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New Bahrain Arbitration Law and
“Free Arbitration Zone” Explained

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The New Bahrain Arbitration Law and the Bahrain “Free Arbitration Zone”

BY JOHN M. TOWNSEND

New arbitration legislation enacted by the Kingdom of Bahrain on July 2, 2009 makes it the first country in the world to create the equivalent of a free trade zone for arbitration. That legislation, Legislative Decree No. 30 (The Decree), gives parties to an agreement calling for international arbitration the option of holding the arbitration in Bahrain without concern that the courts of Bahrain might interfere with, or set aside, the resulting award, as long as the parties seek to enforce the award only in another country. The result is the creation of what this article will call the Bahrain “Free Arbitration Zone.”



**How
Bahrain's new
Arbitration Law and
"Free Arbitration Zone"
address concerns that multi-
national companies have
about arbitrating interna-
tional commercial dis-
putes in the Middle
East.**

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The new legislation also creates a new Bahrain Chamber for Dispute Resolution (BCDR), which is intended to become both a Bahraini national and a Middle Eastern regional arbitration center that will be run with the help of the American Arbitration Association (AAA). Creating an international arbitration center from scratch is not an easy proposition, especially in a part of the world in which users of arbitration have been critical of the judicial structure within which arbitration has up to now had to be conducted. In spite of the convenience of having regional arbitration centers in the Middle East, many corporations have remained cautious about siting arbitrations there out of concerns that local courts are inexperienced in dealing with arbitration and that awards against influential local parties (especially those connected with or favored by governments) might simply be set aside.

The Problem: Lack of Confidence in the Local Courts

The primary objective of users of arbitration in designating the site for an arbitration in a dispute resolution clause is to select a location from which a fair and enforceable arbitration award may be expected to emerge. Convenience is important, as is the availability of qualified arbitrators and counsel. There are those who believe that the quality of the local cuisine also plays a part. But overriding all other considerations is finding a neutral forum in which neither party feels at a disadvantage, and where the courts will support the arbitration process and not second-guess the arbitrators.

Under the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention), the treaty that governs the enforcement of arbitration agreements and awards around the world, the courts of the country where the arbitration takes place have jurisdiction to set aside any arbitration award made in that country.¹ Selection of the site of the arbitration has therefore, up until the new Bahraini law, carried with it the selection of which courts will have a primary role in reviewing any award.

Most parties will decline to locate an arbitra-

tion in the other party's home country, especially if the other party is considered influential there. Rather, they will look for a neutral site, reasonably convenient to both parties, with a friendly arbitration law, in which the courts have acquired a reputation for respecting arbitration awards. Every drafter of dispute resolution agreements has his or her preferred list of sites in various parts of the world. But very few, at least from outside the region, would include a location in the Middle East on that list.

Users of arbitration have been reluctant to conduct arbitrations in the Middle East for two principal reasons. The first is that the courts there have little or no track record showing an understanding of international arbitration, or of respecting and enforcing arbitration awards. Indeed, the information available tends to create anxiety about the fate of an arbitration award when it reaches the courts.

The second concern is how courts in the Middle East are likely to treat awards that may be seen as inconsistent with *Shari'a* law, which in many Middle Eastern countries has the force of public policy. For example, *Shari'a* law forbids the charging or payment of interest. Since many other legal systems deal with the time value of money in terms of interest, this can create special problems in enforcing arbitration awards that emerge from those systems.

The Bechtel Case. The *Bechtel* case presents a vivid example of what parties fear about siting an arbitration in the Middle East.² In July 2000, International Bechtel Co. Ltd. and the Department of Civil Aviation of the Government of Dubai submitted a contractual dispute to arbitration at the Dubai Chamber of Commerce and Industry.³ The Dubai Chamber appointed a prominent Swiss lawyer as the sole arbitrator, and the arbitration was conducted under the laws of Dubai at the Dubai Chamber.⁴ On Feb. 20, 2002, after hearing evidence and statements from at least 15 witnesses, the arbitrator issued an award in favor of Bechtel for \$24.4 million.⁵

The Dubai government sought to overturn the award. It filed a complaint in the Dubai Court of

One reason for the reluctance to site international commercial arbitration in the Middle East is that the courts there have little or no track record showing an understanding of international arbitration or respecting and enforcing arbitration awards.

