

P.R.I.M.E. Finance
Panel of Recognized International Market Experts in Finance

Dispute Resolution in South Asia: Progress & Challenges



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Potential for ADR in the South Asian Financial Markets

- Total derivative transactions (OTC) globally have continued to grow at a strong pace and currently stand at notional of roughly USD 700 Trillion (June 2014).
- It is only natural that where the underlying market grows, so do some undesirable consequences – a rise in disputes.
- South Asian countries have also seen a sharp growth in OTC derivatives and a rise in disputes – 2007-2010 period.
- Derivatives in South Asia are mostly traded under ISDA Master Agreements and English Law, even those between local counterparties.
- For disputes resolved by UK Courts to be enforced, it is important that South Asian countries have laws which allow for foreign awards to be enforced locally.
- P.R.I.M.E. Finance can play a very important developmental role in South Asia where the legal frameworks for financial products is in its infancy.



Significant Arbitration Acts in South Asia

- Arbitration Act 1937: India became signatory to Protocol on Arbitration as well as the Convention on the Execution of Foreign Arbitral Awards
- Arbitration Act 1940: This Act was designed to provide extensive judicial review by affording multiple opportunities to litigants to approach the courts for intervention

*A telling comment on the working of the 1940 Act by Justice DA Desai, Supreme Court of India, 1981: "the way in which the proceedings under the Act are conducted and without an exception challenged in courts, it has made lawyers laugh and legal philosophers weep" **

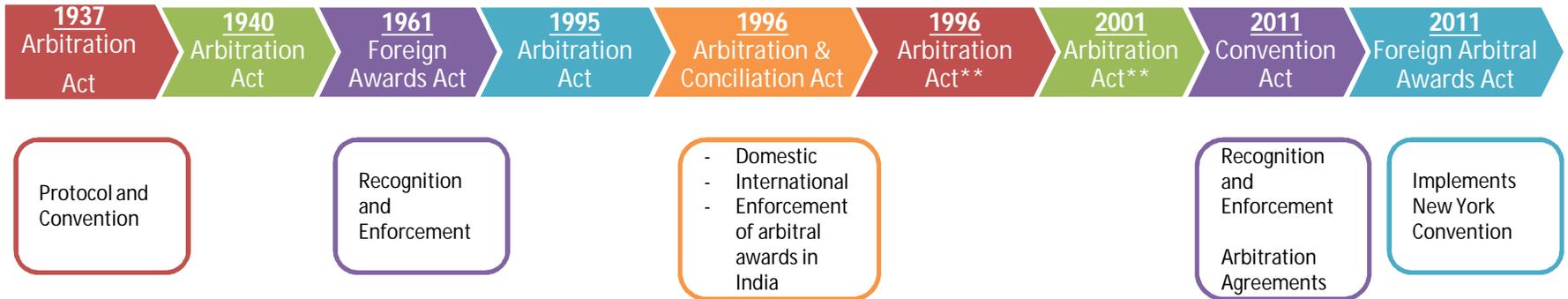
It was also said that arbitration under this statute meant litigation with an extra round

- Arbitration & Conciliation Act 1996: (India) The aim of this Act was to bring the Indian judicial process in line with international standards as set out in the UNCITRAL model law. The stated objectives were:
 - To minimize the supervisory role of courts in the arbitral process
 - To provide that every final arbitral award is enforced in the same manner as if it were a decree of the court

* The Arbitration Law of India: A Critical Analysis, Sumeet Kachwala, Asia International Arbitration Journal, Vol 1, No. 2, Pg 105-126.



Evolution of International Commercial Arbitration Legislation in South Asia



	1937	1940	1961	1995	1996	1996	LM-PAK 2001	2011	LM - IND 2011
India*	✓ (R)	✓ (R)	✓ (R)		✓				
Pakistan	✓ (R)	✓						✓	✓
Bangladesh	✓ (R)	✓ (R)					✓		
Sri Lanka				✓					
Nepal						✓			

*only India is not a signatory to ICSID, ** similar to the Indian Act & in line with UNCITRAL

LM-PAK: Manzoor Textile Ltd v Nichimen Corp (Japan) [2000] Karachi HC MLD 041

LM-IND: Bharat Aluminum Co. v Kaiser Aluminum Technical Services Inc. [2012] INSC 500



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Litigation/Arbitration of Derivatives in South Asia

Pakistan:

