

June 29, 2007

Expanding Business Opportunities through International Arbitration

David A. Baron

Partner, McDermott, Will & Emery LLP

Adjunct Professor of International Law, American University

As competition for investment is increasing throughout the world, economies seeking investment – both foreign and domestic – are realizing that business transactions follow stability. One of the best ways to ensure stability is to assure investors that when they enter a new market, they will be able to retain control of their profits and personnel, enforce contracts, and engage in productive activities – and that they will not be trapped by inefficient regulations. If an investor thinks his/her property is going to be expropriated, suspects the rules of the game will change arbitrarily, or feels the system is unstable, then most often that investor will decide that it is not worthwhile to do business in that market.

International arbitration is one way to bridge the gap between investors or foreign companies and domestic entities by providing a neutral and independent mechanism for resolving disputes when they arise. International arbitration is part of the rule of law and it brings the stability that is so essential to foreign investment; it is particularly relevant to investment in emerging markets with weak or unstable institutions. While international arbitration plays a role in reducing uncertainty in business dealings, governments can also contribute by improving the legal and regulatory climates in their individual countries.

To comment on this article, visit CIPE's Development Blog: www.cipe.org/blog.



published by the

Center for International Private Enterprise

an affiliate of the U.S. Chamber of Commerce

1155 Fifteenth Street NW · Suite 700 · Washington, DC 20005 · USA

ph: (202) 721-9200 · web: www.cipe.org · e-mail: cipe@cipe.org

Introduction

As competition for investment is increasing throughout the world, economies seeking investment, both foreign and domestic, are realizing that business transactions follow stability. One of the best ways to ensure stability is to assure investors that when they enter a new market, they will be able to retain control of their profits and personnel, enforce contracts, and engage in productive activities – and will not be trapped by inefficient regulations. If an investor thinks his/her property is going to be expropriated, suspects the rules of the game will change arbitrarily, or feels the system is unstable, then most often that investor will decide that it is not worthwhile to do business in that market.

International arbitration is one way to bridge the gap between investors or foreign companies and domestic entities by providing a neutral and independent mechanism for resolving disputes when they arise. International arbitration is part of the rule of law and is a mechanism for implementing the rule of law in places where it might not otherwise exist or be fully employed to solve problems. It brings the stability that is so essential to foreign investment, and is particularly relevant to investment in emerging markets with weak or unstable institutions because arbitration establishes a working system for resolving disputes.

What is international arbitration?

In its most basic form, international arbitration is a private, non-judicial dispute resolution process by which parties from different states present a dispute to neutral arbitrators. The end goal is to arrive quickly and painlessly at a resolution that is final and binding. That generally means that there are no appeals. The lack of available appellate review can be seen as either an advantage or disadvantage, but the reality is that successful appeals are very rare in international arbitration.

Arbitration proceedings result from written arbitration agreements, which are developed with the mutual consent of the parties involved. Such agreements say, “If we have a problem we’re going to

fix it in a way that is established in this document, in compliance with certain rules and procedures.” Without this written consent, it is not possible to enforce arbitration. The consent must be in writing to fall within the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, also known as the New York Convention. The most attractive feature of the New York Convention is that an arbitration ruling can be enforced judicially in any country that is a party to the New York Convention.

Arbitration is not possible without the prior consent of all parties involved. As a result, arbitration agreements often have an interesting effect on parties bound by them once the parties realize that a dispute has arisen. When one party knows it has acted wrongfully, it often does not want to go to arbitration – because it knows the rules and knows it is likely going to lose. Likewise, when two parties have a disagreement without having previously consented to arbitral dispute resolution, it is more difficult to reach a consensus on how to reach a solution.

To the extent that the dispute involves a commercial entity and a government or state-owned entity, the necessary consent between the parties can happen without ‘privity of contract.’ Many countries have signed bilateral investment treaties or other agreements in which the country has expressed general consent to submit disputes concerning international investments to binding international arbitration. Where such international agreements are applicable, affected commercial entities can attempt to obtain similar relief through arbitration and enforce any resulting judgment through the Convention on the Settlement of Investment Disputes between States and Nationals of Other States, also known as the ICSID Convention.

Arbitration is merely one way to resolve disputes. Other methods include negotiation, mediation, litigation, and, unfortunately, violence. Violence is one extension of problem-solving; cases are frequently brought before the International Court of Justice in which opposing parties have been shooting at one another before they finally agree to arbitration. If a dispute can be reduced to an arbitration clause or an

arbitration agreement, it can be resolved in a much more straightforward manner in accordance with the rule of law.

Negotiation is a valuable alternative. Arbitration is an adversarial process – there are two sides, and the two sides disagree. In the international commercial context, the two sides may not interact in a violent manner, but they are exchanging rhetorical barbs. So, if it is possible to resolve a dispute through negotiation before moving to arbitration or litigation, so much the better.

