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Analysis of the Problem for Use of the Arbitrators

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ANALYSIS OF THE PROBLEM
FOR USE OF THE ARBITRATORS

If you do not already have a copy of the Problem, it is available on the Vis Moot web site, https://www.vismoot.org/wp-content/uploads/2022/11/22-11-07-CASE-Final_corrected-with-PO-2.pdf . If you downloaded the Problem during October, you will need to download the revised version issued at the beginning of November which includes Procedural Order No. 2 (PO 2).

This analysis of the Problem is primarily designed for the use of arbitrators. Arbitrators who may be associated with a team in the Moot are ***strongly urged*** not to communicate any of the ideas contained in this analysis to their teams before the submission of the Memorandum for RESPONDENT.

The analysis will be sent to all teams after all Memoranda for RESPONDENT have been submitted. Many of the team coaches/professors participate as arbitrators in the Moot and therefore receive this analysis. It only seems fair that all teams should have the analysis of the Problem for the oral arguments. If the analysis contains ideas teams had not thought of before, the respective teams will still have to turn those ideas into convincing arguments to support the position they are taking. At the same time, the analysis is not intended to give away all possible arguments. For that reason, this analysis often does no more than merely flag the issue without mentioning the arguments for or against a certain position. It does not contain a full analysis of the problem, in particular not all possible interpretations of the various contractual provisions or other communications.

All arbitrators should be aware that the legal analysis contained herein may not be the only way the Problem can be analyzed. It may not even be the best way that one or more of the issues can be analyzed. The number of issues that arise out of the fact situation makes it necessary for the teams to decide which of the issues they emphasize in their submissions and oral presentations. Arbitrators should keep in mind that the team's background might influence its approach to the Problem and its analysis. In addition, the decision may be influenced by the presentation a team has to respond to. Full credit should be given to those teams that present different, though fully appropriate, arguments and emphasize different issues.
In the oral hearings, particularly in the elimination rounds, arbitrators may inform the teams which issues they should primarily focus on in their presentation, if they want to discuss certain issues specifically. They should do so, if they want to make the in-depth discussion of a particular issue part of their evaluation.

INTRODUCTION

This year's Problem arises in connection with a contract for the purchase and supply of Unmanned Aerial Systems (UAS) ("Agreement") by Claimant (Drone Eye) to Respondent (Equatoriana Geoscience). Respondent is a state-owned entity which had been created by the previous government of Equatoriana in the context of a special program to develop the rural Northern Part of Equatoriana. Following a major corruption scandal in connection with that development program the election led to a new government which immediately declared a moratorium on all contracts concluded in connection with the program to allow further investigation. That also affected the Agreement between Claimant and Respondent. The ensuing negotiations were finally terminated by Respondent with a letter of 30 May 2022 (Claimant Exhibit C 8). In that letter Respondent also declared that it "no longer considers itself bound" by the Agreement for two reasons. First, the contract was most likely obtained by bribery. Respondent's main negotiator, its COO Mr. Field, had been charged with corruption in connection with two other contracts, and investigations were under way also in relation to the Agreement. Second, Respondent terminated the contract pursuant to the Equatorianian International Commercial Contract Act (ICCA) for an alleged misrepresentation of the qualities of the UAS sold. Claimant denies all – so far unproven – corruption charges and Respondent's ability to terminate the Agreement under the law of Equatoriana for misrepresentation. In its view the Agreement is governed by the CISG which excludes the termination under the local law.

In light of the ongoing investigations into the corruption allegation and the – likely – absence of the requested parliamentary consent to the submission to arbitration the issues to be discussed by the students at the present stage of the proceedings are limited to the following four questions:

1. In relation to arbitration:
    a) Is the signing of the Agreement including the arbitration clause by the Minister of Development of Development and Natural Resources sufficient to establish the jurisdiction of the arbitral tribunal notwithstanding the fact that the Parliament never explicitly consented to the submission to arbitration as requested under the Equatorianian Constitution?
    b) If the Tribunal's jurisdiction can be established should the proceedings be stayed until the investigations against Mr. Field have been concluded or, alternatively, bifurcated to address only abstract legal issues which do not depend on the outcome of the corruption allegations?

2. In relation to the CISG the issues to be discussed at the present stage are the following:
    a) Is the Agreement governed by the CISG?
    b) In case the Agreement is governed by the CISG, can Respondent rely on Art. 3.2.5 of the International Commercial Contract Act of Equatoriana (ICCA) to

avoid the contract as stated in its letter of 30 May 2022 or is Claimant correct that this is excluded in light of the facts invoked?

THE FACTS

I. Parties and contractual history[1]

Claimant, Drone Eye plc, is a medium-sized producer of Unmanned Aerial Systems ("UAS") based in Mediterraneo. Its systems, which are in everyday language usually referred to as "drones", are primarily used for geo-science exploration. Claimant has an annual output of around 5 drones per year.

Respondent, Equatoriana Geoscience Ltd, is a private company entirely owned by the Ministry of Natural Resources and Development of Equatoriana ("MND"). It was set up in 2016 when the socialist government announced its Northern Part Development Program ("NP Development Program").

The northern part of Equatoriana, a stronghold of the Socialist Party, is by far the least developed part of the country. It is to a large extent a thickly forested mountain region which is sparsely populated and lacks a well-developed infrastructure. At the same time there are expectations that the region is rich in all types of minerals and other natural resources. Respondent's objective was to organize the exploration and possible development of the expected natural resources in that region as well as improving the infrastructure. In particular, it was supposed to negotiate and conclude the necessary contracts with private parties.

