SVEA COURT OF APPEAL	**JUDGMENT**	Case No.
Department 02	4 May 2009	T 980-06
Division 0204	Stockholm	

CLAIMANT
State Oil Company of the Republic of Azerbaijan (SOCAR)

Counsel: Advokaten M
P.O. Box 7305, 103 90 Stockholm

RESPONDENT
Frontera Resources Azerbaijan Corporation (Frontera)

Counsel: Advokaterna L and F
Eversheds Advokatbyrå AB, Norrlandsgatan 16, 111 43 Stockholm

MATTER
Challenge of arbitral award

CHALLENGED ARBITRAL AWARD
Arbitral award rendered in Stockholm on 16 January 2006, see appendix

JUDGMENT OF THE COURT OF APPEAL

1. Frontera's motion on dismissal of documentary evidence is rejected.

2. The motions of the claimant are rejected.

3. SOCAR is ordered to compensate Frontera for its litigation costs in the amount of SEK 1,429,567 and USD 98,380. The amounts shall incur interest pursuant to Section 6 of the Swedish Interest Act from this day until the day of payment.

4. Frontera's motion on joint and several liability for litigation costs under Sections 3, 6 and 7 of Chapter 18 of the Swedish Code of Judicial Procedure is rejected.

UNDERLYING EVENTS AND AGREEMENTS

SOCAR is a state owned company in Azerbaijan which administers the country's oil findings. Frontera is a company with its seat in the Cayman Islands. In November of 1998 an agreement was entered into by and between SOCAR and Frontera as well as certain other contractors (omitted in the following account). The agreement, called PSA, entailed that Frontera was granted the right to exploit certain oil fields in Azerbaijan in consideration of Frontera delivering a certain amount of oil at a discounted rate to SOCAR – so-called LMO deliveries, where LMO stands for Local Market Oil. Oil production in excess thereof was eligible for export at world market rates. Section 26 of the PSA and appendix 6 thereto contain provisions on arbitration. In short, they provide that if a dispute arises the parties shall meet to seek an amicable solution, and failing that within 30 days of the notice on the dispute it shall be resolved by arbitration under the UN World Trade Committee rules on arbitration, the UNCITRAL rules. Further, it is provided that the arbitration proceedings shall take place in Stockholm (see the entire arbitration clause in the attached arbitral award, p. 2-4).

The ensuing events can be divided in to four periods of time, having regard to the claims subsequently put forth in the arbitration proceedings.

November 1999 – March 2000

During this period Frontera delivered LMO oil to SOCAR. Differences of opinion arose relatively early between the parties on the LMO deliveries and the payment for them. As a part of the discussions thereon, SOCAR and Frontera agreed on 10 February 2000 that Frontera would be permitted to export at world market rates as from 1 April 2000 (the February Agreement). The actual meaning of this agreement is a matter of dispute between the parties.

April 2000 – November 2000

During this period Frontera exported all oil at world market rates, i.e. no LMO deliveries to SOCAR were carried out.

November – December 2000

In the middle of November of 2000, the Azerbaijani customs stopped, following orders from SOCAR, Frontera's exports of oil. SOCAR acquisitioned oil from Frontera during November and December of 2000 without paying for it.

On 14 November 2000 Frontera and the European Bank for Reconstruction and Development (the Bank) entered into an agreement pursuant to which Frontera transferred its rights under the PSA to the Bank as security for a loan taken out with the Bank.

In December of 2000 SOCAR and Frontera agreed that Frontera would resume LMO deliveries to SOCAR as from 1 January 2001 (the December Agreement).

January 2001 – March 2002

Frontera carried out LMO deliveries to SOCAR during the entirety of this period.

On 4 July 2001 Frontera and the Bank entered into a transfer agreement pursuant to which the Bank assumed Frontera's part of the PSA, i.e. the security under the agreement of 14 November 2000 was utilized.

During the first half of 2002 the Bank wound up its participation in the project by selling off its stake. On 21 April 2002 a "Deed of Release" was entered into between Frontera and the Bank. The agreement was a final settlement between Frontera and the Bank, who thereafter had no claims on each other, and consequently issued securities under the loan were released by the Bank. The Deed of Release granted the Bank the right to resolve the "LMO dispute" with SOCAR. The LMO dispute was related to the differences of opinion arisen earlier surrounding the oil deliveries to SOCAR. The parties disagree on the detailed meaning of the LMO dispute.

On 4 July 2002 the "July Agreement" was entered into between SOCAR, the Bank and a few other contractors, however Frontera did not participate. The

July Agreement settled the LMO dispute and the Bank's participation in the project was thereby ended in its entirety.

THE ARBITRATION PROCEEDINGS

Frontera requested arbitration against SOCAR in July of 2003. The arbitral tribunal comprised former Senior Judge of Appeal N, advokat H (appointed by Frontera) and advokat T (appointed by SOCAR). A final oral hearing was held in Stockholm on 7-10 March 2005. With respect to the time periods related above, the parties maintained, inter alia, as follows during the arbitration proceedings.