For example, an American company may have a dispute with partners in Mexico. Although the two parties signed contracts, agreements, and a payment schedule, each time payments are due, the Mexican counterparts want to re-negotiate the contract. Rather than jumping into arbitration, this case should first be examined in a cultural context. It may come to light that the Mexican parties view each payment as a new negotiating opportunity. Had the American company been more aware of these circumstances going into the agreement, these externalities could have been built into the payment structure. In this case, arbitration would put the two parties through unnecessary conflict.

Likewise, when two parties can agree to take a case to a neutral third party for mediation, a resolution can be reached without the cost formal arbitration entails. This is particularly the case when both parties want to retain a relationship and work towards a long-term deal. Even if the parties are in an advanced stage of disagreement and do not ever want to work together again, they may be able to at least agree on a common goal.

Litigation differs from arbitration in that it uses domestic court systems, where one party is usually sitting in their home territory – creating numerous difficulties (both perceived and real) for the foreign participant in terms of navigating local waters and having equal access to the legal system. More importantly, litigation is a more formal process than arbitration, which, as a manifestation of the consent of the parties, is less strict, more flexible, and frequently better equipped to meet the parties' needs to resolve the dispute.

There are several types of arbitration. One is *ad hoc arbitration*, in which two parties agree in writing to address any future problems by arbitration. *Ad hoc* arbitration means that parties will either create their own mechanisms for resolving the dispute, or adapt mechanisms from other sources.

The second type is *institutional arbitration*, in which parties approach an established international arbitration body and invoke its services in order to resolve a dispute. The three major international arbitration institutions are the International Court of Arbitration of the International Chamber of Commerce (ICC), the London Court of International Arbitration, and the American Arbitration Association's International Center for Dispute Resolution. These institutions have mechanisms and rules that are already in place. The rules establish many important procedures, such as how the arbitrators are appointed, how they are compensated, the time frame for the arbitration proceedings, and how the proceedings are to be conducted.

There are some advantages to working outside the boundaries of an established system and framework. One advantage is that *ad hoc* arbitration can be less expensive. To use the ICC, parties have to pay the Chamber an amount of money based on the amount at issue in the dispute. The bigger the dispute, the higher the cost of arbitration. In addition to having to pay the fees of the arbitrators, costs cover the fees of the administrative staff and the overhead that goes into developing these mechanisms. On the other hand, working outside of the established system has its costs, too. For example, if parties decide to develop their own rules and pick their own arbitrators, it may be very difficult to reach agreement about who should resolve the dispute and how the arbitration will be conducted.

By far, institutional arbitration is preferred by multinational companies and corporations and entities that do business abroad. According to a recent study by PriceWaterhouseCoopers, 76 percent of the respondent multinational companies prefer to do international arbitration through one of the major institutions, and 95 percent will continue to use institutional arbitration. Several factors reveal the cause of this overwhelming

preference: in some instances multinational companies prefer institutional arbitration because of the prestige; in others, they prefer it because of the certainty of the process. In addition, they may prefer institutional arbitration because it is neutral and not affiliated with either party.

were fair and that there were no significant violations of due process. The domestic court is more likely to agree that the award was rendered by arbitrators who were not corrupt, and who gave the case their careful consideration such that the court can enforce the award with confidence.

Advantages and Disadvantages of International Arbitration

Advantages

- Separation of a dispute from a party's legal system
- Impartiality of tribunal
- Speed – can avoid delays of national court systems
- Specialized expertise of arbitrators
- Flexibility/informality of procedures
- Control of rules by prior consent of the parties
- Enforcement of awards is often easier than that of domestic court judgments
- Confidentiality of proceedings
- Flexibility within linguistic/cultural differences
- Finality – generally no appeal
- Case-by-case resolution of a dispute
- Often less expensive than litigation

Disadvantages

- Generally no appeal
- Compromise is more likely than “all or nothing”
- Confidentiality is not absolute and is difficult to enforce
- Arbitral tribunals have limited powers
- Can be as expensive and slow as litigation
- Difficult to obtain party consent in multi-party disputes
- Arbitrators may be field experts and not legal experts
- Lack of precedent sometimes leads to lack of uniformity of decisions
- Case-by-case resolution may focus more on the facts of the case than applicable law
- Interim relief and discovery may be limited

International institutions also play an important role in facilitating enforcement of an arbitral award. When parties take a decision from an established institution to a domestic court and request enforcement, judges understand that the procedures

In cases where a company is involved with or in a country that is not a signatory to the New York Convention, it should take certain measures to protect its interests. It should ensure that the international dispute resolution clause provides for international arbitration outside of the given country, and that should arbitration occur, that it will happen in a country that has signed the New York Convention. Depending on whether the money is located in a country that is also a signatory to the New York Convention, an award may or may not be useful when it comes to actual enforcement. If the assets are hidden, investors should be aware that it will be difficult to enforce the arbitration decision and should build their risk projections and profit margins accordingly.

