Traps for the unwary: the pitfalls of *ad hoc* arbitration

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**Abstract**

An *ad hoc* arbitration at first blush may be seen to provide an opportunity to have a bespoke process for resolution of trust disputes. But, if contemplating trust arbitration, settlors and trustees need to bear in mind that the process does not always go as planned. There is scope for parallel litigation even with an arbitration agreement that appears to be completely water-tight. Moreover, once locked into arbitration, it is hard to escape from it.

**Introduction**

Arbitration is a voluntary process of dispute resolution where a neutral third-party renders a final and binding decision as between the arbitrating parties, which can be enforced almost as if it were a judgment. Proponents of international commercial arbitration would argue it has numerous advantages over litigation: principally confidentiality, expense, expertise and impartiality of arbitrator, and speed of resolution.

In international commerce, the overwhelming practical benefits of arbitration can clearly be seen and understood. Western companies contracting with counterparties in emerging economies do not wish to be at the mercy of that foreign legal system, where there might be a risk of corruption, at the very least a lack of neutrality or actual bias in favour of the local counterparty. In contrast, arbitration allows the parties to choose their arbitrators, with the aim of securing both impartiality and relevant expertise. They can choose a neutral jurisdiction to be the seat of the arbitration, thus ensuring neutrality of forum. In highly confidential or commercially or fiscally sensitive disputes, arbitration enables the parties to choose to resolve their dispute in a jurisdiction that can best accommodate those requirements.

Arbitration is a matter of contract between parties to that contract. Parties to an arbitration agreement bind themselves as to where, how, and which disputes will be resolved. Proceedings brought in breach of an agreement to arbitrate will be restrained. In common law jurisdictions, arbitration agreement can never oust the court’s jurisdiction over the parties; thus, English Courts merely ‘stay’ proceedings brought in breach of an agreement to arbitrate. This is not peculiar to trust disputes, or indeed any particular type of dispute. It is, however, peculiar to common law jurisprudence. In contrast, in Civilian law jurisdictions, the jurisdiction of the court and that of arbitrators under a valid arbitration agreement are ‘mutually exclusive in legal theory’, and the courts must dismiss proceedings brought in breach of a valid agreement to arbitrate.¹

Arbitration can, just like litigation, go spectacularly wrong for one of the arbitrating parties. In litigation,
all is not necessarily lost as the party often has a right of appeal. Likewise, in an arbitration the seat of which is England and Wales, Sections 67 to 70 of the Arbitration Act 1996 gives access to the Court to appeal and/or challenge arbitration awards in certain cases. The same is not necessarily true, however, in other jurisdictions.

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Its source being contractual, the parties can choose, by their contract, whether to arbitrate in accordance with institutional rules (‘Institutional Arbitration’), such as those of the International Chamber of Commerce, or whether they wish to have a ‘tailor made’ arbitration (‘Ad Hoc Arbitration’), which is not under the aegis of any arbitral institution. The parties select their own arbitration format and structure, thus enabling (in theory at least) the parties to design a bespoke dispute resolution mechanism. Because Ad Hoc Arbitration can be bespoke the agreement or clause should cover all aspects of the arbitration, from applicable law, procedural rules, selection of arbitrator(s), to the place and the language in which the arbitration will be conducted. In the context of trust disputes in particular, careful consideration needs to be given to who can and/or should be party to the agreement. Failure to get it right at the outset, can lead to major problems later on. Far from having chosen a confidential and speedy dispute resolution process, the parties can find themselves locked into complex and expensive parallel sets of arbitration and court proceedings.

How it can go wrong in practice

The recent decision of Colman J in A v B [2007] 1 All ER (Comm) 591^2 is perhaps the paradigm example of how an Ad Hoc Arbitration can go spectacularly wrong (in the sense of being different to the parties’ expectations), and far from saving money and offering a speedy and confidential dispute resolution process by a single forum, it provoked at least three sets of parallel proceedings in England and in the Bahamas at colossal expense. It is a salutary reminder that arbitration is based in contract, and the Court will not readily allow parties to escape from that contract.