Frontera

November 1999 – March 2000 (claim A)

According to Frontera, SOCAR was liable to pay for LMO deliveries during this time. Therefore, Frontera claimed approximately USD 2.3 million, which was named claim A in the arbitration proceedings. Frontera further maintained that SOCAR's failure to pay had entailed that Frontera's obligation to deliver LMO oil under the PSA had ceased. According to Frontera, the February Agreement meant that SOCAR admitted that Frontera was not obliged to deliver LMO oil and that Frontera was allowed to freely export oil for an unlimited time.

November – December 2000 (claim B)

Frontera claimed compensation in the amount of almost USD 2 million for the value of the oil deliveries which SOCAR during this period unjustly acquisitioned from Frontera without payment. This was called claim B.

January 2001 – March 2002 (claim C)

For this period Frontera claimed compensation from SOCAR in the amount of approximately USD 11.5 million, called claim C. According to Frontera, the LMO deliveries during this period ought instead to have been sold at world market rates, since Frontera considered itself entitled to freely export oil also during this period.

SOCAR

SOCAR disputed claims A and B on the grounds that all rights between the parties with respect to the LMO dispute had been finally settled through the July Agreement. In addition, it was maintained that Frontera in any event had received payment for all outstanding claims attributable to the years 1999 and 2000 by Frontera being permitted to export at world market rates between April and November of 2000. In fact, SOCAR was not in delay making the payment for LMO deliveries in the beginning of 2000 and thus Frontera was not entitled to cease with the LMO deliveries. According to SOCAR, the February Agreement entailed merely that SOCAR temporarily waived LMO deliveries, and that SOCAR was entitled to set-off amounts against claim A. SOCAR disputed also claim C on the grounds that the December Agreement entailed that SOCAR was entitled to LMO deliveries during this period. Further, also claim C was covered by the July Agreement.

SOCAR also countersued and moved that the arbitrators should consider a counterclaim of approximately USD 11 million in the event that the July Agreement was considered invalid. The counterclaim related to the period in 2000 during which Frontera exported oil at world market rates.

Frontera’s counterarguments

Frontera objected that none of the claims were settled through the July Agreement. Amongst other things, it was maintained that Frontera’s claims had not been transferred to the Bank, that the Bank had not settled the LMO dispute in such a manner that any of Frontera’s rights against SOCAR had expired and that the LMO dispute in any event included only claim A. Further, it was maintained that both the December and the July Agreements were invalid because of coercion. SOCAR’s objection that also claim C was covered by the July Agreement was in Frontera’s opinion made too late. The counterclaim was disputed.

The arbitral award

On the merits, the arbitrators reached the following conclusions. SOCAR was not late in paying for the initial LMO deliveries in such a way that would entitle Frontera to cease the LMO deliveries at the beginning of the year 2000. The February Agreement consequently entailed that SOCAR voluntarily waived LMO deliveries as from 1 April 2000, and maintained the right to set-off against the previous, unpaid LMO deliveries. Thus, Frontera was permitted to export oil as from 1 April 2000, but SOCAR was concurrently entitled to deduct the difference between world market rates and LMO rates on its existing LMO debt. This applied, according to the arbitrators, until 1 January 2001 when the December Agreement on the resuming of LMO deliveries entered into force. According to the arbitrators, both the December and the July Agreements were binding, but the settlement in the July Agreement covered only claim A.

The conclusions with respect to the various claims in the case were finally the following. Frontera's claim A was rejected, because the Bank had by way of the July Agreement settled the dispute with binding effect for Frontera. Claim B was granted. That dispute was not deemed settled through the July Agreement. Under the February Agreement Frontera was entitled to export oil during this period. SOCAR's acquisitioning of the oil without payment did not comply with the agreement, and thus Frontera was entitled to compensation for the acquisitioned oil (with some deductions). Frontera's claim C was rejected, because the December Agreement meant that Frontera's right to export oil had expired on 1 January 2001. The counterclaim was presented only to cover the event that the July Agreement was not deemed binding. Since the July Agreement was deemed binding, the counterclaim was rejected.

Thus, out of Frontera's claims only claim B of approximately USD 1.2 million was granted. Frontera was ordered to compensate SOCAR for one third of the costs in the arbitration proceedings.

MOTIONS BEFORE THE COURT OF APPEAL

SOCAR has moved that the Court of Appeal shall annul the challenged arbitral award with respect to the part granting Frontera's claims (claim B, item 1 of the operative part of the arbitral award).

Frontera has disputed the motion.

The parties have claimed compensation for their respective litigation costs. Frontera has also moved on joint and several liability for litigation costs, see further below under heading Litigation costs.

Finally, Frontera has moved that the Court of Appeal shall reconsider its previous decision to not dismiss certain of SOCAR's documentary evidence, see further below under heading The investigation before the Court of Appeal.