In its meeting in January 2020, Respondent's supervisory board had approved a request of the board of directors to acquire "*2 to 6 UAS*" with an overall budget of up to EUR 45 million for the acquisition over a period of three years. For the service component another EUR 10 million were authorized over the course of five years. Then, in March 2020, Respondent opened a tender process in connection with the NP Development Program, originally for the delivery of 4 drones primarily for earth surveillance and exploration purposes (Claimant Exhibit C 1).

Claimant submitted a successful bid and was selected as one of the two bidders with which Respondent entered into further negotiations. According to the witness statement of Ms. Leonida Bourgeois, the personal assistant of Respondent's COO and main negotiator Mr. David Field (Respondent Exhibit R 1), at the outset the second bidder, Air Systems, "had a slightly better offer in particular concerning the price for the drones".
A further round of negotiation with Claimant in the first weeks of November 2020 at Claimant's premises led to a considerable change in the content of the negotiations, and eventually the Agreement, as well as to the termination of so far ongoing negotiations with a second bidder, Air Systems. There is no direct account of what happened during the

[1] See also the chart in the appendix of this brief outlining the contractual relationships.

negotiations as the main negotiators on both sides did not submit a witness statement. It is known, however, that due to the insolvency of another customer Claimant was able to repurchase three largely prepaid and finished Kestrel Eye 2010 drones at a favorable price and had made an offer for 6 drones which was 20 % lower per drone than the previous one. At the same time the maintenance and service part of the offer had been changed considerably. The period for which maintenance was offered was extended from two years to four years and the scope of services and spare parts covered by the basic flat fee was significantly reduced.

In the end, the Parties agreed on the purchase of 6 of Claimant's Kestrel Eye 2010 drones for an overall price of EUR 44 million with an additional service and maintenance element for four years. An instalment of the purchase price in the amount of EUR 10 million had to be paid two weeks after signing and the delivery of the first three drones was to occur in January 2022 (Claimant Exhibit C 2).

The Agreement was signed at a formal ceremony on 1 December 2020 by Claimant's CEO, Mr. William Cremer, Respondent's CEO, Ms. Wilhelmina Queen, and Equatoriana's then Minister of Natural Resources and Development, Mr. Rodrigo Barbosa (Claimant Exhibit C 3).

Respondent made the required advance payment and Claimant started acquiring the necessary material for fitting the first drones.

At the time of the tender and the contract conclusion, the Kestrel Eye 2010 was Claimant's top model available on the market. It is more than six meters long and can carry a load of up to 245 kg. Its helicopter-like design allows maximum flexibility when it operates in remote territory. The communication link via radio which limits operations to line-of-sight flights, which is entirely sufficient for the purposes of Respondent (Claimant Exhibit C 4).

In February 2021, Claimant presented its newest UAS, the Hawk Eye 2020, at the air show in Mediterraneo. It is based on a different technology and is considerably larger than the Kestrel Eye 2010. That allows on the one hand for a wider reach and greater payload than the Kestrel Eye 2010, on the other hand, however, requires a small airfield to start and land the drone. The Hawk Eye 2020 has been the outcome of three years of development and extensive testing, following the acquisition of Drone-Aircraft in 2017, an insolvent UAV manufacturer which had been active in that type of aircraft-like technology.

The presentation of the Hawk Eye 2020 led to a discussion between the Parties from March 2021 onwards. Respondent complained that Claimant had not informed it about the newly developed drone but instead had sold it the much older Kestrel Eye 2010 and even threatened to terminate the Agreement. Claimant considered these discussions as an effort to renegotiate the Agreement and contested any allegation that it had cheated upon Respondent. In the end and following the consent of Claimant to an entirely separate request by Respondent to amend the arbitration clause at the end of May 2021 Respondent did not pursue these allegations any further until May 2022.

On 3 July 2021, The Citizen, Equatoriana's leading investigative journal, owned by the leader of the Liberal Party, started to publish a series of headline articles about a massive corruption scheme surrounding the NP Development Program and several high-profile members of the ruling Socialist Party (Claimant Exhibit C 5). As a consequence of the public outcry, the socialist Prime Minister had to resign and call for early elections on 3 December 2021, which resulted in a new government formed by a coalition of several parties, including the Liberal Party.

One of the first steps of the new government was to declare a moratorium on all contracts concluded within the NP Development Program or somehow associated with it. By email of 27 December 2021, Respondent informed Claimant that the Agreement with them would be put on hold until further notice (Claimant Exhibit C 6).

In several calls and meetings with representatives of Respondent and the MND, Claimant tried to find a solution to the problem (Claimant Exhibit C 3). Claimant had, however, the impression that Respondent was no longer interested in obtaining the drones due to a shift in the political agenda and the suspension of the NP Development Program by the new government. Respondent maintained from the beginning that the Agreement was void as it had been obtained by corruption and due to Claimant's alleged misrepresentation of the features of the drones.

In addition, during these negotiations Respondent also denied any obligation to have disputes arising in connection with the Agreement resolved by arbitration. For that, it relied on a provision in the Constitution of Equatoriana according to which the state and state-owned entities could only submit to arbitration with the approval of Parliament. As it turned out, when the Minister of Natural Resources and Development signed the Agreement no such approval existed (Claimant Exhibit C 7).

