expert arbitration and mediation forum, expert witness services, and judicial training and support. It is also engaged in the compilation of a comprehensive central data base of international precedents and source materials.[[18]](#endnote-18) P.R.I.M.E. Finance arbitrations are conducted and administered in collaboration with the Permanent Court of Arbitration, also based at the Peace Palace, under the P.R.I.M.E. Finance Arbitration Rules. These arbitration rules are based on the UNCITRAL Arbitration Rules and adapted to meet the special requirements of complex financial disputes, including with respect to notices, applicable law, currency, interest and taxation. The P.R.I.M.E. Finance Arbitration Rules also permit the parties to conduct emergency and expedited proceedings and to seek interim relief.

 P.R.I.M.E. Finance offers an additional benefit to parties and courts. Since it was established in 2012, P.R.I.M.E. has designated more than 100 legal and financial experts to serve on its Panel of Recognised International Market Experts. These experts have more than 3,000 collective years of relevant experience, and include sitting and retired judges, central bankers, regulators, academics, lawyers, and derivatives market participants. As noted on P.R.I.M.E. Finance’s website:

Many have first-hand experience structuring and executing transactions, as well as with the laws, regulations, and standard documentation of the structured finance market, creating a combination of legal and market expertise that is both ideal for the task at hand and completely unprecedented.

They are also diverse in every way, including geographic representation, market and jurisdictional experience and perspective, linguistic skills and nationalities. And many have reached a point in their careers where they seek the opportunity to “give back” to the financial community through their efforts to foster a safer and sounder global economy. As also noted on P.R.I.M.E.’s website, “P.R.I.M.E. Finance actively mines this resource.”

P.R.I.M.E. Finance’s recent collaboration with the Permanent Court of Arbitration has significantly enhanced the ability of both entities to meet the arbitration and dispute resolution needs in complex financial disputes. The Permanent Court of Arbitration was established by treaty in 1899, and has provided dispute resolution services to the international community for more than one hundred years. As an intergovernmental organization with 121 member states, it often functions at the intersection of public and private international law. This collaboration brings together the expertise of P.R.I.M.E. Finance, including more than 100 of the most senior experts from the world of finance, financial markets law and dispute resolution, and the well-established institutional framework of the Permanent Court of Arbitration, including its 40 lawyers and case managers who undertake the administration of cases. It also permits arbitrations to take place anywhere in the world, and these proceedings may be facilitated by the Permanent Court of Arbitration's host country agreements with many of its member states.

**Expert Judicial Education – P.R.I.M.E. Finance and the Courts**

P.R.I.M.E. Finance has also addressed the need for enhanced education and training for courts and judicial officers who may hear and decide complex financial disputes, including disputes arising from transactions based on industry-standard documentation such as the ISDA Master Agreement. It is a fact of judicial life that a judge cannot be expert in every matter that may come before him or her to be decided, and similarly a fact that when the cases arises, there is likely to be little time to gain a broad perspective of the legal and business context for the dispute. Working with the European Bank for Reconstruction and Development, the International Bar Association, the Municipality of The Hague, and other organizations, P.R.I.M.E. Finance experts have provided training to judges on several continents, from the most sophisticated courts located in New York and Delaware to courts in emerging markets and developing countries. This work complements P.R.I.M.E. Finance’s arbitration and other dispute resolution work, and enhances the capacity of courts to address these disputes. And this, in turn, reduces the risk of inconsistent determinations and outcomes, and the global systemic risk that accompanies it.

**A Recent Example: *In re Caesar’s Entertainment Operating Co.***

One recent example illustrates how P.R.I.M.E. Finance experts were able to address a significant dispute in a prompt, efficient, and effective manner. In *In re Caesar’s Entertainment Operating Co.*, the parties faced a high-profile financial markets dispute concerning some $1.7 billion in credit derivatives. The ISDA Americas Credit Derivatives Determinations Committee convened an External Review Panel comprised of three P.R.I.M.E. Finance experts to address the question whether a “Failure to Pay Credit Event” had occurred for purposes of the parties’ obligations to one another. The potential consequences of this determination, for the case and more generally, were significant, and a swift and authoritative resolution was needed.

The External Review Panel unanimously concluded that the non-payment of interest was protected by a grace period and thus was not a “Failure to Pay Credit Event” for purposes of the market. The unanimous decision was reached within a brisk eight days from the first filed brief. Equally important, the process was a transparent one, and the decision was made public afterwards.[[19]](#endnote-19)

What does this example illustrate? Here, the parties were able to call upon the ISDA dispute resolution process and P.R.I.M.E. Finance’s experts to obtain a prompt resolution of a difficult question. Not every dispute can be addressed through this specialized process, and few will be able to be resolved in a period of days, not weeks or months. But sophisticated parties to complex and technical transactions may well seek to construct the most appropriate process to address a dispute, and the availability of experts in complex financial transactions and documentation can facilitate that process.