SOCAR'S CASE BEFORE THE COURT OF APPEAL

The jurisdiction of the arbitrators

The arbitral award is not covered by a valid arbitration clause. As detailed below, all of Frontera's rights under the agreement referenced by Frontera were prior to the opening of the arbitration proceedings transferred to the Bank, which through the July Agreement irrevocably and finally settled all outstanding issues of dispute with respect to Frontera. Frontera did not reference any circumstance that would have the legal effect of nevertheless bringing those issues within the scope of an arbitration agreement applicable between Frontera and SOCAR. In the event that the Court of Appeal would find that the arbitral award was covered by a valid arbitration clause between the parties, SOCAR maintains on the same grounds that the arbitrators through granting Frontera's claim in any event exceeded their mandate. As a result, the arbitral award shall be annulled pursuant to items 1 and 2 of the first paragraph of Section 34 of the Swedish Arbitration Act (SFS 1999:116).

The dispute has been settled out of court

The arbitration clause originally applicable between Frontera and SOCAR provides that arbitration proceedings relating to a dispute may take place *only if* the parties have first sought to solve the dispute amicably, *and if* such amicable solution was not reached. The dispute that was resolved by ordering SOCAR to pay an amount to Frontera was settled amicably through the July Agreement. The arbitration clause does not cover such a dispute. Thus, the arbitral award is not covered by a valid arbitration clause.

The claim has not been subject to negotiations

In the event that the Court of Appeal would find that the dispute was not settled through the July Agreement, SOCAR maintains that it has not been subject to settlement negotiations as prescribed by the arbitration clause. Therefore, the arbitral award is not covered by a valid arbitration clause between the parties.

The claim is outside the scope of the contractual relationship

In the event that the Court of Appeal would find that the dispute was subject to settlement negotiations as prescribed by the arbitration clause and despite that is not covered by the settlement agreement, SOCAR maintains that Frontera's claim B falls entirely outside the scope of the contractual relationship between the parties and can as a result not be covered by a valid arbitration clause between the parties.

Frontera is not a party because of the transfer

Frontera has transferred the object of dispute to the Bank, and as a result is not able to be a party in the arbitration proceedings. SOCAR maintains, irrespective of the wording and contents of the arbitration clause, that Frontera by way of its transfer of all its rights to the Bank no longer is a party to any kind of contractual relationship with SOCAR. As a result, Frontera was not authorized to request arbitration and, consequently, the arbitrators did not have jurisdiction to resolve the dispute.

Procedural errors

In the event that the Court of Appeal would find that the arbitral award is covered by a valid arbitration clause between the parties and that the arbitrators did not exceed their mandate, SOCAR references as grounds for its case the procedural errors summarized below.

Just as SOCAR, Frontera referenced the circumstances surrounding the so-called LMO dispute as the dispute at the base of both claim A and B during the preparatory exchange of submissions in the arbitration proceedings, at the main hearing as well as when presenting its evidence. After the main hearing Frontera was permitted to change is position and base it on new grounds by maintaining that claim B fell outside the scope of the LMO dispute and as a result fell outside the scope of the settlement of the LMO dispute under the July Agreement.

SOCAR – which would have been in a position to disprove the new grounds by way of documentary and oral evidence if they had been referenced in due time – was not granted the opportunity to respond to or disprove Frontera's claim in its amended form.

Hereby, a procedural error occurred, which was not caused by SOCAR and that likely affected the outcome with respect to claim B. Thus, the arbitral award shall be annulled pursuant to item 6 of the first paragraph of Section 34 of the Swedish Arbitration Act.

Preclusion

None of the circumstances referenced by SOCAR as grounds for its challenge are precluded under the second paragraph of Section 34 of the Swedish Arbitration Act.

The arbitrators themselves review their own jurisdiction over circumstances referenced in the case. Already at the initial stages of the arbitration proceedings as well as on several occasions later, SOCAR referenced the circumstances which meant that the subsequently rendered arbitral award covering claim B was not covered by a valid arbitration clause between the parties and that the arbitrators had exceeded their jurisdiction. Amongst other

things, SOCAR already in its first submission in the arbitration proceedings stressed that claims A and B had been settled with binding effect and resolved after negotiations. SOCAR moved that this issue should be decided separately and explicitly maintained that Frontera had no right to request arbitration for these claims.

The procedural error referenced by SOCAR was not apparent prior to the rendering of the arbitral award. SOCAR could not imagine that the changes and additions made by Frontera after the evidence had been presented and the main hearing held would be considered in the manner as they were. Thus, it was only through the arbitral award that SOCAR was in a position to realize that the dealing with Frontera's changed position constituted a procedural error. Thereby, SOCAR cannot be deemed to, by partaking in the arbitration proceedings or in any other way, have waived to reference the circumstances constituting the procedural error.