By registered letter of 30 May 2022, Respondent finally declared the avoidance of the Agreement, and the negotiations to be terminated (Claimant Exhibit C 8).

II. Initiation of arbitration and relief sought

Based on the above facts, Claimant submitted its Notice of Arbitration on 14 July 2022 asking the Arbitral Tribunal for the following orders (of which only 1, 2 and parts of 3 are relevant for the written or oral submissions at this stage):

1) *To declare that the Arbitral Tribunal has jurisdiction to hear the case;*
2) *To declare that there is a valid Purchase and Supply Agreement between the Parties;*
3) *To declare that Respondent has breached that Agreement by refusing to take delivery of the drones and paying for them;*

4) *To declare that Claimant is entitled to damages for this breach of contract in an amount to be quantified in due course;*
5) *To award Claimant the costs of these proceedings including legal fees and expenditures; and*
6) *To award interest on full amount awarded to Claimant.*

On 15 August 2022 Respondent submitted its Response to the Notice of Arbitration. It asks the Arbitral Tribunal to make the following orders:

1) *To decline jurisdiction to hear the case;*
2) *Subsidiarily, to stay the arbitral proceedings until the investigations against Mr. Field concerning the taking of bribes in connection with the conclusion of the Agreement are concluded or, alternatively, to bifurcate the proceedings into two phases;*
3) *Subsidiarily, to reject all claims;*
4) *To award Respondent the costs of these arbitration proceedings including legal costs, with interest.*

In essence, Respondent contends that the submission to arbitration is not valid since the Parliament did not explicitly consent to it. In addition, it considers the entire Agreement to be invalid as it had been obtained by corruption or at least an actionable misrepresentation as to the quality of the drones justifying its termination under the law of Equatoriana.

THE ISSUES

I. Overview

In a videoconference on 6 October 2022, the Parties agreed on some procedural issues, in particular,

- to conduct the proceedings in good faith – without any prejudice to the bifurcation request;
- to limit the first phase of the Arbitration to questions listed below addressing the Arbitral Tribunal's jurisdiction, Respondent's stay application, questions as to the applicable law, and the avoidance of the Agreement.

Following that, the Arbitral Tribunal has set forth the issues to be decided in the first part of the proceedings, and therefore at issue in the Moot, in Procedural Order No 1 ("PO 1") para. III (1). It has ordered the Parties to address in their next submissions and at the Oral Hearing in Vindobona (Hong Kong) the following issues:

a. Does the Arbitral Tribunal have jurisdiction to hear the dispute?
b. If the Tribunal's jurisdiction can be established should the proceedings be stayed until the investigations against Mr. Field have been concluded or, alternatively, bifurcated?
c. Is the Purchase and Supply Agreement governed by the CISG?
d. In case the Purchase and Supply Agreement is governed by the CISG, can Respondent rely on Art. 3.2.5 of the International Commercial Contract Act of Equatoriana to avoid the contract as stated in its letter of 30 May 2022 or is Claimant correct that this is excluded in light of the facts invoked?

II. General considerations

The Parties are in principle free to select the order in which they address the various issues (PO 1 para. III no. 1, second to last sentence). In the present case the challenge of the Tribunal's jurisdiction as well as the request for a stay or a bifurcation make it advisable to deal with the procedural questions first before addressing the two more abstract legal questions concerning the merits. There may also be teams which address the question of bifurcation as the last question. That is also possible.

In relation to the merits, PO 1 states explicitly that beyond the two questions under c) and d), no further questions referring to the merits of the claims should be addressed. In particular, no questions relating to a possible breach of contract or the right to terminate the contract should be argued. The following remarks are merely intended to highlight the legal issues arising from the Problem. One of the major difficulties of this year's Problem is that there are potentially more (smaller) issues than can be discussed in a meaningful way within the submissions page-limit or the time-limit of the oral presentation. Thus, it is important that the students properly weigh the relevance and strength of the various arguments considering their case narrative.

III. The jurisdiction of the Arbitral Tribunal (PO 1 para. III no. 1 a.)

1. Background

Claimant bases the arbitration on the dispute resolution clause contained in Article 20 of the Agreement (Claimant Exhibit C 2). The original version of the clause, contained in the contract signed on 1 December 2020 by the Parties and the Minister of Natural Resources and Development, was an adoption of the PCA model clause. It provided as follows:

> *Any dispute, controversy or claim arising out of or in relation to this agreement, or the existence, interpretation, application, breach, termination, or invalidity thereof, shall be settled by arbitration in accordance with the PCA Arbitration Rules 2012.*
> *(a) The number of arbitrators shall be three.*
> *(b) The place of arbitration shall be Vindobona, Danubia.*
> *(c) The language to be used in the arbitral proceedings shall be English.*
> *(d) The agreement is governed by the law of Equatoriana.*

The arbitration clause was subsequently amended upon the request of Respondent. In its final form it provides now (changes emphasized):