Ultimately, the English Court came down in favour of arbitration. The claimant was then locked into a process that he alleged was part of a fraud perpetrated on him by the chief protagonist on the other side, and where he alleged that the arbitrator (an English solicitor) was acting for and representing that other chief protagonist. However, according to the English Court the arbitration process took precedence, and had to be allowed to continue in Switzerland.

The cast of characters

This was a case involving a Bahamian discretionary settlement (‘the A Trust’) and a Swiss ad hoc arbitration agreement. The proceedings that followed all stemmed from the catastrophic breakdown in the relationship between two brothers, namely A and C. A was the younger brother.

The A Trust had been established in 1984. A, his spouse and children were within the discretionary class. C and his family were not. C was a protector along with the brothers’ father, H. From 2002 the trustee of the A Trust was D, a Bahamian attorney who had worked with the brothers for many years.

From 1992 to 2000 A and C carried on a very successful trading business, conducted through a network of onshore and offshore companies (‘the A Group’), the shares in which A claimed were held as assets of the A Trust.
The Arbitrator, B, was a well-known London solicitor who had acted for A, C and various of the companies in the A Group. When A and C started falling out, B assisted them to resolve those differences, and was engaged in the mediation of their disputes.

**The underlying dispute**

Disputes arose between the brothers as to A’s participation in the trading business and how A and C would part ways. A alleged that an agreement was reached between them in November 2001 under which A would leave the business and C would pay him a sum of US$37.5 million within three months, and then further additional sums after the taking of an account, so that A was to receive in total 50 per cent of all profits of the A Group from January 1990 to November 2001. In consideration of such payment A was to give up all claims with regard to the A Group.

No payment having been made, A decided to move the assets out of A Trust into two new Bahamian settlements (‘the New Trusts’) over which C had no control; C was a protector of A Trust, but had no such role in the New Trusts.

This was when battle commenced. A took steps to take control of various companies in the A Group. D, as trustee of A Trust, took steps to prevent A dealing with those assets, for example, by giving notice to warehouses holding material on behalf of A Group companies that A was no longer authorized to deal with such property and to Deutsche Bank stating that A was not authorized to deal with the financial affairs of Company K. The relationship between C, D, and A was thus seriously deteriorating.

The fraternal warfare sharply escalated when D entered a criminal complaint against A with the Bahamian Police, the substance of which was that A had stolen and/or fraudulently used share certificates in Company K and had caused the transfer of all the assets of the A Trust to the New Trusts. On 18 June 2004 the Bahamian Police conducted a dawn raid on A’s home seizing computers and other property.

Then the father and joint protector, H, purported to resign as a protector of the A Trust leaving C as sole protector. But soon thereafter, he sought to retract that resignation, alleging it had been procured by undue influence from C’s wife, daughter, and son.

In the meantime there were various meetings between the parties with and without B. A claimed that during those meetings he was told that C would relish any opportunity to damage A by criminal proceedings or otherwise and that his arrangements for such criminal proceedings were well advanced, and that A’s only effective option was to enter into an arbitration agreement naming B as sole arbitrator. A also claimed that he was expressly assured by C and B that there had been no exercise of the Protector’s power to remove him and his children as beneficiaries of the A Trust.

It was against this background that an Arbitration Agreement was concluded between A, C, and D, appointing B as arbitrator.

The Agreement required:

i. the provision by A to a stakeholder — in the event B undertook this role — of documents that would enable the assets transferred to the New Trusts to be returned to the A Trust;

ii. D to procure the withdrawal of the criminal proceedings, whereupon the documents would be released to D; and

iii. the resolution of outstanding disputes in an arbitration, before B as Arbitrator.

Before turning to look in a little detail at the (very) unusual provisions of the Arbitration Agreement, I shall take a short diversion to explain part of what happened thereafter, and the various pieces of litigation that were commenced.

**The litigation**

Several months after the arbitration process had commenced, B made an order releasing the re-transfer documents to D, the effect of which was to re-transfer of assets from the New Trusts back to the A Trust.
In the meantime, A claimed that B stopped acting as his solicitor, and thereafter acted exclusively for C and the A Group.