First Instance, arguing that the arbitrator's warning to the witnesses at the hearing that they were "bound to tell the truth" and could face "severe consequences" for not doing so was insufficient, because Dubai law requires witnesses to declare, "I swear by the Almighty to tell the truth and nothing but the truth."⁶ On Nov. 16, 2002, the Dubai Court of First Instance ruled in the government's favor and vacated the award because the arbitrator did not administer the oath to witnesses in the proper local form. Bechtel appealed to the Dubai Court of Cassation, which affirmed the lower court's decision.⁷

While its appeal in Dubai was pending, Bechtel also filed petitions for judicial recognition and enforcement of the arbitration award in the United States and France. The U.S. federal district court initially denied a motion by the Dubai government to dismiss and stayed proceedings pending the appeal to the Dubai Court of Cassation, while noting that the reasoning of the Dubai lower court in nullifying the award "registers at the hypertechnical fringe of what Americans would call justice."⁸ Nevertheless, after the Dubai Court of Cassation affirmed the lower court's decision, the U.S. court dismissed Bechtel's petition on grounds nearly as technical. The court concluded that Bechtel was not entitled to relief under the New York Convention because the United Arab Emirates, of which Dubai forms a part, was not then a signatory to that convention. The court also found that relief was unavailable under the Federal Arbitration Act because the parties had not agreed that a judgment on the award could be entered in an American court, as required by Section 9 of the FAA.⁹

Bechtel fared better in France, where the Paris Court of Appeal affirmed the *ex parte* enforcement order issued by the Paris Court of First Instance on the ground that the annulment by the Dubai Court of Cassation applied only to the UAE and was without international effect.¹⁰ But Bechtel's ultimate success in France did little to allay fears that Middle Eastern courts might again interfere unduly with arbitrations sited in the region. Users of arbitration remained alarmed by the decisions of the courts of Dubai, which received widespread negative attention.¹¹

Set-Aside Proceedings under the New York Convention. The New York Convention provides for three kinds of interaction between the courts of contracting states and parties to an arbitration agreement or award. First, Article II.1 requires contracting states to recognize and enforce agreements to submit to arbitration differences that are capable of being settled by arbitration.

Article II.3 requires a court of a contracting state to refer to arbitration a dispute brought before it that is the subject of such an arbitration agreement.

Second, Article III of the New York Convention requires courts of contracting states to recognize and enforce awards made in another signatory country. Article V.1 of the convention provides a limited list of reasons for which a court may refuse to enforce an award, including technical or procedural deficiencies in the arbitration agreement or process. Article V.2 of the convention permits, but does not require, a court to refuse enforcement based on the law or the public policy of the enforcing state.¹² Article VI permits a court to stay proceedings while an application to suspend or set aside is pending, as the U.S. court did in its first *Bechtel* decision.

In Article V.1(e), the New York Convention provides for the third—and most important for those selecting a site of arbitration—type of interaction with the local courts. That article permits a court to refuse to enforce an award that has been suspended or set aside by the courts of (1) the "country in which ... the award was made," or (2) the country "under the law of which the award was made."¹³ By recognizing judicial set-aside as a reason why an enforcing court may refuse to recognize an arbitration award, the New York Convention indirectly, but effectively, confers the power to set aside or suspend an arbitration award on either the courts at the site of the arbitration or the courts of the country whose law the parties have chosen to govern the arbitration.

The New York Convention articulates no standard to guide a court in deciding whether to suspend or set aside an award, nor does it provide users of arbitration with insight regarding whether or when courts might decide to exercise that power. The absence of guidelines in the convention itself has greatly influenced users of international arbitration to prefer to arbitrate in jurisdictions with well-established records for exercising restraint in using the power to set aside awards.

Designing a Solution to the Problem: The Free Arbitration Zone

For its new international arbitration center to succeed in attracting business from outside the country, Bahrain needed to provide assurance to the international community that its courts would show appropriate respect for the decisions made by arbitrators. One way to do that would be to wait 20 or 30 years, to allow time for Bahrain and the BCDR to be written into a few

arbitration agreements and to allow the resulting awards to be respected by the courts.