> *"Any dispute, controversy or claim arising out of or in relation to this agreement, or the existence, interpretation, application, breach, termination, or invalidity thereof, shall be settled by arbitration.*
> *If the dispute, controversy or claim concerns an amount less than EUR 1,000,000, then it shall be submitted to arbitration under the UNCITRAL Expedited Arbitration Rules 2021. By contrast, if the dispute, controversy or claim concerns an amount equal to or larger than EUR 1,000,000, or where the amount concerned is unquantifiable, it shall be settled in accordance with the PCA Arbitration Rules 2012.*
>
> *(a) The number of arbitrators shall be one (UNCITRAL Expedited Arbitration Rules 2021) or three (PCA Arbitration Rules 2012), as the case may be;*
> *(b) The place of arbitration shall be Vindobona, Danubia;*
> *(c) The language to be used in the arbitral proceedings shall be English; and*
> *(d) The agreement is governed by the law of Equatoriana.*
>
> *The UNCITRAL Rules on Transparency in Treaty-based Investor-State Arbitration shall apply to any arbitration between the Parties." (Emphasis added)*

According to the witness statement of Ms. Horacia Porter (Claimant Exhibit C 7), who is the team member of Claimant's legal department responsible for the Agreement, Respondent's request to alter the terms of the arbitration clause came out of the blue at a meeting in May 2021. The meeting had been scheduled to discuss Respondent's allegations that Claimant had engaged in misrepresentation concerning the quality of the UAS sold. Since March 2021, there had been discussions between the Parties concerning Respondent's allegations that it had been cheated upon by Claimant who had not disclosed the imminent presentation of the Hawk Eye 2020 shortly after the conclusion of the Agreement during the negotiations. In the context of these discussions, Mr. Field had even threatened the termination of the Agreement for misrepresentation which Claimant, however, considered unjustified. Claimant had no problem with the requested changes and accepted them. By email of 27 May 2021 (Claimant Exhibit C 9), Respondent's CEO, Ms. Queen, send a "*duly executed copy of the amendments to Art. 20*" and expressed her belief that they "*will also solve the remaining outstanding issues*".

Ms. Porter assumed that the background for the change request had been an intention by Mr. Field to "*to help his political friends for the upcoming parliamentary debate in June 2021*". Since the third quarter of 2020 there had been an increasingly negative perception of arbitration in Equatoriana and the opposition had managed to put the issue of submissions to arbitration up for a parliamentary debate. In that debate in early June, the government had adopted as its main line of argument that its ministers had only authorized arbitration clauses providing for transparency, for which it had then given the amended arbitration clause in the Agreement as an example.

2. Discussion

In contesting the jurisdiction of the Arbitral Tribunal Respondent has primarily relied on the absence of any parliamentary approval of the submission to arbitration. Article 75 of the Constitution of Equatoriana imposes specific authorization requirements for arbitration clauses contained in administrative contracts. It provides in its pertinent part as follows:

> *[I]n contracts relating to public works or other contracts concluded for administrative purposes the State of Equatoriana or its entities may submit to arbitration only with consent of the respective minister. If the other party is a foreign entity or the arbitration is seated in a different state Parliament has to consent to this submission.*

While the Minister of Natural Resources and Development had signed the Agreement there had been no consent of the Parliament as requested in the second sentence. While the existing case law on "*administrative contracts*" requiring parliamentary consent only relates to cases for the actual construction of infrastructure, Respondent was of the view that also the Agreement as a preparatory contract fell within the consent requirement. Following Respondent's request for approval by the Minister and by Parliament the Minister had put the discussion about the arbitration clause on the agenda of the Parliament for 27 November under the heading "*Request for approval according to Art. 75: UAV Purchase Agreement by Equatoriana Geoscience Ltd*" (PO 2 – 29). The request for approval was, however, withdrawn on the 27 November and no debate took place. There were no official reasons given for the withdrawal. According to Respondent's Response to the Notice of Arbitration (para. 13) "*it seems likely"* that the withdrawal of the proposal occurred in light of the anti-arbitration sentiment and the absence of many MPs from the ruling party "*the Minister was afraid to have his proposal rejected*". There have been no further attempts to pass the parliamentary procedure. Having received the advance payment due under the Agreement, Claimant did not follow up on the matter.

Claimant submits that, in light of the Minister's signature under the Agreement including the arbitration clause, the validity of which "*has then been ratified by Respondent when it requested its amendment in May 2021*", Respondent may not rely on the lack of consent from the Parliament as an obstacle to the jurisdiction of the Arbitral Tribunal. That would be "*contrary to good faith and the general principles of international arbitration recognized for example in Art. II (1) of the European Convention on International Commercial Arbitration of 21 April 1961 or Art. 177(2) of the Swiss Arbitration Law among many other national and international laws and instruments."* The quoted articles from the European Convention[2] as well as from the Swiss Arbitration Law,[3] provide that state parties may not

[2] Article II (1) of the European Convention on International Commercial Arbitration reads*: "1. In the cases referred to in Article I, paragraph 1, of this Convention, legal persons considered by the law which is applicable to them as 'legal persons of public law'. Have the right to conclude valid arbitration agreements."*

[3] Article 177 (2) of the Swiss Private International Law Act reads: "*Where a party to the arbitration agreement is a State, or an enterprise held by, or an organisation controlled by, a State, it may not invoke its own law in order to contest the arbitrability of a dispute or its capacity to be a party to an arbitration*."

rely on internal restrictions to submit to arbitration. No such express rule exists, however, in the Danubian Arbitration Law.

The case has two features which will play a central role in the good faith argumentation. The first is, that central actors within Claimant were aware of the consent requirement and that it had not been complied with at the time of signing.