A then discovered that C had, as Protector, purported to exercise his power to remove and replace A and A’s children as beneficiaries. In other words, all of the assets had been moved back into the A Trust, but on the face of it A had no remaining interest in those assets.

A brought proceedings in the Commercial Court in England seeking to set aside the Arbitration Agreement on the grounds (inter alia) that it was a part of a fraudulent scheme by C: (i) secretly to purport to remove A and his children from membership of the class of discretionary objects of the A Trust, then (ii) use unlawful, illegitimate and fraudulent means to cause A to enter into the Arbitration Agreement with the effect that (iii) control and direction of the A Group companies and A Trust would pass from A to C and the ownership thereof would pass to D as trustee of the A Trust by (iv) fraudulently leading A to believe that no attempts had been made to remove him from the said class (and that his interests in the A Trust and underlying A Group were therefore secure) while (v) ensuring that his (C’s) interests were secure against enforcement of any award by keeping them or moving them into jurisdictions where any ward made under the Agreement would be unenforceable (eg Liechtenstein). A sought payment from C pursuant to the agreement reached in November 2001.

There were a number of other allegations, but for present purposes those to note are that A also challenged the Arbitration Agreement on the grounds that it was a part of a fraudulent scheme by C: (i) secretly to purport to remove A and his children from membership of the class of discretionary objects of the A Trust, then (ii) use unlawful, illegitimate and fraudulent means to cause A to enter into the Arbitration Agreement with the effect that (iii) control and direction of the A Group companies and A Trust would pass from A to C and the ownership thereof would pass to D as trustee of the A Trust by (iv) fraudulently leading A to believe that no attempts had been made to remove him from the said class (and that his interests in the A Trust and underlying A Group were therefore secure) while (v) ensuring that his (C’s) interests were secure against enforcement of any award by keeping them or moving them into jurisdictions where any ward made under the Agreement would be unenforceable (eg Liechtenstein). A sought payment from C pursuant to the agreement reached in November 2001.

A’s children brought a separate trust claim in the Bahamas. They were not parties to the Arbitration Agreement. They sought orders (i) removing D as trustee of the A Trust, (ii) injunctions restraining D, C, and A from taking any steps in the arbitration on the basis that the Bahamian court had exclusive jurisdiction in relation to the supervision of the A Trust, and (iii) an account and inquiry as to the property of the A Trust and D’s dealings with it.

The Arbitrator’s response to A’s proceedings was to apply to stay them in order to allow him to determine his jurisdiction (under the principle of Kompetenz-Kompetenz). He also applied to stay the personal claims against him for breach of fiduciary duty on the basis that they were (inter alia) an ‘illegitimate attempt to invoke the jurisdiction of the English court to disrupt a foreign arbitration’.

C and D also challenged the Court’s jurisdiction, and sought a stay under Section 9 of the Arbitration Act 1996 and/or on forum conveniens grounds alleging that if there were any disputes not referred to arbitration they should be determined by the Bahamian Court.

The arbitration agreement

The Agreement contained a number of unusual provisions, which I quote in full here before turning to look at some of them in more detail below:

A. Arbitration

1.1 The parties agree to and hereby appoint [B], who accepts such appointment, to act as arbitrator (‘the Arbitrator’), with the broadest possible powers to make final and binding determinations or awards on all issues and disputes between the parties in full and final settlement of them.

1.2 These issues and disputes, which in substantial part were the subject of the Arbitrator’s extensive efforts over a period of several months to help the relevant parties settle matters amicably (and through which he was able to understand the intention of the
parties with regard to this arbitration and its scope), are as follows:

a. Those issues and disputes already known to the Arbitrator in consequence of his many discussions with the parties;
b. Such further issues or disputes as may arise during the arbitration (which the Arbitrator will allow within his discretion);

1.3 This Agreement is governed by Swiss law, the arbitration will be ad hoc, and the seat of the arbitration shall be Geneva, Switzerland.