FRONTERA'S CASE BEFORE THE COURT OF APPEAL

The jurisdiction of the arbitrators

Preclusion

In the main, Frontera maintains that all circumstances referenced by SOCAR in support of the arbitrators lacking jurisdiction to resolve the dispute are precluded under the second paragraph of Section 34 of the Swedish Arbitration Act. In the arbitration proceedings SOCAR presented no objections with respect to jurisdiction based on the circumstances now relied upon in these challenge proceedings.

The circumstances surrounding the transfer to the Bank and the subsequent settlement were referenced by SOCAR in the challenge proceedings only as an objection on the merits, not as an objection with respect to jurisdiction. During the arbitration proceedings SOCAR did not at all maintain that Frontera's claim B had not been the subject of settlement negotiations. Further, no objection with respect to jurisdiction was made on the grounds that claim B fell outside the scope of the contractual relationship between the

parties and was thus not covered by a valid arbitration clause between the parties.

Therefore SOCAR must be deemed to have waived to reference all of these circumstances by participating in the arbitration proceedings without objecting or taking similar action, and is consequently not entitled to reference them in this case.

In addition to the above, the following grounds are referenced in support of the arbitral award being covered by a valid arbitration clause between the parties and that the arbitrators have not exceeded their mandate (the headings for the grounds of the claimant are used also for the respondent's grounds).

The dispute has been settled out of court

1) The issue of whether the dispute had been settled amicably by way of the July Agreement is a decision on the merits, and cannot be subjected to the review of the Court of Appeal: (i) based on the doctrine of separability it is maintained that the arbitration clause in the PSA did not lose its effect because of the entry into of the July Agreement. To the contrary, the July Agreement provides that the arbitration clause in the PSA shall apply also to the July Agreement, (ii) in reference to the claims doctrine it is maintained that the dispute is covered by a valid arbitration clause already because of Frontera's claim that the dispute has not been amicably settled, and (iii) based on the wording of the arbitration clause in the PSA and in the July Agreement it is maintained that it covers all disputes arising between SOCAR and any of the contractors, including Frontera, without any limitations.

2) Frontera and SOCAR met on 20 May 2003 to try to settle the dispute. The dispute was not settled amicably between 20 May 2003 and 16 January 2006, when the arbitral award was given.

3) The dispute was not settled amicably by way of the July Agreement.

The claim has not been subject to negotiations

1) The issue of whether the parties have met to seek a solution acceptable to both parties is merely a procedural issue, and not a precondition for the right to request arbitration.

2) The dispute has been the subject of settlement negotiations. Frontera and SOCAR met on 20 May 2003 to try to settle the dispute. Then and there, SOCAR received notice of the dispute and it was not resolved within 30 days thereof. Frontera requested arbitration against SOCAR through a request for arbitration of 10 July 2003, which was received by SOCAR on 23 July 2003.

The claim falls outside the scope of the contractual relationship

1) The wording of the arbitration clause in the PSA and the July Agreement means that it covers all disputes arising between SOCAR and any of the contractors, including Frontera, without limitations.

2) The factual circumstances referenced by Frontera in support of claim B are directly connected to the PSA. Thus, Frontera's claim does not fall outside the scope of the contractual relationship between the parties.

3) The arbitrators held SOCAR liable to pay claim B based on an established breach of contract. Thus, Frontera's claim does not fall outside the scope of the contractual relationship between the parties.

Frontera is not a party because of the transfer

1) Referring to the doctrine of separability, it is maintained that the arbitration clause of the PSA does not lose its effect due to an alleged transfer of all rights (the subject of dispute) to the Bank. Further, Frontera's claims stem from the time when Frontera was a party to the PSA and such a dispute shall be resolved pursuant to the provisions of the arbitration clause of the PSA, even if it arises after Frontera has ceased to be a party to the PSA. This is supported by the provisions on arbitration in the PSA, which provide that the rights under that section shall survive the expiration or termination of the main agreement. Thus, the dispute involving Frontera's claim B is covered by a valid arbitration clause between the parties and the arbitrators have not exceeded their jurisdiction. The arbitrators' conclusion as to whether Frontera

had transferred the object of the dispute to the Bank is a decision on the merits, which is not subject for the Court of Appeal's review.

2) Referring to the claims doctrine, it is maintained that the dispute is covered by a valid arbitration clause between the parties already by Frontera's claim that the subject of dispute is owned by Frontera. The arbitrators' conclusion on this issue is a decision on the merits, which is not subject for the Court of Appeal's review.

3) The subject of dispute belongs to Frontera.

Procedural errors

In the main, Frontera maintains that SOCAR's grounds are precluded under the second paragraph of Section 34 of the Swedish Arbitration Act. Alternatively, Frontera maintains that no procedural errors occurred without being caused by SOCAR that likely affected the outcome.