Instead, Bahrain chose to address these concerns directly by removing its courts altogether from the picture (except when awards are to be enforced in Bahrain), thus creating the Free Arbitration Zone. To understand how it did so, it is necessary to look at the structure of Legislative Decree No. 30.

The BCDR's Two Types of Jurisdiction. The Decree confers two types of jurisdiction on the new BCDR. The first is called "Jurisdiction under the Law," and the second is called "Jurisdiction by Party Agreement." As discussed below, each represents a different facet of Bahrain's modernization efforts.

Legislative Decree No. 30 permits parties to agree to arbitrate a dispute before the BCDR, with no requirement as to the amount in controversy, and no requirement that the dispute be international or commercial.

Jurisdiction under the Law authorizes referrals to the BCDR of two types of disputes that would otherwise have been heard by the Bahraini courts. The first type comprises disputes brought by or against financial institutions licensed under the terms of the Law of the Central Bank of Bahrain when the amount in controversy exceeds 500,000 Bahraini Dinars (approximately US\$1.33 million).¹⁴

The second type of dispute to be sent to the BCDR as part of its Jurisdiction under the Law consists of all "international commercial disputes" in which the same amount or more is in dispute. The Decree specifies that:

A dispute is *international* if the headquarters of one of the parties to the dispute, the place where a substantial part of the obligations arising from the relationship is performed, or the place with which the subject matter of the dispute is most closely related, is located outside the Kingdom (of Bahrain).¹⁵

A dispute is *commercial*:

if its subject matter concerns relationships of a commercial nature, whether contractual or not, including any transactions or agreements for the supply, exchange, or distribution of goods or services; commercial management or agency; leasing; factory construction; consultancy services; engineering projects; licensing; investment and financing; banking transac-

tions; insurance; franchising; joint ventures; other forms of industrial or commercial cooperation; and transporting goods or passengers by air, sea, or land.¹⁶

Disputes administered under the BCDR's Jurisdiction under the Law will be heard by panels of three arbitrators, two of whom will be judges of the Bahraini courts who will have received special training from the BCDR and the AAA.¹⁷ The third arbitrator will be appointed under the rules of the BCDR. The arbitrators will be required to respect the parties' agreement on the governing substantive law only so long as the provisions of that law "are not inconsistent with the public policy" of Bahrain; in the absence

of such an agreement, the arbitrators will apply Bahraini law.¹⁸ Non-Bahraini lawyers may represent parties to these cases only if Bahraini counsel licensed to appear before the Cassation Court also participate.¹⁹

These provisions effectively create a specialized international commercial court in Bahrain. The Bahraini judiciary will control decision-making by a margin of two to one, but the judges who hear the financial and international commercial disputes will be trained to deal with them. This alone should enhance Bahrain's standing as a Middle Eastern banking and financial center.

Jurisdiction by Party Agreement, by contrast, depends on contract. The Decree permits parties to agree to arbitrate a dispute before the BCDR, with no requirement as to the amount in controversy, and no requirement that the dispute be international or commercial. It is only necessary that "the parties agree in writing to settle it through the chamber."²⁰

Disputes referred to the BCDR for arbitration under its Jurisdiction by Party Agreement will be governed by arbitration rules developed by the BCDR in cooperation with the AAA, and will be administered by the BCDR under a joint venture with the AAA called the BCDR-AAA.²¹ This arrangement was designed to give the BCDR access to both the AAA's experience in administering international arbitrations and its panels of

arbitrators. Both organizations will stand behind arbitrations administered under the Jurisdiction by Party Agreement provisions of the Decree.

