JUDGMENT : Mr Justice Field: Commercial Court. 13th July 2006

1. These are proceedings for relief under ss. 67, 68 and 69 of the Arbitration Act 1996 ("the Act").

2. The claimant ("ESS") is a company engaged in the provision of satellite services for the mobile telephone and internet industry. It has a teleport at Brookman's Park in London. The respondent ("EWN") is a Nigerian company engaged, inter alia, in establishing a telecommunications network in Nigeria.

3. In June 2001 EWN and ESS entered into a contract under which ESS was to provide EWN with satellite equipment, satellite capacity and voice termination services. This contract is known as "*the Main Contract*". The parties also concluded two further linked contracts, a Supplemental Agreement and an Addendum, both of which dealt with the monthly fee payable in respect of satellite capacity. All three of these contracts incorporated ESS's General Terms and Conditions which provided that the contracts were governed by Danish law and any disputes thereunder were to be determined by arbitration in Copenhagen in accordance with ICC rules.

4. On 12 March 2003 the parties entered into a further contract, the Voice Traffic Termination Rate Agreement ("the VTTRA"). Under this agreement ESS was to provide telephony services by the interconnection of telecommunications networks via a satellite from their teleport in Brookman's Park and EWN was to provide ESS with international voice traffic termination into the telecommunications networks in Nigeria. The services provided by the one party to the other were to be paid at a specified rate on the basis of monthly invoices.

5. Sections 15.1 and 16.1 of the VTTRA provide:

> *15. GOVERNING LAW*
> *15.1 This Agreement shall be (a) governed by the substantive internal laws of the United Kingdom applicable to contracts executed and to be wholly performed in United Kingdom without giving effect to any conflict of laws or choice of laws principles which may be applicable thereto and (b) interpreted in accordance with the UNIDROIT Principles of International Commercial Contracts of the International Institute for the Unification of Private Laws [1994] as then in force, applied mutatis mutandis to the extent not inconsistent therewith.*
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> *16. ARBITRATION*
> *16.1 It is the express desire and intent of the parties hereto that any disputes, controversies or claims arising under, out of or by virtue of this Agreement, including those relating to the formation, validity, interpretation, content, performance, non-performance or termination of this Agreement, or the entitlement to damages for any breach thereof, be settled and resolved through negotiation and without litigation. However, should the parties be unable to settle and resolve any such dispute through negotiation, and except for any action or proceeding seeking a temporary restraining order or injunction relating to this Agreement or to compel compliance with this Section 16.1, any such dispute, controversy or claim shall be exclusively and finally settled resolved and determined by arbitration in accordance with the procedures for arbitration set forth in the UNCITRAL Arbitration Rules of the United Nations Commission on International Trade (1976) as then in force.*

6. EWN submitted invoices for approx US$12million under the VTTRA. ESS paid about $2.5million but refused to pay the rest. EWN therefore began an arbitration claim pursuant to Section 16.1. By way of defence ESS effectively admitted the sums claimed under the VTTRA but contended that they had a transaction set-off arising out of claims under the Main Contract. ESS have only ever provided brief particulars of these claims; they allege that their total exceeds the sum claimed by EWN. EWN do not admit ESS's alleged claims.

7. EWN contended that the arbitrators (Mr Alan Gourgey QC, Dr Julian Lew QC and Mr Henrik Lind) did not have jurisdiction to determine the alleged transaction set-off. They pointed to the incorporation of the UNCITRAL Arbitration Rules into the VTTRA by Section 16.1 and relied on Article 19 (3) thereof. Article 19 reads:

> Article 19
> *1. Within a period of time to be determined by the arbitral tribunal, the respondent shall communicate his statement of defence in writing to the claimant and to each of the arbitrators.*
> *2. The statement of defence shall reply to the particulars (b), (c) and (d) of the statement of claim (article 18, para.2). The respondent may annex to his statement the documents on which he relies for his defence or may add a reference to the documents or other evidence he will submit.*
> *3. In his statement of defence, or at a later stage in the arbitral proceedings if the arbitral tribunal decides that the delay was justified under the circumstances, the respondent may make a counter-claim arising out of the same contract or rely on a claim arising out of the same contract for the purpose of a set-off.*
> *4. The provisions of article 18, paragraph 2, shall apply to a counter-claim and a claim relied on for the purpose of a set-off.*

8. The Tribunal directed that they would decide as a preliminary issue whether they had jurisdiction to determine the set-off defence. Each side served written submissions. Very late in the day, ESS advanced an alternative submission that the VTTRA was an amendment of the Main Contract so that their set-off claims and EWN's claims arise out of one and the same contract.

9. In a Partial Award dated 20 March 2006 the Tribunal ruled that they did not have jurisdiction to determine the transaction set-off defence based on a contract separate from the VTTRA. With evident reluctance they went on to decided that they should not award the sums claimed by EWN but should permit ESS to contend in a

subsequent hearing that the VTTRA was an amendment of the Main Contract with the result that the set-off claims and EWN's claims all arise out of the Main Contract.

10. The Tribunal gave two separate reasons for their ruling that they lacked jurisdiction to determine ESS's transaction set-off defence. First, by a majority they decided that even without the incorporation of Article 19 (3) of the UNCITRAL Rules into the VTTRA, on the true construction of Section 16.1 they had jurisdiction only to decide claims brought under the VTTRA. The Tribunal set out paragraphs 3 to 6 of Cresswell J's "Analysis" in ***Metal Distributors (UK) Ltd v ZCCM Investment Holdings*** [2005] 2 Lloyd's Rep 37 at 42, and in paragraph 57 of the Partial Award said: *Firstly, the arbitration agreement in Section 16 1 of The VTTRA is in narrow terms. It provides for "any such dispute, controversy or claim" "arising under, out of, or by virtue of this Agreement", ie The VTTRA, to be "finally settled, resolved and determined by arbitration". No evidence has been presented to the Tribunal to show and the Respondent has not suggested that the set-off "arises under, out of or by virtue of" the VTTRA. The Tribunal has decided that it cannot decide any issues which do not arise out of or relate (sic) the VTTRA as its authority was limited to that agreement.*

11. The second reason the Tribunal gave for their decision was that a set-off based on a claim arising from a contract different from that under which the claimant's claim is made is excluded by Article 19 (3) of the UNCITRAL Rules. On this issue they were unanimous. The gist of their reasoning is to be found in paragraphs 60 – 63 of the Partial Award:

> *60. In any event the Tribunal members are all agreed that Article 19 (3) of the UNCITRAL Rules is an express exclusion of any right of transactional set-off. The UNCITRAL Rules are clear with respect to the use of set-offs: "the respondents may make a counter claim arising out of the same contract or rely on a claim arising out of the same contract for the purposes of a s set-off". (Emphasis added). The Tribunal consider that the UNCITRAL Rules were expressly incorporated in to the arbitration agreement. The Rules must be read together with the arbitration agreement.*
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> *61. The language of Article 19 (3) is clear. To give it the meanings suggested by the Respondent would be perverse in the circumstances of this arbitration. It makes absolutely clear that any counter-claim or set-off in an arbitration under the UNCITRAL Rules must arise out of the same contract; by corollary, if it does not arise out of the same contract it will be outside the Tribunal's jurisdiction.*
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> *62. Nothing precludes parties excluding transactional or any other settlement being sought in a particular situation. Equally, parties can and do determine the nature of the jurisdiction clause, and decide that certain types of dispute would be determined in different fora, eg financial issues in a national court, technical issues before an expert, and legal and factual issues before an arbitration tribunal. Article 19 (3) is a provision of this kind. It is a clear limitation of the extent to which the UNCITRAL Rules can apply generally to this arbitration, but is also an express limitation on the matters which may be dealt with in an arbitration concerning the VTTRA.*
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> *63. Furthermore, for the reasons given above, the Tribunal is not persuaded by the Respondent's argument that transactional set-off is a matter of substantive law such that it should apply regardless of the terms of the arbitration agreement and the UNCITRAL Rules. Those two instruments are an integral part of the parties' agreement to arbitrate and to allow transactional set-off would go against the express terms of the arbitration agreement and Article 19 (3) of the UNCITRAL Rules*