On the merits

SOCAR's claims that Frontera following the main hearing was permitted to change its position based on new grounds by claiming that claim B fell outside the scope of the LMO dispute are not correct. The grounds of the arbitral tribunal with respect to claim B are set out in Section 5.2.4 of the arbitral award, under the heading "Do a substantial part of Frontera's claims fall outside the scope of the term LMO dispute?", where the arbitrators conclude that the Bank was not authorized to agree on claims B and C. Already in its submission of 12 October 2003 (Statement of Claim), Frontera dealt with the relevant issue and, amongst other things, noted that the Bank had not settled any of Frontera's claims and that a substantial part of Frontera's claims fall outside the scope of the LMO dispute. Further, already at this stage Frontera differentiated between oil delivered during the last quarter of 1999 and the first quarter of 2000 (claim A) and oil unjustly acquisitioned by SOCAR during the fall of 2000 (claim B). Thereafter, Frontera has, just as SOCAR, in the rest of the exchange of submissions and during the hearing categorized only deliveries during 1 September 1999 until

1 April 2000 as deliveries of, and payments for, local market oil during 1999 and 2000. Frontera did not during the arbitration proceedings attest that the term LMO dispute as defined in the Deed of Release included Frontera's claim B. Frontera did not change its position on any of these issues during the arbitration proceedings.

The exchange of submissions that took place following the hearing in the arbitration proceedings further provides that SOCAR – after SOCAR had received Frontera's submission of 16 May 2005 (post hearing submission) containing the allegedly new grounds – was granted the opportunity to submit its views on the issue. In a letter from the Chairman of the arbitral tribunal of 5 July 2005 the parties were specifically asked how they interpreted the term LMO dispute and if it covered only claim A or claim A as well as B. SOCAR provided its views thereon in a submission of 21 July 2005. Thus, SOCAR was not only granted the opportunity to present its views on the circumstances which SOCAR now claims were changed by Frontera at a late stage in the proceedings and which SOCAR was not granted opportunity to argue, but SOCAR actually did provide its views on the issue. Thus, no procedural error occurred.

Preclusion

During the arbitration proceedings it was clear to SOCAR that the arbitrators in their arbitral award would settle the issue dealt with under heading "Do a substantial part of Frontera's claim fall outside the scope of the term LMO dispute?" SOCAR did not at any point, whether in its submission of 21 July 2005 or elsewhere, object that the arbitrators did not grant SOCAR the opportunity to present its views on any wholly or partially new claim in Frontera's post hearing submission of 16 May 2005, or state that SOCAR would like to submit new evidence. This is despite the fact that the purpose of the letter of 5 July 2005 was stated to be, amongst other things, to ensure, pursuant to the principle of a fair trial, that the parties had the opportunity to clarify their positions on certain matters and to permit the counterparty to respond to new arguments. In addition, SOCAR has in an e-mail of 29 November 2005 expressed that SOCAR is anxious to receive the arbitral

award. Thus, SOCAR must be deemed to have waived the right to reference the circumstances now referenced by partaking in the arbitration proceedings without objection or otherwise.

THE PARTIES' FURTHER DETAILS ON OTHER ASPECTS

In addition to the grounds accounted above, the parties have before the Court of Appeal mainly provided details on the circumstances surrounding the arbitration proceedings and the contents of the written submissions referenced in the present case, and based thereon argued for their respective positions. The main aspects of the underlying events and the arbitration proceedings are set out above. In its grounds, the Court of Appeal will discuss in more detail aspects of the arbitration proceedings and the documentary evidence to the extent required.

THE INVESTION BEFORE THE COURT OF APPEAL ETC.

The parties have referenced exhaustive documentary evidence, mainly comprising the documents included in the arbitration proceedings. At the request of SOCAR, SOCAR's counsel in the arbitration proceedings Ms. D, has been heard as a witness. At Frontera's request, the Chairman of the arbitral tribunal, Mr. N has also been heard as a witness.

In a decision of the Court of Appeal of 17 February 2009, the Court of Appeal rejected Frontera's motion that certain documentary evidence, comprising some of the agreements relevant in the case (the July Agreement etc.), should be disallowed. At the main hearing Frontera moved that the Court of Appeal should reconsider the decision at a suitable time. The Court of Appeal does not find reason to deviate from the previous conclusion on the issue. Thus, the motion to disallow the evidence shall be rejected.

GROUNDS OF THE COURT OF APPEAL

The arbitrators' jurisdiction

Are the objections to the jurisdiction of the arbitrators precluded?

The provision on preclusion set out in the second paragraph of Section 34 of the Swedish Arbitration Act provides that a party is prevented from referencing a circumstance which it, by partaking in the arbitration proceedings without objection or otherwise, must be deemed to have refrained from referencing. Thus, a party who does not object to a procedural error during the arbitration proceedings loses its right to reference the error in subsequent challenge proceedings. Section 34 of the Swedish Arbitration Act does not provide a time within which a party must object in order to not lose the right to rely on it, so this must be determined having regard to all circumstances in the case. However, with respect to objections to the jurisdiction of the arbitrators, a party who partakes in the proceedings without immediately raising an objection on the jurisdiction is deemed to have accepted their jurisdiction to resolve the dispute. Thus, objections on jurisdiction must be made no later than in the Statement of Defense (see Government Bill 1998/99:35 p. 236, Heuman “Skiljemannarätt” p. 289 f. and Lindskog “Skiljeförfarande” p. 976 f.) Also Article 21.3 of the UNCITRAL rules provides that such objections shall be made no later than in the Statement of Defense.