The Decree grants parties great flexibility under the Jurisdiction by Party Agreement. First, unlike disputes submitted under the Jurisdiction under the Law, the Decree provides no public policy constraints for the choice of substantive law. Rather, it provides that the tribunal shall determine the appropriate substantive law to apply only “if the parties do not agree on the applicable choice of substantive law.”²² Second, for disputes submitted under this jurisdiction, the Decree permits party representation by non-Bahraini lawyers without the need to associate with local counsel.²³

The Free Arbitration Zone. Under the BCDR’s Jurisdiction by Party Agreement, the parties have the additional option of conducting their arbitration within the Free Arbitration Zone, cutting off all recourse to the courts of Bahrain to challenge any subsequent arbitration award, unless that award is to be enforced in Bahrain. To take advantage of this option, the parties must agree in writing that: (1) a law other than that of Bahrain will govern any dispute between them, (2) the parties will not challenge any award that may result before the courts of Bahrain, and (3) any challenge will, instead, be brought only before the courts of the country whose law has been chosen to govern the dispute. The source of this authority is Article 25 of the Decree, which provides:

Without prejudice to the procedures set forth in Articles 23 and 24 of this law concerning the enforcement of the Dispute Resolution Tribunal award, *parties to the dispute shall not be entitled to appeal for the annulment of the Dispute Resolution Tribunal award in accordance with Article 24 of this law if the parties have agreed in writing [1] that foreign law will govern the dispute, [2] that they will not challenge the award before the courts of Bahrain, and [3] that any challenge against the award shall be before the competent authority in another state.*²⁴

The New York Convention, as has been seen, permits a proceeding to vacate an arbitration award to be brought before either the courts of the country in which the arbitration has taken place, or the courts of the country “under the law of which” the award was made.²⁵ Article 25 creates the Free Arbitration Zone by permitting the parties to elect the latter of those options, to the exclusion of the former, in their agreement.²⁶ Thus, for example, if the parties agree that any dispute between them will be submitted to arbitration in Bahrain, but under Swiss law, and that

any challenge to the award must be brought in the courts of Switzerland and may not be brought in the courts of Bahrain, then they may conduct their arbitration in Bahrain without any concern about interference from the Bahraini courts.

The Arabic text of the Decree creates a slight ambiguity by using the phrase *b-il-buTlaan* (بالبطلان) to provide that the parties shall not be entitled to appeal “for annulment” of the award. One might have expected the Decree to use either *bi-naqD* (بنقض) (to set aside) or *b-ilghaa`* (بالغاء) (to cancel), which are the terms used in the Arabic versions of the New York Convention²⁷ and the UNCITRAL Model Law on International Commercial Arbitration,²⁸ respectively. Practically speaking, however, the legislation should have the same effect as if the more conventional terms had been used. The only provision of any Bahraini law that grants jurisdiction to local courts to hear appellate challenges to BCDR-AAA awards issued pursuant to the chamber’s Jurisdiction by Party Agreement is Article 24 of the new Decree, which uses the same phrase *b-il-buTlaan* to allow parties “to appeal to the Cassation Court for the annulment of the Dispute Resolution Tribunal award.”²⁹ If the parties have entered into the written agreements necessary to take advantage of the Free Arbitration Zone, however, Article 25 provides that the parties are not entitled to make such appeals, cutting off the only jurisdictional route provided by law to the Bahraini courts.

A Remaining Role for the Courts

Although proper invocation of the Free Arbitration Zone will prevent the Bahraini courts from entertaining a proceeding to set aside an arbitration award between parties that elect it, that election does not remove the local courts from all contact with BCDR-AAA awards and proceedings, or their attendant arbitration agreements.

First, under Article II of the New York Convention, the Bahraini courts will retain jurisdiction and the obligation to enforce an agreement to arbitrate.

Second, the Bahraini courts will also retain jurisdiction, and an obligation to enforce, an award resulting from such an arbitration, if either party chooses to enforce it in Bahrain. But the Decree distinguishes for purposes of enforcement between tribunal awards, depending on the type of jurisdiction exercised by the BCDR. Article 15 provides that an award issued pursuant to the BCDR’s Jurisdiction under the Law “shall be deemed a final judgment by the courts of Bahrain ... [and] shall be enforceable unless the Cassation

Court orders its suspension”³⁰ Article 23 provides that an arbitration award issued pursuant to Jurisdiction by Party Agreement shall be enforced like any other arbitration award subject to the New York Convention.