12. I take first the Tribunal's unanimous decision on the meaning and effect of Article 19 (3) of the UNCITRAL Rules.

13. In ***Aectra Refining and Manufacturing Inc v Exmar NV*** [1994] 1 WLR 1634 at 1649 Hoffmann LJ said: *Transaction set-off ….. is a cross-claim arising from the same transaction or one so closely related that it operates in law or in equity as a complete or partial defeasance of the plaintiff's claim. The category covers a common law abatement of the price of goods or services for breach of warranty, as explained by Parke B in **Mondel v Steel** (1841) 8 M & W 858, 872 and equitable set-off, as explained by Morris LJ in **Hanak v Green** [1958] 2 QB 9, 19. At common law, as Parke B said, the purchaser "defend[s] himself by showing how much less the subject matter of the action was worth" and in equitable set-off the defendant asserts what Morris LJ called "an equity which went to impeach "the title of demand".*

14. Founding on this description of transaction set-off, Mr Shepherd QC for ESS boldly submitted that wherever a contract is governed by English law any claim under the contract can be met with the defence of transaction set-off based on a different contract whatever the wording of any arbitration agreement or exclusive jurisdiction clause. In his submission, this was because transaction set-off "fixes on the claim" and "automatically reduces the claim". In support of this submission he relied on the observations of the Court of Appeal in *Aecta* that the court would allow a transaction set-off to be raised as a defence notwithstanding that the set-off was founded on a contract containing an arbitration agreement which in any other circumstances would be enforced by a mandatory stay. He also relied on the following passage in the judgement of Gross J in ***Ronly Holdings Ltd v JSC Zestafoni G Nikoladze Ferroalloy Plant*** [2004] EWHC 1354 (Comm) (para 33):

> *……I agree, however, that no detailed consideration of set-off is called for. My reasons are these:*
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> *i) Questions of some intricacy arise as to the classification of set-offs and the correct approach to be followed when a claim before an arbitrator is met by an argument that there is a set-off available arising under some separate transaction over which the tribunal does not have jurisdiction. Provisionally, I would be minded to think that an arbitrator does or should have jurisdiction to allow a "transaction" set-off, in effect amounting or akin to a*

*defence, to be raised to reduce or extinguish a claim, even though that set-off arises under another contract, outside the tribunal's jurisdiction: see: **Aectra Refining**, at pp.1648 and following and ... sic) **Glencore v Agros**, at pp. 416-417, both supra. As it seems to me, the investigation and determination of the availability and amount of such a set-off do not involve the arbitrator arrogating to himself a jurisdiction over separate contracts which he does not have (albeit that considerations of issue estoppel may well arise); instead, these steps form part of the process of arriving at a conclusion of whether a defence is properly available in respect of the contract as to which the arbitrator alone has jurisdiction. However, all these observations are provisional only, given that for reasons which follow, such questions do not arise for decision in this matter.*

15. Mr Shepherd's alternative submission was that bearing in mind that the VTTRA is governed by English law (which includes the law of transaction set-off), the true construction of Section 16.1 and Article 19 (3) of the UNCITRAL Rules was that transaction set-off based on a different contract from that founding the claimant's claim was not excluded from the arbitration.