- FX Forwards and Cross-Currency Swaps (“CCS”) are the main derivatives transacted in Pakistan
- While there is an active interbank market in FX Forwards, the State Bank of Pakistan allows CCSs only for hedging after checking documentation of the underlying import/export transaction
- In 2008 PKR devaluation of nearly 35% caused havoc
 - Prior to the crisis number of corporates had entered into CCSs with exposure to PKR devaluation (similar to the Asian Crisis of 1997)
 - Having suffered large MTM losses, the corporates defaulted but the banks did not exercise their rights under ISDA – no law suits
 - All instances were resolved through bilateral negotiations due to:
 - Longstanding relationship between the banks and their clients
 - Lack of clarity on whether an award under English law by a UK court, as per the ISDA Master, would be locally enforceable
 - Lack of a developed domestic legal framework for derivatives



Litigation/Arbitration of Complex Financial Instruments in South Asia

India:

- The INR's volatility in 2007-2010 caused market participants to take positions through derivatives (ostensibly hedging transactions) based on INR's strength
- These transactions unraveled when the currency's subsequent depreciation
- RBI has since then produced guidelines focused on FX derivatives**
- Regulations on OTC derivatives emerged and tightened hedging requirements
- Lack of a clear legal framework (derivatives law) and, hence, a lack of precedence pushes parties to arrive at a negotiated out-of-court settlements
- With greater clarity in India on enforceability of foreign awards, the use of ISDA Master by litigants is set to increase

*http://www.business-standard.com/article/opinion/p-vaideyanathan-iyer-no-time-for-miracles-104062201001_1.html

**<http://rbi.org.in/scripts/NotificationUser.aspx?Mode=0&Id=6175>



Litigation/Arbitration of Complex Financial Instruments in South Asia

Sri Lanka:

Despite the fact that Sri Lanka has a fledgling derivatives market, the most well know regional case is one involving Ceylon Petroleum and various banks:

❖ **Standard Chartered Bank v Ceylon Petroleum Corporation [2011] EWHC 1785**

Under **UK governing law**, ICC arbitration rules, London seat

- Standard Chartered Bank (SCB) alleged that Ceylon Petroleum Corporation (CPC) was unable to make retirements against the hedge worth USD 160mn plus interest
- CPC filed that SCB had deceived to be the advisor but inwardly exposed them to vast and disproportionate downside risks

“In a commercial context, particularly where the parties take independent legal advice, there is every good reason for the Court to allow the parties to allocate their respective risks and responsibilities, and not to re-write their agreement so as to undermine reasonable commercial expectations”

“I accordingly find that the alleged misrepresentations were not made and that CPC has in any event not proved inducement. Even if that be incorrect, I find that CPC is contractually estopped from asserting its misrepresentation claim. Its counterclaim founded on misrepresentation accordingly fails”

“For the reasons set out above the Counterclaim fails. In the above circumstances it is not necessary to rule upon the issues raised of causation and loss and damage”

- The Challenge becomes making hedgers understand that loaning money on a hedge is not inappropriate since they are gaining on the underlying position.

*<http://www.bailii.org/ew/cases/EWHC/Comm/2011/1785.html>



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Challenges for Arbitration in South Asia

- While progress has been made in the South Asia region since the 1937 Act, there remain a number of challenges which are slowly giving way to an enlightened approach by the courts:
 - Interference of domestic courts with the arbitral processes and awards
 - Use of the “public policy” arguments
 - Use of “forum non conveniens” – Delays caused by local counterparties citing excessive hard currency expense in travel to foreign venues and high legal costs of retaining counsel abroad
 - Issues of Governing Law and separability
 - Rising backlog of cases causing further delays in arbitration cases mainly due to:
 - Increase in public’s awareness of their rights
 - Urbanization and waning of the non-judicial traditional dispute resolution institutions (jirgas, panchayats, etc.)
- Backlog of legal cases:
- India: 30M – of which 4M are High Court cases and 65,000 Supreme Court cases *
 - Pakistan: 3M – of which 178,000 are High Court cases and 22,000 Supreme Court cases **

* Hindustan Times (2013), ** Pakistan Today (2013)



Role P.R.I.M.E. Finance Can Play

- Provide education and training to relevant judicial and non-judicial institutions on the topic of financial dispute settlement
- Hold joint seminars to provide information on how P.R.I.M.E. Finance's involvement as one of ISDA's designated arbitration institutes offers a meaningful alternative to emerging markets in terms of a neutral forum of (locally based) experts, facilitating sound dispute resolution in disputes involving (complex) financial instruments
- Consider operating as a think tank for governmental institutions in relation to relevant new legislative proposals
- Consider participating in a possible consultation round with the South Asian Association for Regional Cooperation (SAARC) which is currently in the process of standardizing dispute resolution mechanisms within the member countries



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