Therefore, if asked to enforce an award resulting from the BCDR-AAA’s Jurisdiction by Party Agreement in Bahrain, the Bahraini courts retain the ability to refuse enforcement or stay proceedings for any of the reasons enumerated in Articles V and VI of the New York Convention. These grounds are echoed in the Decree.³¹ And one of the grounds on which recognition and enforcement of an award may be refused is if the tribunal award contradicts the public policy of Bahrain.³² The use of the Free Arbitration Zone thus only prevents Bahraini courts from setting aside an arbitration award destined to be enforced elsewhere; it does not require them to enforce that award within Bahrain.³³

By allowing the Bahraini courts to refuse enforcement of an award for all of the reasons permitted by the New York Convention, includ-

ing that of public policy, Legislative Decree No. 30 should ensure that the adoption of the Free Arbitration Zone will not result in the enforcement within Bahrain of any award offensive to the country’s public policy, including *Shari’a* law. Of course, one would hope that an award destined to be enforced in Bahrain would be written with sufficient sensitivity to local concerns that it would avoid offending Bahraini policy in the first place.

Conclusion

Parties who qualify for and elect the Free Arbitration Zone, and who do not intend to enforce the resulting arbitration award in Bahrain, have a significant new option. They may agree to hold their arbitration in one of the most friendly and convenient locations in the Persian Gulf, under any law other than Bahrain’s to which they may agree, and under rules written and administered by the BCDR with the help of the AAA. And they may do so without concern that the courts of Bahrain will interfere with or set aside the award of the arbitrators. ■

The legislative decree creates a Free Arbitration Zone by allowing the parties to agree not to seek enforcement or annulment of the award in Bahrain.

ENDNOTES

¹ New York Convention, art. V. Bahrain ratified the New York Convention in 1988. The text of the New York Convention is available on the UNCITRAL Web site at www.uncitral.org.

² *Bechtel* is not the only such example. A decision of the Egyptian Court of Appeal nullifying an arbitration award against the Egyptian Air Force led to the famous *Chromalloy* decision, which enforced the award in the United States in spite of its having been set aside in Egypt. *In re Arbitration between Chromalloy Aeroservices, Inc. and the Arab Republic of Egypt*, 939 F. Supp. 907 (D.D.C. 1996).

³ The *Bechtel* arbitration is described in two decisions of the U.S. District Court for the District of Columbia, to which the award was submitted for enforcement. See *In re Arbitration between Int’l Bechtel Co. Ltd. & Dep’t of Civil Aviation of Gov’t of Dubai*, 300 F. Supp. 2d 112 (D.D.C. 2004) (*Bechtel I*); 360 F. Supp. 2d 136 (D.D.C. 2005) (*Bechtel II*).

⁴ See Renewed Motion to Dismiss

Petition to Confirm Arbitration Award, *Bechtel II* (No. 03-0277).

⁵ *Bechtel I*, *supra* n. 3, 300 F. Supp. 2d at 114-15.

⁶ *Id.* at 114 (quoting *Int’l Bechtel Co. Ltd. v. Dep’t of Civil Aviation of Gov’t of Dubai*, Case No. 288/2002 (Dubai Court of First Instance)); Renewed Motion to Dismiss Petition to Confirm Arbitration Award, *Bechtel II* (No. 03-0277), *supra* n. 4 (quoting the Dubai Court of Cassation Judgment dated May 15, 2004).

⁷ *Bechtel II*, *supra* n. 3, 360 F. Supp. 2d at 136-37.

⁸ *Bechtel I*, *supra* n. 3, 300 F. Supp. 2d at 118.

⁹ *Bechtel II*, *supra* n. 3, 360 F. Supp. 2d at 137 & n.3. The UAE ratified the New York Convention on June 13, 2006.

¹⁰ *Direction Générale de l’Aviation Civile de l’Émirat de Dubai v. Société Int’l Bechtel*, 2006 Rev. Arb. 695 (Paris Court of Appeal, Sept. 29 2005).

¹¹ See, e.g., Raid Abu-Manneh, “Dubai: A Regional Arbitration Center?” available at www.mondaq.com (Aug. 20,

2009) (The low point for arbitration in Dubai was possibly the UAE’s Court of Cassation’s decision in *Dubai Aviation Corporation v. Bechtel*); Alan Scott Rau, “Fear of Freedom,” 17 *Am. Rev. of Int’l Arb.* 469, 481, n.38 (2006) (the fact that the courts of Dubai had annulled an award against the state’s own civil aviation authority, and in favor of a foreign company, was ‘perhaps not totally irrelevant to a true understanding of the court’s decision’” (quoting Thomas Clay, Note, 2007 *J. Droit Int’l* (Clunet) 1236, 1248); “some foreign states—neophytes in the recondite world of international arbitration—are not yet able to understand the proper standards for the review of awards”).

