Tailor Your International Arbitration Agreements to Reduce Time, Control Costs, and Reach Desirable Outcomes

CHEAT SHEET

- *Conventional wisdom.* The New York Convention helps resolve private commercial disputes, whereas the Washington Convention facilitates trade and investment treaties, such as the North American Free Trade Agreement (NAFTA).
- *Keep in step.* Following a pre-arbitration tiered or stepped process saves time and reduces arbitration costs.
- *Global conventions.* To meet international demand, there are regional counterparts to the New York Convention, including the Panama Convention and the Arab Convention.
- *Location, location, location.* The legal place or "seat" of arbitration is critical in negotiations, because the arbitration laws of the legal seat will determine how the agreement will be enforced, and how it can be challenged.

By Kimberly Taylor and John W. Hinchey

The international business community has expressed frustration over the cost and time of arbitration proceedings. Arbitrators, the business community contends, are not sufficiently proactive in moving cases along because the longer the case drags on, the greater the arbitrators' fees. However, the alternative of litigating in foreign courts is not an attractive option. With no obvious recourse, there is more attention given to effective means and methods to reduce the time, cost, and uncertainty of international arbitration.

The costs of arbitration can vary. It can be more expensive than court litigation because the party needs to select and pay an arbitrator in a private proceeding. Hearing facilities do not come without significant fees. Court judges, their clerks, officers, and the courtrooms in which they reach a decision are publicly supported and therefore less expensive. But, the value of having a panel of experienced, expert decision-makers, with limited prehearing discovery, flexible procedures, and limited opportunity to challenge an arbitration award, can easily compensate for the added expense of a private proceeding and will often be less expensive than litigation. Still, the expense of international arbitration is the greatest concern of arbitral process users.

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The International Chamber of Commerce (ICC) Court of Arbitration issued their first report on *Techniques for Controlling Time and Costs in Arbitration* in August 2007.[1] The report presented statistics provided by the ICC Court of Arbitration, based on ICC cases that went to a final award in 2003 and 2004. Interestingly, the earlier edition of the report indicated that the lion's share of arbitration costs involved the preparation and presentation of the case, specifically noting that on average, the costs of arbitration broke down as follows:

- Costs incurred by the parties to prepare and present their case: 82 percent.
- Arbitrators' fees and expenses: 16 percent.
- Administrative fees and expenses: Two percent.

These earlier findings show that not much has changed. The costs of pre-hearing document disclosure and discovery still generally consume the majority of arbitration expense, as also indicated by more recent surveys and reports.

Corporate counsel have an opportunity when entering into contracts to control arbitration costs, reduce delay, and promote efficiency, but they only have that opportunity once, and it is often difficult to negotiate these provisions. That leverage is also dramatically reduced once the contracts are in place. International arbitrations, in particular, are more sensitive to the arbitration agreements than US-based arbitration. International arbitrators and arbitral institutions are exceptionally keen to "follow the agreement," because if they don't, any award is subject to challenge under one or more of the applicable international conventions, treaties, or local laws where the arbitration agreement or contract will be enforced.

There is a distinction between the arbitration agreement and the underlying business contract, of which the arbitration agreement is typically only a part. This is because the arbitration agreement, which typically obligates the parties to resolve disputes arising out of the business contract by arbitration, is considered a separate or "severable" standalone agreement, for purposes of conferring jurisdiction and authority upon the arbitrators. In other words, legally, the agreement to arbitrate is considered as a separate or independent agreement from the commercial contract, and in some cases the parties will actually have a separate arbitration agreement that is entered into after the dispute arises. But, in the vast majority of instances, the agreement to arbitrate (referred to in legal literature as the "arbitration agreement") is included as part and parcel of the commercial transaction.

International arbitration takes place within a legal framework of international conventions and local laws, whether case law or legislation, or a combination. The starting point for any discussion of international commercial arbitration is the Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958 (New York Convention). More than 140 countries have acceded to the New York Convention, making it one of the most widely adopted and most successful pieces of international legislation in history. The New York Convention is primarily directed at two points in the process of resolving disputes by arbitration: the beginning (i.e., recognition of the agreement to arbitrate) and the end (i.e., enforcement of the resulting arbitration award).

There are two practical reasons why arbitration awards that are enforceable under the New York Convention are preferred to court judgments. First, because more countries are parties to the New York Convention, as contrasted with treaties recognizing the validity of foreign judgments, enforcement of international arbitration awards is generally easier and more reliable than enforcement of a foreign court award. This is because an enforcement of an international arbitration award is mandatory in countries that are parties to the New York Convention. Without a treaty between the country rendering the

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judgment and the country in which enforcement is sought, by contrast, enforcement of a foreign court award depends upon local country considerations of comity. Second, very few commercial parties are willing to subject themselves to the vagaries of litigation in foreign courts. In many international transactions, this second consideration is especially significant because the parties to a contract may have little or no connection to the place where the contract is to be performed or where its effects may be felt.