1.4 The Arbitrator will have the discretion to act *ex aequo et bono* whenever he may find it suitable or equitable, paying due regard in all circumstances to the parties’ equal treatment and their right to be heard in fair adversarial proceedings.

1.5 The parties agree that the Arbitrator may represent or continue to represent them, outside of this arbitration, for reward, and represent or continue to represent such other persons or entities, as the parties may, in their sole discretion, desire.

1.6 The parties expressly waive any rights they may have to challenge the appointment of the Arbitrator on any ground, including on the grounds that he

a. endeavoured to help the relevant parties settle matters amicably, and/or
b. was engaged in the mediation of their disputes, and/or
c. has been legal advisor (and [his firm] have been legal advisors) over the course of many years to [A], [C] and companies owned (or formerly owned) by [A], [C] and the [A] Trust, and/or
d. accepts instructions in accordance with 1.5 above.

1.7 The parties acknowledge that they each had legal representation both prior to and during the negotiation and finalisation of this Agreement.

1.8 In the making of determinations or awards the Arbitrator may draw on information he acquired during the course of his relationship with the parties or any one or more of them. He shall not make reasoned determinations or awards, unless so requested by all parties.

1.9 The parties expressly agree to waive their rights to

a. challenge any determination(s) or award(s) by the Arbitrator through set aside proceedings or any other proceedings;
b. oppose enforcement of the Arbitrator’s determination(s) or award(s) in any jurisdiction.

Notable features of the agreement are, first of all, that B did not have to apply legal principles in making his decisions—he could act according to what he thought was fair and equitable (*ex aequo et bono*). Secondly, in making those decisions, he did not have to give reasons for the awards he made, unless all parties requested him to do so. Thirdly, the parties expressly waived their rights to challenge his awards, and agreed that they would not oppose enforcement of awards in ‘any jurisdiction’. Finally, as to the disputes to be referred to arbitration, these were not specified other than being those ‘already known to the Arbitrator’ and any further issues that might arise during the arbitration, as to which he had an apparently unfettered discretion to assume jurisdiction over them.

As Colman J observed, ‘an agreement in these terms could never have been entered into unless all parties reposed a very high degree of confidence in B’s impartiality, objectivity and fairness in deciding on his ultimate award’.3

3. Para 36.
The judgment

Colman J granted the Defendants’ applications. He found that there were two consequences of the Arbitration Agreement being governed by Swiss Law, with a Geneva seat. First, not only was the meaning of the terms of the Arbitration Agreement to be determined in accordance with Swiss law, but so was the question of the effect of the alleged vitiating factors (fraud, duress, breach of fiduciary duty) on the enforceability of the Arbitration Agreement. Secondly, it meant that Geneva or the Swiss courts were those having the sole supervisory jurisdiction over the arbitration. So, if A had a complaint about B’s conduct leading up to the conclusion of the arbitration (even if such conduct took place in England) he first had to exercise his remedies in Switzerland. A could not pursue his personal claims against B until after B had made his final award or become functus officio.

Colman J therefore stayed the English proceedings to enable B:

To proceed to conduct the arbitration in Geneva subject to such remedies in the Swiss courts as may be available.4

This meant that A was locked into the arbitration process in Switzerland and had no access to the English Court, at least until after the arbitration had been concluded.

History does not recount what happened in the Bahamian trust claims, nor what happened in the arbitration itself. What if the arbitrator had gone on to decide he had jurisdiction, and then went on to render a final award? What could have happened?

Enforcement

Some of the most interesting, and challenging, questions that might arise in the context of a trust arbitration were not addressed in A v B. It is suggested that the most interesting question is how arbitration awards might be enforced against trust assets. In England, the starting point is Section 101 of the Arbitration Act 1996 which provides (in relation to New York Convention awards) that they ‘shall be recognised as binding on the persons as between whom it was made’, and they may by leave of the court ‘be enforced in the same manner as a judgment or order of the court to the same effect’.