In order for a party to maintain the right to challenge an unambiguous objection against how the case is dealt with is required (see, for example, Heuman p. 301). The objection raised must also be relevant to the grounds for the challenge. If a party has presented a claim which is not covered by the arbitration clause the counterparty must, in order to maintain the right to claim that the arbitrators lack jurisdiction, clarify this. It is not sufficient to dispute the claim on its merits (see Lindskog p. 972).

Already in its first submission in the arbitration proceedings, on 30 January 2004 (Statement of Defense), SOCAR objected that claims A and B had settled and resolved following negotiations by way of a binding agreement. However, this was made by disputing the merits, and not as an objection to the jurisdiction. There is nothing in the Statement of Defense that would indicate that SOCAR considered the arbitrators to lack jurisdiction to try Frontera’s claim B. The only possible objection on jurisdiction in the

Statement of Defense relates to claim C, against which SOCAR objected, amongst other things, that the claim had not been made by Frontera earlier and thus had been submitted for arbitration prematurely (SOCAR subsequently withdrew this objection).

Later, SOCAR has in an e-mail of 16 February 2004 and in a submission of 2 April 2004 moved that the issue of the meaning of the settlement shall be decided separately. Also this motion appears to have had as requested outcome a rejection on the merits. It is true that SOCAR has in its submission to the arbitrators of 2 April 2004 stated that "Frontera are not entitled to bring proceedings in respect of Claims A and B because both claims were resolved by the 4th July 2002 Protocol", which appears to be an objection on jurisdiction. Against the background of what SOCAR subsequently maintained during the arbitration proceedings it does not, however, appear likely that SOCAR by that statement actually meant that the arbitrators should not try the case on its merits. To the contrary, SOCAR has moved to have an arbitral award rejecting Frontera's motions, which was also achieved with respect to claims A and C. The determining factor is, in any event, that the objection set out in the submission of 2 April 2004 was made too late, since this was not SOCAR's first submission in the case.

Other than the above, SOCAR has only raised objections on jurisdiction with respect to claims made later in the arbitration proceedings and which are not relevant in these challenge proceedings (see Section 5.1.3 of the arbitral award).

Thus, the conclusion of the Court of Appeal is that SOCAR is not entitled to reference the circumstances now referenced in support of the arbitrators lacking jurisdiction to try claim B, since the circumstances are precluded under the second paragraph of Section 34 of the Swedish Arbitration Act. Therefore, there are no grounds to annul the arbitral award pursuant to items 1 or 2 of the first paragraph of Section 34 of the Swedish Arbitration Act.

The procedural error

Briefly on the parties' respective positions

SOCAR maintains that the procedural error is that the arbitrators, after the main hearing, allowed Frontera to alter its grounds and that SOCAR was not granted the appropriate opportunity to argue and disprove Frontera's altered grounds. Since this error became apparent only through the arbitral award, SOCAR has not been able to object earlier.

Frontera maintains that it has not altered its grounds and that SOCAR in that event ought to have objected during the arbitration proceedings to maintain its right to challenge. Instead, SOCAR clarified its position on the merits with respect to the relevant issue and thereafter requested that an arbitral award be rendered. SOCAR has been granted the opportunity to argue, and has done so.

More on the arbitration proceedings in this respect

As noted above, a main hearing including the taking of evidence was held in Stockholm on 7-10 March 2005.

Hereafter, the parties submitted one submission each of 16 May 2005 called "post hearing submission/brief", as agreed with the arbitral tribunal. In its post hearing submission, Frontera argued, amongst other things, that the LMO dispute only had involved claim A, the only LMO delivered by Frontera to SOCAR during 1999 and 2000.

In a letter of 5 July 2005 the Chairman of the arbitral tribunal noted, on behalf of the arbitral tribunal, inter alia, the following (here translated from English, as are the statement of the parties below):

[*TRANSLATOR'S NOTE: HERE TRANSLATED BACK INTO ENGLISH*]

> The arbitral tribunal notes that some claims and arguments made in the post hearing briefs submitted by the parties appears wholly or partially new. Against that background, the arbitral tribunal finds it appropriate and in accordance with the principle of fair trial to allow the parties to clarify their statements in some respects, to explain the reason why claims have been made late, to the extent not already explained, and to permit the counterparty to respond to new arguments.

Thereafter, six specific questions were posed, of which question five read:

> Item (L) of the Deed of Release and Indemnity of 21 April 2002 contains a reference to the "LMO dispute". How do the parties interpret this term? Does it include only claim A, or claim A as well as claim B?