16. Mr Shepherd relied on Article 1 (2) of the UNCITRAL Rules which provides *"These Rules shall govern the arbitration except that where any of these Rules is in conflict with a provision of the law applicable to the arbitration from which the parties cannot derogate, that provision shall prevail"*. In his submission "the law applicable to the arbitration from which the parties cannot derogate" in Article 1 (2) is the law chosen by the parties to govern the contract, in this case English law, which includes the law of transaction set-off. Mr Shepherd also relied on Article 33 (3) of the UNCITRAL Rules: "*In all cases, the arbitral tribunal shall decide in accordance with the terms of the contract and shall take into account the usages of trade applicable to the transaction"*. In Mr Shepherd's submission, this meant that the governing law of the contract prevailed over any procedural rule such as Article 19 (3).

17. I cannot accept Mr Shepherd's submissions. First, an arbitral tribunal's jurisdiction depends on the scope of the arbitration agreement. The jurisdiction of an English court is not so dependent. Accordingly, the observations of the Court of Appeal in *Aectra* are not to be taken to be as conferring jurisdiction on an arbitral tribunal to determine transaction set-offs based on a separate contract regardless of the scope of the arbitration agreement. The views of Gross J set out above were expressed to be provisional and the wording of the arbitration agreement in that case does not appear in the judgement. If Gross J was intending to say that however the arbitration agreement is worded the tribunal will have jurisdiction to determine a transaction set-off based on a separate contract, I respectfully disagree with him. I prefer what Cresswell J said in *Metal Distributors* (p.43): whether the tribunal has jurisdiction over a set-off depends on the true construction of the arbitration agreement.

18. Second, the "law applicable to the arbitration from which the parties cannot derogate" in Article 1 (2) of the UNCITRAL Rules is not the law chosen to govern the contract but the procedural law of the forum, such as is provided for in s. 4 of the Act and Schedule 1 thereto.

19. Third, Article 33 (3) the UNCITRAL Rules does not give precedence to the law governing the contract over procedural rules that are relevant to determining the jurisdiction. Section 16.1 of the VTTRA is to be construed against the background of the VTTRA as a whole, including Section 15.1 and in light of the incorporation of Article 19 (3) of the UNCITRAL Rules.

20. Fourth, the plain and ordinary meaning of Article 19 (3) is that a respondent may raise a set-off, whether in his defence or in a counter-claim, only if it is founded on a claim arising out of the same contract as that on which the claimant's claim is based. I agree that there is a certain tension between Article 19 (3) and Section 15.1 (the English law clause) but there is no rule that the governing law of the contract is to prevail over any conflicting procedural rules as submitted by Mr Shepherd. Instead, the words used by the parties including any provisions incorporated into the contract are to be construed using the conventional canons of construction applicable to commercial contracts.

21. The meaning and effect of Article 19 (3) is clear. Further, this meaning is not contrary to commercial common sense, for, as in this case, the contract relied on for the set-off might be subject to an entirely different arbitration regime and governing law and it may well be that the set-off claim exceeds the primary claim, in which case there will in any event have to be a separate arbitration to establish entitlement to the balance. It follows, in my opinion, that notwithstanding that the parties chose English law as the governing law of the VTTRA, they agreed by signing up to Section 16.1 and the incorporation of Article 19 (3) that a respondent could not raise a transaction set-off arising out of a different contract from that on which the claimant's claim is based.

22. Accordingly, I uphold the Tribunal's unanimous ruling that they lacked jurisdiction to determine ESS's defence of transaction set-off.

23. This conclusion makes it unnecessary to decide if the majority's construction of Section 16.1 without regard to Article 19 (3) was well founded and I decline to do so.

24. Mr Shepherd accepted that his s.68 and s.69 applications added nothing to his s. 67 application. In the result therefore all three of ESS's applications are dismissed.

Mr Philip Shepherd QC and Ms Jessica Chappel (instructed by Kerman & Co LLP) for the Claimant
Mr Simon Browne-Wilkinson QC and Mr Edward Levey (instructed by DLA Piper Rudnick Gray Cary) for the Defendant