So what of an award made by an arbitrator that purports to vary the terms of a discretionary settlement, or appoint assets out of the trust, or even declares the trust to be invalid/a sham? Is that an order in rem that can be enforced against the assets themselves? Or is it an order in personam? How is to be enforced? Is it to be regarded in the same way as a variation order made by the Family Division? What if enforcement is sought against underlying assets in another jurisdiction (e.g. a civilian jurisdiction that does not have trusts as part of its law)?

The trustee may well have been a party to the arbitration agreement, but perhaps some key beneficiaries were not aware of the arbitration, or were not able to consent (e.g. minors). The facts might lend themselves to an argument that the trustee committed a breach of trust in entering into the arbitration agreement, but can this be used as a platform from which to impugn the award at the enforcement stage?

Section 103 envisages that recognition can only be resisted by the ‘person against whom it is invoked’. Beneficiaries of a discretionary settlement have no interest in its underlying assets, and prima facie would not fall within this class. Do they have locus
to object to enforcement? How would a civilian court approach their entitlement to be heard?

Even if the hurdle of locus could be overcome, the next question would be whether there were grounds to resist enforcement. The burden of proving grounds for non-enforcement ‘is firmly on the party resisting enforcement’, at least where enforcement is sought in England. The only ground that looks like it might be potentially available to beneficiaries under the New York Convention is that ‘a party to the arbitration agreement was (under the Law applicable to him) under some incapacity’; in other words, arguing that the trustee’s breach of duty in entering into the arbitration agreement meant it was ultra vires and beyond his authority, thus rendering the agreement void or voidable. However, this would involve giving the word ‘incapacity’ a much wider meaning than is commonly understood. Would a civilian court approach the question of incapacity in the context of a trustee differently to a court in a common law jurisdiction?

These are all interesting questions that will no doubt fall to be resolved if trust arbitration becomes commonplace. In the meantime, I raise them because it seems to me that if there is to be legislation permitting trust arbitration, the draftsman needs to think about the range of types of award that are appropriate or possible, and how they can be effectively enforced.

We cannot ignore the reality that arbitration has developed in the context of commercial disputes between ‘contractual counterparties’. A person who is not a signatory to the arbitration agreement is prima facie not bound by the award. This flows inexorably from its ‘contractual’ source. Thus, when it comes to enforcement against a non-party, that person can resist enforcement under Article VI of the New York Convention (Section 103 of the Arbitration Act 1996 in England).

Thus, arbitration legislation both in England and abroad all proceeds from the single fundamental premise that there has been a contractual agreement to exclude the Court’s jurisdiction. How can a provision in a trust document sensibly be fitted into that model? The source of the obligations of a trustee is not contractual; the Court does not assume jurisdiction over a trustee because it is asked to enforce a contractual bargain to which he is a party. Rather, it is a relationship of confidence, which the Court enforces under its inherent equitable supervisory jurisdiction. If legislation is to be drafted to facilitate trust arbitration, it needs to deal head-on with the particular nuances of trust law. It is submitted that legislation that inserts a simple adjunct to the current Arbitration Act 1996 will not be enough.

But now I must return to the subject of this article, namely Ad Hoc Arbitration and how to avoid pitfalls.

Avoiding pitfalls

Procedural rules

Arbitration Institutions tend to have pre-established mechanisms, rules, and procedures that govern the arbitration process, which have been proven to work in previous disputes. Procedural rules provide a useful framework, enabling the parties to know what are their rights, what sanctions might be applied if they are delinquent, and what is the likely timetable for the arbitral process.

An Ad Hoc Arbitration does not necessarily require the parties to start from scratch and draft their own rules. They can use the rules of an arbitration institution without submitting the dispute to that institution. If they do not adopt established rules, the parties will need to start from scratch and set out clearly the

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rules under which the arbitration will be carried out. These might include:

- procedure to initiate arbitration proceedings
- means of dealing with the refusal of a party to proceed with arbitration
- where the arbitration is to take place and in what language
- selection of arbitrators
- powers of arbitrators
- scope of disclosure
- outline of hearing procedures
- use of experts
- availability of interim remedies
- time allowed for making of awards
- rights of appeal
- how costs are to be determined

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**Seat and governing law**

The seat determines which Court will supervise the arbitral process. It therefore needs to be chosen with care. In the context of a trust dispute, at least in cases where issues peculiar to trust law are likely to arise, an appeal to the Court might be necessary, and so it might be sensible to have the seat in a common law country, where Judges are more experienced at dealing with such disputes. Having said this, in England at least, arbitration matters generally fall within the domain of the Commercial Court, which is not necessarily the ideal forum for resolving appeals on questions of trust law.