Ms. Porter from Claimant's legal department confirmed in her witness statement (Claimant Exhibit C 7) that she had informed Mr. Bluntschli, Claimant's COO, and main negotiator of the Agreement, about the requirement. Mr. Bluntschli himself was aware that at the time of signing it on 1 December 2020 the Parliament had not yet consented to the submission to arbitration. That becomes obvious from his email of 29 November 2020 to Respondent's COO Mr. Field. In that mail Mr. Bluntschli informed Mr. Field that he was "*glad to hear that the Minister does not consider the cancellation of the Parliamentary Debate and the decision [about the submission to arbitration] to be an obstacle to his approval of the agreement and that the signing procedure can proceed as planned*" (Respondent Exhibit R 4). Ms. Porter reports in her witness statement that Mr. Bluntschli told her later that he considered the lacking consent to be unproblematic at the time as the "*Minister had assured him that the parliamentary approval was just a formality and would be forthcoming after the Christmas break".*

Ms. Porter herself had also been aware that the Agreement had been scheduled to be discussed in Parliament on 27 November 2020. Due a five-week COVID absence from work she had originally, however, not realized that the debate had been cancelled on short notice. Thus, on 6 December 2020, when she received the signed Agreement and saw that it had been signed by the Minister, she had originally believed that the Parliament had consented to the arbitration clause. Only during the discussions on the amendments of the arbitration clause in May 2021 she learned from Mr. Bluntschli, that the signature of the Minister had been made without prior consent of Parliament. In light of Respondent's request to change the arbitration clause, which Ms. Porter considered to be a confirmation of the arbitration agreement, she did at that time not check whether the Parliament in the meantime had consented to the arbitration clause. That examination was only made in 2022, when Respondent terminated the negotiations, and it revealed that the Parliament never explicitly consented to the submission to arbitration.

The second feature is Respondent's request to amend the arbitration clause in May 2021. The Notice for Arbitration is not entirely clear whether Claimant raises the request only as an additional element for its good faith argumentation or as a separate ground for the validity of the arbitration clause ("*validity has been ratified*"). The same applies to the witness statement of Ms. Porter (Claimant Exhibit C 7) which states that "*Respondent subsequently – even if not expressly at least implicitly – confirmed the arbitration agreement*". It is obvious from the email sent by Respondent's CEO, Ms. Queen, on 27 May 2021 confirming the agreement that the Ministry was at least informed about the change request. Whether any confirmation of the arbitration clause by Respondent contained in the change request – even if made in cooperation with the Ministry – can replace the consent of Parliament to the submission to arbitration seems doubtful. It could,

however, be an element in the good faith discussion. According to the prevailing view the amendment of an existing arbitration clause as such does not require parliamentary consent.

Beyond the issue of parliamentary consent, Respondent had also based its challenge of the Tribunal's jurisdiction on the potential invalidity of the arbitration agreement due to corruption or the termination of the Agreement for misrepresentation. To overcome the problems resulting from the doctrine of separability, treating the arbitration clause as a separate contract, Respondent tries to argue that the arbitration clause "*would not have been concluded but for the bribes paid and the misrepresentation by Claimant*". That argument must be addressed at least shortly. In light of the doctrine of separability, it is important that any challenge and discussion focusses on how the arbitration clause as such (and not merely the Agreement) is affected by the corruption or misrepresentation.

For the discussion of the jurisdictional question, the following facts and considerations may be relevant:

- The Agreement had been signed not only by Respondent but also by the Minister for Natural Resources and Development, who knew that the required consent of Parliament was lacking.
- Claimant was aware that the Parliament's consent was required, and its COO, Mr. Bluntschli, knew that the Minister signed the Agreement though the required consent of Parliament had not yet been declared.
- The Minister had apparently assured Mr. Bluntschli that consent of Parliament was only a formality and would be forthcoming.
- There had been a strong anti-arbitration sentiment in the Parliament of Equatoriana at the time of the signing.
- The signing of the Agreement had been a public act which had been widely reported in the press, including a critical article by The Citizen. Thus, the members of Parliament could have been aware of the Minister's transgression of powers given the withdrawn request for approval.
- Although Respondent apparently considered the contract to require parliamentary consent there is not yet a binding decision on preparatory agreements as the existing case law covers only cases for the actual construction of infrastructure (PO 2 – 29). According to the statute of Respondent the signature of the Minister as the Chairman of the Advisory Board would have been required anyway, as the Agreement involved a liability which is higher than EUR 25 million (PO 2 – 37).

IV. Stay or bifurcation of the arbitration proceedings (PO 1 para. III no. 1 b.)

1. Background

One of Respondent's main defences against the claims raised is that the Agreement is void as its conclusion had been obtained by corruption. Claimant contests all allegations of corruption pointing in particular to the fact that no suspicious payments could be found during an internal investigation. The negotiation history of the Agreement as well as the reputation of Respondent's COO, Mr. Field, who negotiated on behalf of Respondent, however, at least justify further investigations into the allegation of corruption. At present, such investigations are conducted by the public prosecution office in the context of a broader corruption investigation.

Respondent asks for a stay of the arbitral proceedings "*until the investigations against Mr. Field concerning the taking of bribes in connection with the conclusion of the Agreement are concluded*". Alternatively, Respondents asks to bifurcate the proceedings in two phases and to deal in the first phase only with those issues which are not directly related to the corruption allegations. The Parties agreed that the bifurcation request would only extend to the invalidity of the Agreement due to corruption (PO 2 – 52).

