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Insights

BEWARE THE HYBRID ARBITRATION CLAUSE

Jan 31, 2022

SUMMARY

The recent Privy Council decision in Flashbird Ltd v Compagnie de Sécurité Privée et Industrielle SARL has highlighted some of the problems that can arise from the use of hybrid arbitration clauses.

This blog considers the issues that arose in that case and how parties can avoid them.

HYBRID ARBITRATION CLAUSES

Hybrid arbitration clauses can come in a variety of forms. A common example is the mutual or unilateral option clause where one or both parties have the right choose between arbitration and litigation, so that they can select the most appropriate forum after the dispute has arisen. Unilateral option clauses have proved popular with the banking/finance sector, particularly in the context of loan agreements, as they offer the maximum flexibility to a lender. However, the flexibility of hybrid clause can come at a price.

Even with careful drafting, hybrid clauses often give rise to jurisdictional disputes. It's essential to set a clear trigger point for exercising the choice of a particular option and to set out the effect of exercising the option on any other proceedings. Failure to do so can result in attempts to seize jurisdiction and costly parallel proceedings.

Another issue is the extent to which different jurisdictions will enforce unilateral option clauses (and awards arising from them). Whilst many jurisdictions will enforce unilateral option clauses, the approach is not universal. Jurisdictions where there are significant concerns over the enforceability of unilateral option clauses include: France, Russia, Poland, Turkey, Bulgaria, Democratic Republic of Congo and Romania. The consequences of including a unilateral option clause in agreements connected with a jurisdiction that considers them to be invalid can be severe. The arbitration clause may be declared void, potentially resulting local courts assuming jurisdiction, and any resulting arbitral award may be unenforceable.

MIX OF ADMINISTERING INSTITUTION AND ARBITRATION RULES

Another (less common) example of a hybrid arbitration clause is an agreement that provides for arbitration administered by one arbitral institution but conducted under the arbitration rules of another arbitral institution.

This sort of hybrid clause gives rise to some serious complications, as highlighted in the recent Privy Council decision in Flashbird Ltd v Compagnie de Sécurité Privée et Industrielle SARL.

The case concerned an appeal against a decision of the Supreme Court of Mauritius dismissing an application to set aside an arbitration award.

The dispute arose out of a consultancy contract under which Flashbird was to assist the Compagnie de Sécurité Privée et Industrielle SARL ("CSPI"), in obtaining a contract for the management and development of security and safety services at international airports in the Republic of Madagascar.

The arbitration clause in the contract 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."

In August 2016, Flashbird filed a request for arbitration with the Secretariat of the Arbitration and Mediation Center ("MARC") of the Mauritius Chamber of Commerce and Industry.

In October 2016, MARC designated a sole arbitrator to determine the dispute. CSPI objected to the appointment of a sole arbitrator and applied to the Permanent Court of Arbitration at the Hague for the appointment of three arbitrators. The application was rejected.

The arbitration proceeded without the participation of CSPI and, in October 2017, the arbitrator issued a final arbitral award in favour of Flashbird.

HYBRID ARBITRATION CLAUSE?

In December 2017, CSPI applied to the Supreme Court in Mauritius to set aside the award on the grounds that the arbitral procedure was not in accordance with the agreement of the parties.

CSPI contended that on the proper interpretation of the arbitration agreement the arbitral procedure, and in particular the constitution of the tribunal, should have been in accordance with the rules of the International Court of Arbitration of the International Chamber of Commerce ("ICC") rather than the rules of MARC.

The parties agreed that paragraph 2 of the arbitration clause referred to the ICC arbitration rules. This created a contradiction between the chosen arbitration institution (MARC) (paragraph 1) and the chosen arbitration rules (ICC Rules) (paragraph 2). This contradiction was exacerbated by the fact that the MARC rules provide that by nominating MARC as the arbitration institution the parties are bound by the MARC rules (article 1.2), whereas the ICC Rules provide that the International Court of Arbitration of the ICC is the only organisation authorised to administer arbitrations under the ICC Rules (article 1.2).

CSPI argued that the arbitration clause was "hybrid" arbitration clause – meaning that MARC was to administer the arbitration, but should do so in accordance with the ICC rules. This meant that the arbitration and, specifically the constitution of the tribunal, should have been conducted in accordance with the ICC Rules.

The arbitrator disagreed. He resolved the contradiction by holding that: paragraph 1 (choice of MARC) should prevail over paragraph 2; and the reference to "international" in paragraph 2 was an error and should properly be interpreted as being a reference to the Mauritius Chamber of Commerce and to MARC. In his view, the choice of the seat of arbitration at Port Louis, Mauritius reinforced the connection to an arbitration centre physically located in Mauritius.

SUPREME COURT DECISION

On appeal, CSPI submitted that there was a material difference between the ICC and MARC rules on the constitution of the tribunal and that, if the ICC Rules had been applied, three arbitrators would have been appointed, not one.

The Supreme Court rejected that submission and, in doing so, did not think it necessary to rule on the question of the proper interpretation of the arbitration clause. It noted that under the ICC Rules there is a presumption (absent any agreement between the parties) that one arbitrator be appointed unless it appears to the ICC Court that the dispute warrants the appointment of three arbitrators. It held that CSPI failed to show that the constitution of the tribunal would have been any different under the ICC Rules. Further, CSPI failed to show that "substantial prejudice" had been suffered as a result of the arbitration procedure not being in accordance with the agreement of the parties.

PRIVY COUNCIL DECISION

The Privy Council agreed with the Supreme Court, that CSPI failed to show that following the ICC Rules would be likely to have led to the appointment of three arbitrators. The one qualification made by the Privy Council was that, if the clause were interpreted a hybrid arbitration clause, then the question would be whether MARC, applying the ICC Rules, would be likely to have appointed three arbitrators instead of a sole arbitrator – as opposed to whether the ICC would have done so (as suggested by the Supreme Court).

The Privy Council also agreed that CSPI had failed to show that the alleged failure to follow the agreed procedure resulted in any material prejudice justifying the setting aside of the award.

BEWARE THE HYBRID ARBITRATION CLAUSE

Although the Privy Council was not required to decide whether the arbitration clause was a "hybrid" it did recognise the problems that can arise from such clauses.

The issues include jurisdictional disputes and procedural uncertainty – particularly where an arbitral institution is required to act within an unfamiliar procedural framework and to apply different institutional rules. These are both significant issues, which compromise the efficiency of the arbitration process and open up the possibility of challenges to an arbitration award – with significant cost consequences for the parties.

The Privy Council recognised that it is possible to agree to this sort of "hybrid" arbitration clause but, in view of the manifest complications and disadvantages in doing so, thought "clear words should be required to establish such an agreement."

This raises the question of whether the parties had intended to choose arbitration administered by one arbitral institution under the rules of another or whether this was in fact a drafting error. The arbitrator believed the latter to be the case, noting that it was reasonable to assume that the parties had referred to two institutions through an error of word substitution.

What is clear is that what may have been a simple error arising out of the word "international" in the arbitration clause led to severe delay and significant costs on both sides: with a challenge to the resulting award through the courts in Mauritius all the way to the Privy Council. It is a salutary lesson on the importance of careful drafting and to beware of inadvertently creating a hybrid arbitration clause.

This article first appeared as a blog on Practical Law Arbitration on 28 January 2022.

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