For several of the other questions posed it was noted that the arguments to which the questions related appeared new, but this was not noted for the above question. Following the questions, the letter stated that the parties' responses and comments should strictly relate only to the above issues and that the arbitral tribunal would disregard comments on other issues.

Both parties submitted responses at the end of July of 2005 containing answers to the arbitral tribunal's questions. Frontera's response to question 5 was that the term LMO dispute in the Deed of Release only covered claim A and provided arguments thereon. SOCAR responded that "Deed of Release relates to, and deals with, the dispute between SOCAR and the contractor and Frontera's position with respect to that dispute. In this respect it deals with both claims A and B and possibly also (which is the position of SOCAR) also all grounds in favor of claim C".

Thereafter, in August of 2005, SOCAR submitted a couple of submissions on the costs of the arbitration proceedings. Finally, SOCAR stated in an e-mail of 30 November 2005 to the Chairman of the arbitral tribunal "I am being pressed by my clients as to when an arbitral award will be given in this matter. I hope that you do not object to my writing to you asking, but my clients insisted".

Is the claim on procedural error precluded?

The Court of Appeal's starting point for the determination whether the procedural error is precluded or not is that preclusion covers only errors that are known to the party and not errors that the party ought to have been aware of, since a party cannot be deemed to have refrained from objecting to an error that was unknown to him. Thus, a party cannot be considered obliged to object during the arbitration proceedings until it has become aware of the

circumstances constituting a procedural error (see, for example, Heuman p. 296 ff. and Lindskog p. 974 f. and therein provided references, which provide that also other opinions exist). This is in line with Article 30 of the UNCITRAL rules, which provides that a party *who knows* that the procedural rules have not been complied with, and continues to partake in the arbitration proceedings without immediately objecting thereto, loses its right to object.

With respect to the issue of burden of proof and the evidential requirement for when the challenging party became aware of the relevant circumstances jurisprudence provides different opinions. Here it should be noted that Heuman, referencing the difficulties in proving the issue, considers it reasonable to apply the "scale tipping" principle or to set a very low threshold for one party. Therefore, Heuman argues against a decision by Svea Court of Appeal in which preclusion was not considered at hand when the respondent in the challenge proceedings had not shown that the challenging party knew of the grounds giving cause for challenge referenced in the challenge proceedings (see Heuman p. 298). Lindskog, however, is of the opinion that it is for the respondent in the arbitration proceedings to establish that the challenging party had sufficient knowledge at such a stage of the arbitration proceedings that the claimant lost its right to challenge by not objecting (Lindskog p. 975).

In the present case, the arbitral tribunal did not make any specific procedural decision during the arbitration proceedings, which gave SOCAR cause to object. The question is instead whether it can be required that SOCAR should have objected that the arbitrators possibly would commit a procedural error by considering Frontera's arguments in the arbitral award, or worded differently, if SOCAR ought to have clarified to the arbitral tribunal that what it considered as new information should not be taken into consideration in the arbitral tribunal's upcoming award and that it, if the new information was to be taken into consideration, wished provide further arguments and evidence. There are grounds to hold this opinion, since a party realizing that the arbitral tribunal will render a specific incorrect procedural decision ought not be able

to “withhold its objections entirely” and still maintain its right to challenge (Heuman p. 294).

In the letter from the Chairman of the arbitral tribunal of 5 July 2005, the parties were specifically asked of their views on this issue. The letter did not state that the arguments on the relevant issue appeared new, something that was noted for several of the other questions. In these circumstances SOCAR ought to, through its counsel, have realized that the arbitral tribunal would take these arguments into consideration in its decision. However, that is not sufficient to establish preclusion, since the provision on preclusion – as noted above – is based on the fact that the party refrained from objecting and not on a principle of negligence.

With respect to the issue of what SOCAR’s counsel, Ms. D, realized at the relevant point in time, she herself maintained as follows in her witness statement. She was of the opinion that the post hearing brief should only include a summary of the parties’ cases. She assumed that Frontera’s new arguments would not be taken into consideration since they had been presented so late and also because Frontera did not have any evidence in support thereof. That the arguments were nevertheless taken into consideration and was considered of determining importance became apparent to her only through the arbitral award.

When evaluating the evidence on this issue, mainly Ms. D’s witness statement and the written submissions in the arbitration proceedings, the Court of Appeal finds that there is not sufficient evidence for the conclusion that Ms. D actually was aware of – or must have been aware of – the potential procedural error, even by applying the scale tipping principle. Thus, SOCAR did not have the knowledge required to trigger an obligation for SOCAR to object in order to maintain the right to challenge. Therefore, the Court of Appeal concludes that SOCAR cannot be deemed to have refrained from objecting on the grounds of procedural error. Thus, the right to challenge has not been precluded.

Did a procedural error occur?