In essence, the latter is the approach adopted by the Arbitral Tribunal until it will render its final decision on the stay and bifurcation request. The issues to be addressed by the Parties in this first phase of the arbitration in relation to the merits are not dependent on any findings in relation to the alleged corruption. They merely concern abstract legal questions in relation to the applicability of the CISG and the consequences thereof for the ability to declare the avoidance of the contract for misrepresentation under national law.

Details about the doubtful reputation of Mr. Field and the presently ongoing investigation against him can be found in two articles of the journal The Citizen which have been submitted by the Parties as Exhibits. The first article dates from 3 July 2021 (Claimant Exhibit C 5). It marks the start of a series of articles which revealed the major corruption scandal surrounding the Socialist Party and its Northern Part Development Program. The last part of the article is dedicated to Mr. Fields who had risen through the ranks of the Socialist Parties before becoming the COO of Respondent and seemed to be immune against all previous corruption allegation which earned him the nickname "*Teflon David*". The article closes with the promise that this may be different this time. The Citizen and its research network had been able to trace back some of the secret accounts revealed in the Panama Papers to Mr. Fields and one payment on such accounts to a successful contender for a controversial commercial contract awarded by Respondent. The public outcry resulting from this, and the other articles of the series finally led to the election of a new government in December 2021.

One of the first actions taken by the new government, besides the moratorium on all contracts concluded under the Northern Part Development Program, was the appointment of a special public prosecutor, Ms. Fonseca, to investigate the corruption scandal surrounding the Socialist Party and the contracts concluded under the program. The second article, dating from 22 May 2022 (Respondent Exhibit R 2), reports about the

conduct of these investigation and corruption charges brought against Mr. Field. Those had been made public by Ms. Fonseca in a press conference on 21 May 2022. Ms. Fonseca had informed the public that her team is now able to prove that two payments in the amount of EUR 850,000.00 and EUR 1,150,000.00 were directly associated with the award of two major contracts by Respondent to companies run by Mr. Fields relatives. She had further stated that she would look also in the conclusion of the Agreement and promised that all investigations against Mr. Field would be finalized "*by the end of 2023 at the latest*".

The article also mentions the oddities in the negotiation history of the Agreement and the critical comments thereon by competitors. Originally, the drones were to be used exclusively for providing high resolution pictures of the remote areas of the Northern Part, necessary to discover and evaluate the existence of rare minerals and other natural resources. Allegedly, that purpose was enlarged given the very favorable offer by Drone Eye and the load which the Kestrel Eye 2010 drone could carry. The Minister is reported having stated in his speech that a "*drone which normally carries cameras or other surveillance equipment in its cargo compartment should also be able to transport urgently needed spare parts or medicine to remote areas of the Northern Part of Equatoriana."* However, The Citizen also reports that sources consider the sudden change of the contract's scope within a tender process to be odd considering the purpose of such a process, to acquire comparable offers. Furthermore, according to those sources, drones which are merely used for transporting goods are much cheaper than those which are used to carry high precision equipment for geological and other scientific studies.

2. Discussion

The applicable PCA-Rules regulate the conduct of the arbitral proceedings in Section III. The general rule can be found in Article 17 which provides in its para. 1 as follows:

> *Subject to these Rules, the arbitral tribunal may conduct the arbitration in such manner as it considers appropriate, provided that the parties are treated with equality and that at an appropriate stage of the proceedings each party is given a reasonable opportunity of presenting its case. The arbitral tribunal, in exercising its discretion, shall conduct the proceedings so as to avoid unnecessary delay and expense and to provide a fair and efficient process for resolving the parties' dispute.*

Thus, within the broad limits set by the obligation to treat the parties equally and to give each of them a "*reasonable opportunity of presenting its case*" the Arbitral Tribunal has wide discretion as to the conduct of the proceedings. The situation is comparable under the Danubian Arbitration Law where Article 19 (2) ML empowers the Tribunal in the absence of an agreement by the Parties to the contrary to "*conduct the arbitration in such manner as it considers appropriate*".

Thus, it is for the teams to provide arguments why the Arbitral Tribunal should exercise its discretion concerning a possible stay or a least a bifurcation in favor of their clients. In principle, the criteria mentioned in Article 17(1) 2nd sentences PCA-Rules can be invoked by both parties. Respondent will probably put strong emphasis on the "*opportunity of presenting its case*". The use of sovereign investigative powers by the public prosecution office may provide additional evidence which would otherwise not be available and could then be used by Respondent in the Arbitration. In general, having the public prosecution office investigating the central factual disputes may also be more efficient and save expenses otherwise incurred by the Parties. Furthermore, a stay minimizes the risk of potential conflicts between the award and the findings in the criminal proceedings. In particular, if Mr. Field is found guilty of accepting undue payments for the conclusion of the Agreement, the enforcement of an award which comes to the opposite conclusion and enforces a contract obtained by bribery will clash with the public policy of Equatoriana where the award will most likely be enforced.

Claimant by contrast will probably put more emphasize on the avoidance of delay and the efficiency of the proceedings. In case the investigation of Ms. Fonseca leads to charges against Mr. Field the ensuing first instance criminal proceedings against Mr. Field take on average 6 months so that a judgment could be expected in June 2024 at the earliest. It appears likely that the arbitral proceedings would be finished before that date. Furthermore, while there had been an expectation that the proceedings will be finished by June 2024 there is naturally no guarantee for that.