The second category of international agreements relevant to international arbitration is investment-related conventions and treaties, most notably the "Convention on the Settlement of Investment Disputes between States and Nationals of Other States of 1965" (the Washington Convention). As its name implies, the Washington Convention is concerned with investment disputes arising between states and nationals of other states. Similarly, bilateral investment treaties (BITs) and multilateral investment treaties, such as the North American Free Trade Agreement, provide an avenue for commercial parties to resolve investment disputes against foreign governments. Whereas the New York Convention is designed to facilitate the resolution of all manner of private commercial disputes, the investment treaties are primarily designed to facilitate trade and investment between or among the signatories, including instrumentalities of the state parties.

Although the New York Convention is one of the most important pieces of international legislation establishing a framework for the practice of international arbitration, there are various regional conventions and treaties that may also be relevant in a given dispute. Thus, for example, there are regional counterparts, including the Panama Convention and the Arab Convention, which may include signatories that have not acceded to the New York Convention or create rights and obligations not otherwise present. However, the regional treaties consistently recognize the same types of exceptions for both recognition of agreements to arbitrate and enforcement of arbitration awards as those found in the New York Convention.

The arbitration agreement, which may be only a part of the underlying business contract, is the starting point for determining the authority or lack thereof that the arbitrators will have over the arbitration process. If there is an arbitration agreement in a commercial contract, it may likely be basic and bare-bones, as are those typically recommended as the standard by various arbitral institutions and ADR organizations, or they can be comprehensive and elaborate — designed to deal with the probable and possible issues that can arise in a commercial context. The key objective is to try to tailor the dispute resolution process to deal with the potential problems that are likely to arise between or among the parties on that particular transaction, and with a view to avoiding or resolving issues fairly, efficiently, and economically. Parties have maximum flexibility in drafting arbitration agreements, but there are a few provisions that can have the greatest effect on the outcome of a dispute and how arbitrators will manage and administer an arbitration proceeding.

Unilateral option to arbitrate

The greatest uncertainty in drafting arbitration clauses is that one cannot know, until the dispute develops, whether certain tactical or strategic benefits may accrue from submitting the dispute to a court or to an experienced arbitral panel. While most arbitration agreements provide that both or all parties to the agreement

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have the right to arbitrate disputes, it is not unheard of for a party with front-end transactional leverage to insist on a unilateral right to elect whether to arbitrate or litigate disputes. While there seems to be a trend toward enforcing such provisions, despite defenses of lack of mutuality, the absence of consideration or unconscionability, the legal authorities in the United States indicate no clear majority rule or consensus among the state and federal courts regarding this issue. If the law applicable to the substance of the contract, or the place or seat of the arbitration is that of another country, the laws that may be applicable to both the substance of the contract and to the arbitration process should be carefully examined before relying on an asymmetrical clause affording one, but not another, party the right to arbitrate a dispute. For example, recent decisions by the highest courts in both France and Russia have held that contractual provisions under which one party has the unilateral right to select the procedure for resolution of disputes are invalid.

Pre-arbitration tiered or stepped processes

It is now common in arbitration agreements to find tiered or stepped dispute resolution clauses, particularly in long-term commercial relationships. The chief reasons for stepped provisions are to save time and cost by resolving the dispute at the earliest stage possible. The various tiers or steps of dispute resolution often found in commercial contracts include:

- Required submission of notice of the claim or dispute to a designated professional, for example, in the construction context, an engineer, quantity surveyor, or other official or agent acting on behalf of the responding party, to make an interim decision, pending further proceedings
- Required negotiations concerning the claim or dispute, usually between senior executives having no direct involvement with the circumstances giving rise to the dispute; and/or,
- Submission of the dispute to mediation or conciliation, but, failing voluntary or ultimate resolution by the parties to the dispute; and
- Submission of the dispute to final, binding arbitration.

While arbitration is generally regarded as the preferred method for resolving major disputes in international contracts, even at its best arbitration is costly and time-consuming. For this reason, arbitration should be thought of as a last resort, when all else fails. And, if the parties do choose to attempt to resolve a dispute by mediation or mandatory negotiation prior to resorting to arbitration, the procedure can be specified in the arbitration agreement. Having an appropriate, pre-arbitration ADR clause may often result in the resolution of the dispute by a relatively cheap and cost-effective procedure without the necessity of resorting to arbitration.

Scope of issues to be arbitrated — Perhaps the most important clause of an arbitration agreement, certainly the clause that has received the most attention, is the "scope" clause. This is the clause that defines and describes the types of differences, issues, and disputes that the parties agree shall be subject to arbitration. For example, some fairly common limited "scope" clauses in arbitration agreements have to do with the amount in controversy. The parties may be comfortable with arbitration only when lesser amounts are at stake, and will agree to arbitrate claims for amounts under the monetary ceiling, but they may reserve for litigation claims and disputes involving amounts in excess of the ceiling. Similarly, the parties may want to restrict the types or amounts of damages that can be awarded. Another option is preserving issuance of injunctive relief to the judiciary, while agreeing that the arbitrators shall have authority to grant all monetary relief.