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In a trust dispute, it is sensible for the arbitration clause to specify the substantive law that will govern the underlying dispute, and also what law should govern the arbitration agreement—the two can be (and often are) different. Careful thought needs to be given to this. Absent an express choice of applicable law, the law of the seat will be applied.

The parties may also specify a procedural law; if they do not, the procedural law of the seat will apply.

**Defining the disputes to be referred**

In A v B the disputes referred were:

- a. Those issues and disputes already known to the Arbitrator in consequence of his many discussions with the parties

and

- b. Such further issues or disputes as may arise during the arbitration (which the Arbitrator will allow within his discretion).

These words were found by Colman J to be wide enough to encompass A’s fraud and duress claims against C, even though B (the arbitrator) was a witness of fact to those claims. This reflects the English Court’s jealous protection of arbitration as a process agreed by and pursuant to a contract. To what extent that rationale can properly apply in a trust context, where beneficiaries are unlikely to be parties to an arbitration contract, remains to be seen.

Of course, it is not unusual to find very widely drafted arbitration clauses in commercial contracts. The English Court’s approach to the construction of...
such contracts is a liberal one since the House of Lords decision in *Premium Nafta Products Ltd & Ors v Fili Shipping Co Ltd & Ors* [2007] 2 CLC 553. In that case the House of Lords emphatically rejected any approach to construction that involved Judges considering ‘the effects of the various linguistic nuances’ of the words used. Rather, they said that ‘the time has come to draw a line under the authorities to date and make a fresh start’. The starting point now is:

the assumption that the parties, as rational businessmen, are likely to have intended any dispute arising out of the relationship into which they have entered or purported to enter to be decided by the same tribunal. The clause should be construed in accordance with this presumption unless the language makes it clear that certain questions were intended to be excluded from the arbitrator’s jurisdiction. As Longmore LJ remarked, at para 17: ‘if any businessman did want to exclude disputes about the validity of a contract, it would be comparatively easy to say so’. 7

The lesson to be learned from this is that when drafting a reference to arbitration, parties need to be clear as to what, if any, disputes they would wish the Court, rather than arbitrator, to determine, and to identify these expressly. Otherwise, they will fall within the disputes referred.

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**Choice and number of arbitrator(s)**

There are obviously a number of qualities that the ideal arbitrator would possess. In deciding whom to appoint, the following attributes are obviously desirable:

- Impartiality
- Experience
- Expertise in the underlying dispute

A panel of three arbitrators is standard for international commercial arbitrations, but in a dispute involving smaller claims, a single arbitrator might be more appropriate.

If the reference to arbitration is to be found in the trust instrument, rather than after a dispute has arisen, the clause should specify what kind of expertise the arbitrator must have.

**Conclusions**

Arbitration can be a just and an efficient means to resolve business disputes; that proposition is self-evident. But it only works if the process is flexible enough to mirror the parties’ rights in litigation, and protects their fundamental rights to a fair hearing. There is no reason in principle why trust arbitrations should not work, provided that careful thought is given, not just to the process itself, but also to the variety of possible awards that might be made and how they might be enforced. The salutary lesson to learn from *A v B* is that once locked in to arbitration, it is very hard to escape from it.

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7. Para 13, *per* Lord Hoffman. And see also Lord Hope at para 26:

The proposition that any jurisdiction or arbitration clause in an international commercial contract should be liberally construed promotes legal certainty. It serves to underline the golden rule that if the parties wish to have issues as to the validity of their contract decided by one tribunal and issues as to its meaning or performance decided by another, they must say so expressly. Otherwise they will be taken to have agreed on a single tribunal for the resolution of all such disputes. (emphasis applied).