Initially, the Court of Appeal notes that the alleged amendment of the case was presented by Frontera already in the submission of 16 May 2005, called post hearing submission. The following submission by Frontera of July, containing responses to the arbitral tribunal's questions, did not entail any change in this respect and is not of any particular importance for the decision on this issue.

In the Court of Appeal's opinion the most apparent conclusion is to view Frontera's statements on the LMO dispute in the post hearing submission as Frontera's clarification of its position to SOCAR's grounds for disputing the claims based on the settlement and that Frontera has argued thereon, rather than amending its case. This appears to be how the arbitral tribunal viewed the matter, which is clear from Mr. N's witness statement and the fact that he did not in his letter of 5 July 2005 note that the relevant issue was new.

Irrespective of how to classify Frontera's arguments in the submission, it can be noted that there are no provisions, whether in the Swedish Arbitration Act or in the UNCITRAL rules, that new circumstances or new evidence may not be presented after an oral hearing in arbitration proceedings. Instead, there are more general rules that a party may not alter its case in a manner deemed inappropriate by the arbitrators having regard to, for example, the timing of the alteration (Article 20 of the UNCITRAL rules and Section 23 of the Swedish Arbitration Act) and that evidence may be disallowed if it is justified having regard to the time at which it is referenced (Section 25 of the Swedish Arbitration Act). Under Article 29.1 of the UNCITRAL rules the arbitral tribunal may make a separate decision to close the proceedings ("declare the hearings closed"). As clarified by Mr. N's witness statement no such decision was made by the arbitral tribunal in these proceedings. Even if Ms. D understood the situation so that no new arguments should be presented in the submissions following the oral hearing it has not been established, or even argued, that there was a binding agreement between the parties or an order from the arbitral tribunal that new circumstances or evidence was not eligible to be referenced following the hearing. As noted by Frontera, a party is

entitled to move for the reopening of the proceedings under Article 29.2 of the UNCITRAL rules in cases where the hearings have been declared closed.

Against this background the arbitrators cannot be deemed to have committed a procedural error already by taking Frontera's arguments in the post hearing submission – or in the following submission, which repeated the same position on the relevant issue – into consideration, irrespective of the proper classification of these arguments.

Even if Frontera was not prohibited to present its arguments at the time it did, it should be noted that it did involve a clarification during the late stages of the arbitration proceedings. Both the Swedish Arbitration Act and the UNCITRAL rules provide that the general rules that a party should be granted to present its case appropriately and sufficiently are always applicable (Section 23 of the Swedish Arbitration Act, Article 15 of the UNCITRAL rules). This ought reasonably to include a requirement that SOCAR in the relevant situation should have been granted the opportunity to argue Frontera's claim that the LMO dispute covered only claim A and present its views on the matter. In this respect the Court of Appeal finds it clear that SOCAR has been granted the opportunity to argue against Frontera's claim, and has also done so. The question posed in the letter of 5 July 2005 from the Chairman of the arbitral tribunal did not set any restrictions with respect to the parties' response to the question. Thus, there has been no limitations as regards the opportunity to argue or reference evidence, if SOCAR deemed it necessary. SOCAR has further not objected to the question, but answered it and requested that an award should be rendered. As noted under the issue of preclusion above, SOCAR had no justified reason to assume that the arguments were irrelevant, particularly because the parties were asked a specific question on that particular issue. That SOCAR, as it turned out, misjudged the procedural situation cannot entail that a procedural error was committed.

Thus, no procedural error has occurred.

Summary of the Court of Appeal's conclusions

SOCAR's objections against the jurisdiction of the arbitrators are precluded. The circumstances referenced by SOCAR with respect to procedural errors are not precluded, but the Court of Appeal finds that no procedural error occurred. Therefore, the motions of the claimant shall be rejected.

Litigation costs

Upon this outcome, SOCAR shall be ordered to compensate Frontera for its litigation costs. SOCAR has left it to the Court to decide whether the amount is reasonable. The claimed amount, which is substantially lower than the amount claimed by SOCAR, is in the Court of Appeal's opinion reasonable.

Frontera has also moved that Mr. M and Ms. D shall be held jointly and severally liable with SOCAR to compensate Frontera's litigation costs pursuant to Sections 3, 6 and 7 of Chapter 18 of the Swedish Code of Judicial Procedure, since they as SOCAR's counsel have opened unnecessary proceedings and incurred costs for Frontera.

Ms. D has not appeared as counsel for SOCAR in the case before the Court of Appeal, and the motion shall, with respect to her, be rejected already on those grounds. The Court of Appeal does not find that the circumstances are such that there are grounds to hold any counsel jointly and severally liable, and so the motion is rejected also with respect to Mr. M.

The judgment of the Court of Appeal may not be appealed (second paragraph of Section 43 of the Swedish Arbitration Act).

[ILLEGIBLE SIGNATURES]

The decision has been made by: Senior Judge of Appeal KB, and Judges of Appeal IH and USG, reporting Judge of Appeal. Unanimous.