¹² The public policy provision is in Article V.2 of the New York Convention, it provides:

Recognition and enforcement of an arbitral award may also be refused if the competent authority in the country where recognition and enforcement is sought finds that:

(a) The subject matter of the difference is not capable of settlement by arbitration under the law of that country; or

(b) The recognition or enforcement of the award would be contrary to the public policy of that country.

¹³ Article V.1(e) of the New York Convention states that recognition and enforcement of the award may be refused if “[t]he award has not yet become binding on the parties *or has been set aside or suspended by a competent authority of the country in which, or under the law of which, that award was made.*” (Emphasis added.)

¹⁴ Legislative Decree No. 30, art. 9(1) (2009) (Bahr) (hereafter referred to as Decree). The translations in this article of provisions in this Decree are by Daniel McLaughlin. They are not official translations.

¹⁵ Decree, *supra* n. 14, art. 9(2) (emphasis added). ¹⁶ *Id.*

¹⁷ Article 1 of Decree, *supra* n. 14, requires a majority of the tribunal in cases arising under the Jurisdiction under the Law to be judges.

¹⁸ Decree, *supra* n. 14, at art. 11(a)

¹⁹ Decree, *supra* n. 14, at art. 30(a).

²⁰ Decree, *supra* n. 14, at art. 19

²¹ The Arbitration Rules for disputes brought under the BCDR's Jurisdiction by Party Agreement and Jurisdiction under the Law are available in English and Arabic, respectively, at <http://bcdraaa.org/Rules.asp>.

²² Decree, *supra* n. 14, art. 20.

²³ Decree, *supra* n. 14, art. 30(b).

²⁴ Decree, *supra* n. 14, art. 25 (emphasis and bracketed numerals added).

²⁵ New York Convention art. V.1(e). A notorious example of the exercise of that power by a court in the country whose law applied was the 2008 decision of the Supreme Court of India in *Venture Global Engineering v. Satyam Computer Services*, permitting a challenge before an Indian court on the basis of Indian public policy to an arbitration award handed down in the United States under a contract governed by Indian Law.

²⁶ Such an agreement will be effective only if: (1) the law of the country that is a party to the New York Convention is specified, and (2) the courts of that country will accept the jurisdiction so conferred.

²⁷ Cf. New York Convention art. V.1(e), available at www.uncitral.org/pdf/arabic/texts/arbitration/NY-conv/NY-conv-a.pdf (Arabic) (using (إنه نقض))

to refer to awards that “have been set aside”).

²⁸ Cf. UNCITRAL Model Law on International Commercial Arbitration art. 36(2), available at www.uncitral.org/pdf/arabic/texts/arbitration/ml-arb/07-86996_Ebook.pdf (Arabic) (using the word “to cancel” (بالغاء) in the translation of the English phrase “If an application for setting aside ... an award has been made” (إذا قدم طلب بإلغاء قرار تحكيم)).

²⁹ Decree, *supra* n. 14, art. 24(A).

³⁰ *Id.* at art. 15.

³¹ These reasons include deficiencies in the arbitration agreement (Decree, *supra* n. 14, art. 24(A)(1); cf. New York Convention art. V.1(a)), process (Decree, *supra* n. 14, art. 24(A)(2); cf. New York Convention art. V.1(b)), and award (Decree, *supra* n. 14, art. 24(A)(3); cf. New York Convention art. V.1(d)).

³² Decree, *supra* n. 14, art. 24(A)(5); cf. New York Convention art. V.2(b).

³³ The Cassation Court of Bahrain has jurisdiction over proceedings to set aside awards in disputes submitted pursuant to the chamber's Jurisdiction under the Law, as well as for disputes submitted under Jurisdiction by Party Agreement when the parties have not elected or do not qualify for Free Arbitration Zone treatment.