Furthermore, the set-up of the criminal investigations against Mr. Field have let his lawyers to doubt the fairness of the proceedings, as reported in the article of The Citizen of 22 May 2022 (Respondent Exhibit R 2). It had turned out that the CEO of the unsuccessful bidder in the drone deal had been Ms. Fonseca's brother-in-law. Furthermore, her son's fiancé, Ms. Bourgeois, is the former personal assistant of Mr. Field. She had profited from his removal by first becoming the head of the internal investigation at Equatoriana Geoscience from where she had moved to the office of Ms. Fonseca, her future mother-in-law.

Facts and arguments which may be relevant for the discussion could be:

- The likely length of the investigations and eventual future criminal proceedings.
- The existence of red flags for corruption and the resulting likelihood of a finding of corruption.
- The fairness of the investigation due to the personal connections of Ms. Fonseca and her team with Mr. Field (brother-in-law CEO of the unsuccessful second bidder; future daughter in law previous assistant).
- The (non-)availability in the arbitral proceedings of the two central witnesses which had negotiated the Agreement and are now both either under arrest or no longer working for one of the Parties.
- The (non-) availability of court support to overcome problems in obtaining evidence otherwise not available under the relevant arbitration laws (Mediterraneo and Equatoriana; Danubia?).

V. The applicability of the CISG to the Agreement (PO 1 para. III no. 1 c.)

1. Background

Article 2 CISG excludes certain international sales contracts from the CISG's sphere of application. That exclusion is either based on the purpose for which the contract has been concluded, the form of its conclusion or the goods covered. Concerning the latter Article 2 CISG provides in its pertinent part (emphasis added):

> *This Convention does not apply to sales:*
> *[…]*
> *(d) of stocks, shares, investment securities, negotiable instruments or money;*
> *(e)* ***of ships, vessels, hovercraft or aircraft****;*
> *(f) of electricity.*

Unmanned Aerial Vehicles (UAVs) are not explicitly mentioned as excluded goods, but the question arises whether they constitute aircrafts in the sense of Article 2 (e) CISG.

The Aviation Safety Act of Equatoriana defines the notion aircraft in its Article 1 as follows:

> *(a) aircraft: any vehicle with or without an engine, heavier or lighter than air that is used or intended to be used for moving persons or objects in the air without any mechanical connection to the ground. Unmanned Aerial Vehicles are treated accordingly as aircrafts if their overall length exceeds 90 cm or if their payload is higher than 50 kg.*

Furthermore, it imposes in its Article 10 the following registration requirements for aircrafts:

> *Any aircraft owned or operated by a private entity in the territory of Equatoriana shall be registered at the aircraft registry. Transfer of ownership in such aircraft is only perfected upon registration.*

2. Discussion

Whether a drone / UAV constitutes an aircraft in the sense of Article 2 is open to discussion. The outcome depends on the interpretation of the notion "*aircraft*" in Article 2 CISG which is governed by the principles set out in Article 7 CISG. Thus, the teams have to find an autonomous meaning for the notion, taking into account the CISG's "*international character and to the need to promote uniformity in its application and the observance of good faith in international trade".* The national provisions are thus not determinative but can only be factors in finding an autonomous meaning of the notion or its subsequent application.

In light of the maintenance element involved in the Agreement many teams will also address Article 3 (2) CISG. It will, however, be very difficult to argue that the provision of the services is the "*preponderant part*" in the sense of Article 3 (2) CISG leading to its non-applicability.

Facts and arguments which may be relevant for the discussion could be:

- Article 1 of the Aviation Safety Act of Equatoriana that foresees that Unmanned Aerial Vehicles "*are treated accordingly as aircrafts*".
- The properties of the UAVs, the risks of its use as well as similarities and differences to other aerial vehicles.
- The relevance of transporting goods and humans for defining an aircraft – as both the Kestrel Eye 2010 and the Hawk Eye 2020 are able to carry other cargo fitting into the payload bays instead of the surveillance equipment, but neither of Claimant's UAVs has the ability to carry humans.
- The drafting history of Article 2 (e) CISG and the consequences and potential of its narrow or broad interpretation.
- The Parties' intention of using the Kestrel Eye 2010 for transport / like an aircraft.
- The relevance of national registration requirements and potential interference of the CISG with such requirements.
- The (varying) use of the notion "*aircraft*" in the description of the UAS in the contractual documents and the Parties' communications.
- The nature of the Agreement concerning the sale of goods and the provision of services (Article 3 (2) CISG).
- The role played by the maintenance services in the negotiation process of the Agreement and their value (including / excluding) spare parts.

VI. Termination for misrepresentation (PO 1 para. III no. 1 d.)

1. Background

In its letter of 30 May 2022 (Claimant Exhibit C 8) terminating the negotiations between the Parties, Respondent based its termination of the Agreement on a "*serious misrepresentation of the quality of the Kestrel Eye 2010 drone*", relying on "*Article 3.2.5 of the International Commercial Contract Code of Equatoriana as interpreted by the Equatorianian Supreme Court*".