Selection of tribunal

One of the most important provisions in an arbitration agreement is specifying how the arbitrators shall be selected, including the number of arbitrators, the appointing authority, and the qualifications of the tribunal. If the arbitration agreement fails to make provision for selection of the tribunal, the selection process will be administered under the applicable arbitration rules, if any, designated by the parties, and the decisions respecting the number and qualifications of the arbitrators will then be made by the designated arbitral institution or appointing authority. In virtually all cases, the parties to the contract have the highest and best appreciation of who their ultimate judges should be, and it is almost advisable to consider and specify those requirements in the arbitration agreement.

Choice of institutional or non-institutional arbitration

The various considerations for determining whether an international arbitration should be administered by an established arbitral organization or whether the parties themselves

should administer the arbitration ad hoc are discussed widely in arbitration literature. While some parties prefer non-institutional or ad hoc arbitration, surveys indicate that most corporate business users elect to have institutionally administered arbitration. However, if the decision of the parties is that the arbitration shall be administered by an arbitral organization, the various arbitral organizations and institutions have recommended, but not necessarily required, that clauses be used to specify administration of the arbitration by that particular institution along with that institution's arbitration rules.

The significance of the legal "seat" or "place" of an international arbitration is critical, because the arbitration laws of the legal seat will determine the extent to which, on the front end, the arbitration agreement will be recognized and enforced and, on the back end, the grounds on which an award can be challenged.

Legal place or "seat" and location of arbitration

The significance of the legal "seat" or "place" of an international arbitration is critical, because the arbitration laws of the legal seat will determine the extent to which, on the front end, the arbitration agreement will be recognized and enforced and, on the back end, the grounds on which an award can be challenged. Recent surveys indicate that the preferred countries as seats of international commercial arbitrations (not necessarily in order of preference) are: London, Paris, New York, Geneva, Hong Kong, and Singapore. The key factors in choosing a seat of arbitration are said to be whether the local jurisdiction has "arbitration friendly" laws and courts; arbitration laws that are similar to or consistent with the New York Convention; proximity to the parties or where the transaction took place; convenience to the parties, witnesses and counsel; and various other non-legal factors such as accessibility to international airports and good hotels and restaurants.

However, it may be more convenient for the parties, counsel, and tribunal to conduct the actual hearings or deliberations in locations other than the designated seat of the arbitration. To accommodate these differing needs, it is perfectly acceptable to provide one location or place as the legal seat of the arbitration, while a portion or all of the hearings, meetings, and even deliberations are conducted in different locations.

Time limits

Some drafters, with understandable motives to curtail the time and cost of arbitration proceedings, will attempt to place time limits on the time or duration of the overall process or the dates and time for hearings. But, unless the nature and scope of the dispute can be predicted with accuracy, the attempt to limit, by advance agreement, the duration and times of the process can cause more problems than benefits. One reason that "careful thought" should be given to placing absolute time limits on the length of arbitral hearings or the time for rendering awards is that, if the award is not issued within the time specified, a court may determine that the award is not valid and should be set aside or vacated. The International Bar Association has suggested a "middle ground" type clause, with certain time limits on prehearing procedures but with a "best efforts" requirement on the rendering of a final award. For example, the clause may provide that the award shall be rendered within

specified days of the appointment of the arbitrators, unless the arbitral tribunal determines, in a reasoned decision, that the interest of justice or the complexity of the case requires that such limit should be extended.

Confidentiality and privacy

One of the selling points of arbitration is that it is private and that the proceedings are not accessible by persons not involved in the transaction or dispute. While this notion is generally true and reflected in the rules of most arbitral institutions, it is not necessarily the case that the record of the proceedings, including the testimony and evidence offered in the arbitration, will be confidential unless expressly agreed to be so by the parties and required by the tribunal.

When commercial contracts are negotiated and drafted, the provisions for dispute resolution do not normally attract great attention. It has been said that the dispute provisions in most contracts are "midnight clauses" because they are drafted, almost as an afterthought, during the last hours of negotiation. Others have noted that "arbitration is a procedure that has too few lawyers in the beginning (when the clause is drafted) and too many at the end (when an arbitration is actually underway)." This is unfortunate because careful drafting of an arbitration agreement can avoid business catastrophes and save days and months, if not years, and thousands, if not millions, of dollars, especially when a serious dispute arises.

With these realities in mind, corporate counsel have the first and best opportunity to control the destinies of their clients at the time of drafting the arbitration agreements — before disputes have arisen, when business relations are at their best, and when everyone is cooperating to "get the deal done." **ACC**

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1 *https://iccwbo.org/publication/icc-arbitration-commission-report-on-techniques-for-controlling-time-and-costs-in-arbitration.*