**Conclusion – Defining and Embracing a Role for Experts**

Complex financial disputes, like every dispute, require dispute resolution procedures that are fair, just, efficient, and effective. Courts that may hear these disputes benefit from expert judicial education and, where possible, expert guidance and testimony. Parties to such disputes may elect arbitration or mediation, either before the dispute or after it arises, and they will benefit from neutrals who have both expertise and experience in these matters. Similarly, an expert’s perspective can be fundamental to the trial or arbitral process and in enabling the tribunal to come to a sound decision. This may especially be so where the interpretation of industry-standard documents such as the ISDA Master Agreement is among the tasks at hand. And in a mediation, an expert mediator or advisor may assist the parties in identifying the significant facts and relevant issues and in assessing the strengths and weaknesses of their case.[[20]](#endnote-20)

More generally, dispute resolution procedures, whether through the courts or through alternative forms of dispute resolution, work best when they work in harmony with each other. In a complex financial dispute, depending on the interests of the parties and the facts of a case, some disputes are best litigated, while others are best arbitrated, and others may benefit from a facilitated negotiation. But whether the path chosen by the parties is litigation, arbitration, mediation, or something else, the process and the outcome will benefit from the participation of experts, including decision-makers, neutrals, and trainers. P.R.I.M.E. Finance has defined a new model for expert resources to be made available to courts, parties, and financial markets, in furtherance of its mission to foster a more stable global economy and financial marketplace by reducing legal uncertainty and systemic risk, and to promote the rule of law.

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1. See JP Braithwaite, ‘OTC Derivatives, the Courts and Regulatory Reforms’, *Capital Markets Law Journal*, 7(4) (2012), 1-22. [↑](#endnote-ref-1)
2. Fedax NV v The Republic of Venezuela, ICSID Case No ARB/96/3, Ceskoslovenska Obchodni Banka, AS v The Slovak Republic, ICSID Case No ARB/97/4, Abaclat v Argentina, ICSID Case ARB/07/5, Ambiente Ufficio SpA and others v Argentine Republic, ICSID Case No ARB/08/9, Deutsche Bank AG v Democratic Socialist Republic of Sri Lanka, ICSID Case No ARB/09/2. [↑](#endnote-ref-2)
3. http://www.bis.org/publ/otc\_hy1511.pdf. [↑](#endnote-ref-3)
4. [2010] EWHC 3372 (Ch). [↑](#endnote-ref-4)
5. See J. Golden, ‘The Courts, the Financial Crisis and Systemic Risk’, *Capital Markets Law Journal*, 4 (2009), ss 141 – 9, at s 143. [↑](#endnote-ref-5)
6. See J. Golden, ‘Judges and Systemic Risk in the Financial Markets’ Fordham Journal of Corporate & Financial Law, Vol. XVIII (2013), pp. 327-337, at 330-331. [↑](#endnote-ref-6)
7. [2010] EWHC 3372 (Ch), CA. [↑](#endnote-ref-7)
8. In Re Lehman Brothers Holdings Inc, No 08-13555 (JMP) (Bankr, SDNY 15 September 2009). Also see J. Ross, ‘ The Case for P.R.I.M.E. Finance: P.R.I.M.E. Finance cases’ , *Capital Markets Law Journal*, 7(3) (2012), 221-270. [↑](#endnote-ref-8)
9. See J Golden and P Werner, ‘ The Modern Role of Arbitration in Banking and Finance’*, International Financial Disputes Arbitration and Mediation*, (2015), pp 5-6. [↑](#endnote-ref-9)
10. See J. Golden, ‘Judges and Systemic Risk in the Financial Markets’ Fordham Journal of Corporate & Financial Law, Vol. XVIII (2013), pp. 327-337, at 330-331. [↑](#endnote-ref-10)
11. [2014] EWHC 3103 (Comm) (emphasis added). [↑](#endnote-ref-11)
12. http://www2.isda.org/news/isda-publishes-the-2013-isda-arbitration-guide. [↑](#endnote-ref-12)
13. ISDA, MEMORANDUM FOR MEMBERS OF THE INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION, INC.: The use of arbitration under an ISDA Master Agreement (19 January 2011), http://www2.isda.org/functional-areas/public-policy/financial-law-reform/page/3; ISDA MEMORANDUM FOR MEMBERS OF THE INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION, INC.: The use of arbitration under an ISDA Master Agreement: feedback to members and policy options (10 November 2011), http://www2.isda.org/functional-areas/public-policy/financial-law-reform/page/2. [↑](#endnote-ref-13)
14. In addition, several other publications and studies have led to an increased awareness by banks and other financial institutions of the potential advantages of the use of arbitration in resolving their disputes, see e.g. PwC and Queen Mary, University of London, *Corporate Choices in International Arbitration: Industry Practices* (2013), 8. [↑](#endnote-ref-14)
15. See S Jagusch, ‘ Enforcement’, *International Financial Disputes Arbitration and Mediation*, (2015), pp 474-518. [↑](#endnote-ref-15)
16. https://assets.hcch.net/docs/510bc238-7318-47ed-9ed5-e0972510d98b.pdf. [↑](#endnote-ref-16)
17. Jeffrey Golden, Governor and Honorary Fellow, London School of Economics and Political Science; 3 Hare Court, Temple; Retired founding partner, US law practice, Allen & Overy LLP. [↑](#endnote-ref-17)
18. http://primefinancedisputes.org. [↑](#endnote-ref-18)
19. The briefs, the decision and even a video of the hearing itself are available on-line at [www.ISDA.org](http://www.ISDA.org). [↑](#endnote-ref-19)
20. See M. Hammes, A. Yanos, and J. Bédard, ‘Expert Witnesses in Arbitration,’ Corporate Disputes Magazine (Oct-Dec 2012 Issue). [↑](#endnote-ref-20)