Article 3.2.5 of International Commercial Contract Act (reference to Code in letter is wrong) provides as follows:

> *ARTICLE 3.2.5 (Fraud)*
> *A party may avoid the contract when it has been led to conclude the contract by the other party's fraudulent representation, including language or practices, or fraudulent non-disclosure of circumstances which, according to reasonable commercial standards of fair dealing, the latter party should have disclosed.*

In its Call for Tender (Claimant Exhibit C 1) Respondent described the requested product as "*state-of-the-art unmanned aircraft systems".* That was acknowledged in the recitals of the Agreement (Claimant Exhibit C 2) where it is stated that the tender process was initiated "*for the acquisition of state-of-the-art aircrafts*". In the Agreement's main part defining the seller's obligations Article 2 states in litera (a) that the seller undertakes

"to supply to the BUYER 6 of its newest model of Kestrel Eye 2010 UAS, out of which 4 are equipped with state-of-the-art geological surveillance feature further specified in Annex A to this Agreement".

Also, the General Product Information for the Kestrel Eye 2010 refer to its "*state-of-the-art design*" (Claimant Exhibit C 4). Moreover, in its letter of 29 November 2020 preceding the conclusion of the contract, Claimant's COO Mr. Bluntschli explicitly mentioned that the Kestrel Eye 2010's "*advanced technology guarantees its suitability for state-of-the-art data collection and aerial surveillance*" (Respondent Exhibit R 4). He also described it as the "*top model*" and the "*latest model of the Kestrel Eye 2010 family*".

In Respondent's view the Kestrel Eye 2010 does not represent "*state-of-the-art*" technology nor was it at the time of contracting Claimant's "*newest model*", "*latest model*" or "*top model*" as had been insinuated by Mr. Bluntschli on several occasions.

The Kestrel Eye 2010 had been developed originally already in 2010 and had been sold from 2012 onwards with some minor subsequent amendments and updates. Despite the release of the Hawk Eye 2020, the Kestrel Eye 2010 will still be produced until the end of 2024. By then a decision will be taken whether it will be replaced by a newly developed drone using "helicopter technology", i.e. powered lift technology, or whether Claimant will concentrate solely on the Hawk Eye 2020's "aerodynamic lift technology" with fixed wings. So far, no further updates of the Kestrel Eye 2010 family are planned.

While both UAVs, Kestrel Eye 2010 and Hawk Eye 2020, meet all the minimum requirements as stipulated in Annex B of the Call for Tender and could be used for the surveillance purposes pursued, Respondent would have profited from the additional functionalities of the Hawk Eye 2020 and would have been able to operate it (PO 2 – 12).

When the Agreement was negotiated in autumn 2020, Claimant had largely finished the development of the Hawk Eye 2020 and was in the test flight phase. If Respondent had bought the Hawk Eye 2020, Claimant would have been able to deliver three Hawk Eyes 2020 in 2022. (PO 2 – 14). Already in 2017, Claimant's press release concerning the acquisition of Drone-Aircraft announced that it wanted to enlarge its portfolio of available drones by using the newly acquired technology. Thus, while no details were available it was generally known in the market that Claimant was developing a new UAV. Respondent, however, had no positive knowledge about Claimant's activities and had never specifically asked Claimant whether the later was developing a new UAV.

According to the jurisprudence of the Equatorianian Supreme Court, Claimant probably would have been obliged to actively inform Respondent about the forthcoming presentation of the Hawk Eye 2020. The Supreme Court has held in a comparable case, albeit in a domestic setting, that an experienced private party contracting with a newly formed government entity is under far-reaching disclosure obligations covering all information potentially relevant for the government entity. Given that the Equatorianian courts have the reputation of deciding in favor of the state and its entities in case of doubt it is likely that this jurisprudence would be extended to the present case.

2. Discussion

The underlying problem is well evidenced by Respondent's termination letter giving as a reason for the termination a "*serious misrepresentation of the quality of the Kestrel Eye 2010 drone*". On the one hand, the possibility to terminate an agreement for misrepresentation is in principle a question relating to "*the validity of the contract*", which is pursuant to Article 4 (a) not governed by the CISG but by the national law. On the other hand, the CISG clearly regulates the conformity of the goods in relation to their "*quality, and description required by the contract*" in Article 35 and thus excludes any reliance on the national law in this regard.

In essence the question for the teams to discuss is whether based on the established facts, in particular the reliance on a wide-reaching disclosure obligation under the law of Equatoriana, the issue is to be classified as a misrepresentation or as a question relating to the conformity of the goods. In the later case Respondent would most likely have lost any remedies, if they ever existed, due to Article 39 CISG. In the former case, reliance on Article 3.2.5. ICCA could be possible (though Art. 3.2.12 may exclude reliance). The classification has to be made on the basis of the principles underlying the CISG and its interpretation as set out in Article 7 CISG.

Facts and arguments which may be relevant for the discussion could be:

- The legal nature of the requirements by Claimant and the statements made by Respondent (particularly by Mr. Bluntschli and in the General Product Information).
- The meaning of the wording "*state-of-the-art*" and "*newest technology*".
- The differences between the two UAVs.
- The timing of the negotiations of the Agreement and the development of the Hawk Eye 2020.
- The merger clause in the Agreement potentially excluding reliance on some evidence.
- The time when the first complaints were raised, the conduct of the negotiations and the timing of the termination notice.
- Compliance with the requirements of Art. 3.2.5 ICCA.
- The (lack of) precedential value of the decision of Equatorianian Supreme Court.

APPENDIX: ENTITIES AND PERSONS INVOLVED