While 137 countries have already signed the New York Convention, that number does not include every country in which one may conduct business. In countries that are not yet signatories to the New York Convention there is an opportunity for the international business community to approach legislatures and government leaders in those countries about joining the New York Convention, thus creating opportunities for more secure investments in the future.

How does the process work?

First, there is a dispute. Two parties disagree; one wants to do something and the other wants to do something else. Before approaching an international arbitration institution, the parties need to establish what the original agreement was and how each party perceives that agreement to have been broken (or not). An arbitration clause guides the two parties into the next stages of arbitration; needless to say, without the clause there may be as many arguments over how to arbitrate as over the dispute itself. As the parties approach an arbitration institution, each will submit

a written statement of testimony, in which legal and factual arguments are presented. After the statements have been submitted, the institution holds a hearing and decides whether to take the case. If the case is taken, the next stages are enacted by the arbitrators.

In international arbitration, arbitrators are not bound to follow any particular precedent or governing law. Depending on the background of the arbitrators themselves, a decision may stem more from a civil law tradition or a common law tradition. Arbitrators need not necessarily be lawyers, and may instead be experts in a particular field. Parties may choose to submit a request for arbitration *ex aequo et bono* – according to what is right and good, in which case the arbitrators would come to a decision purely based on equity.

The discovery stage of the arbitration process is generally less complicated than that of litigation as what is needed is usually limited to what is relevant and specifically identifiable. Arbitrators may request additional discovery (or stop discovery) because depositions are generally not permitted. If it becomes apparent that one side is not producing documents that are known to exist, arbitrators will likely choose to include an adverse inference that one side was uncooperative. While this method cannot put anyone in jail or fine the parties for contempt of court, it has grown into a mechanism to internally ‘police’ the arbitration process. At the same time, The International Bar Association has recently come out with rules for permitting limited international discovery in international arbitrations. While the rules are relatively new, they seem to be working and are growing in their use and popularity.

Another unique and appealing element of arbitration is that the decisions, or at least the proceedings, are usually confidential. Most of the time parties do not want the public to know that there is a dispute, and in fact the parties may plan for confidentiality in the arbitration clause itself. That said, with the Internet in particular, more and more decisions are being published all the time.

The final stage of arbitration is enforcement. Enforcement occurs through a number of mechanisms, and may be worked into an arbitration agreement in

the first place, or decided upon by the arbitrators. The New York Convention on the Enforcement of Arbitral Awards of 1958 attempts to guarantee that the results of arbitrations will be accepted. Yet even in the best possible scenario where the institutions, arbitrators, and processes are seen as fair, the award may be seen as unfavorable by one or even both parties and may be challenged in domestic courts. Under the New York Convention, however, the grounds for challenging an arbitral award are very limited.

Arbitration Clauses from the Main International Institutions

Each of the institutional arbitration mechanisms discussed previously – the ICC, the London Court of International Arbitration, and the American Arbitration Association – have all promulgated model arbitration clauses. Essentially, they have told the international community that they are in the business of fixing problems. This does not, however, mean that anyone should just blindly take an arbitration clause from a website or a different agreement and insert it into a new contract. Simply because a clause invokes the ICC does not mean that it is the best dispute resolution clause for the particular needs of either party signing a contract.

Just as there is variety in dispute resolution clauses, there are differences between international arbitration institutions; again, it depends on the needs of both parties signing a contract as to which institution they might choose. The difference is most readily seen in who the arbitrators actually are. Parties using the ICC, for example, will likely work with an arbitrator of some international renown. Their services cost more, but they generally have significant experience that may be relevant to resolving a large international commercial dispute. Parties using a Latin American dispute resolution center, for example, would likely be working with a Latin American arbitrator, and the arbitration would most likely be conducted in Spanish. Regional dispute resolution centers may cost less than those of a large international institution, and the administrative personnel working with the parties and are more likely to come from a Latin American cultural background. The point is that these international institutions exist

to address cultural and linguistic differences that occur between parties, so everyone is international in scope and experience.

Examining sample or model arbitration clauses of each of the different institutions shows how different they are and how each can present different opportunities and different problems, depending on the language used to write an arbitration clause. One clause or institution is not better than another in every case, but it is essential to choose what is most appropriate under the circumstances in each situation when drafting a dispute resolution clause.

American Arbitration Association (AAA)

1. Any controversy or claim arising out of or relating to this contract shall be determined by arbitration in accordance with the International Arbitration Rules of the International Centre for Dispute Resolution.
2. Any dispute, controversy, or claim arising out of or relating to this contract or the breach thereof, shall be finally settled by arbitration administered by the Commercial Arbitration and Mediation Center for the Americas (CAMCA) in accordance with its rules, and judgment on the award rendered by the arbitrator(s) may be entered in any court having jurisdiction thereof.
3. Any dispute, controversy, or claim arising from or relating to this contract, or the breach, termination, or invalidity thereof, shall be settled by arbitration in accordance with the Rules of procedure of the Inter-American Commercial Arbitration Commission in effect on the date of this agreement.
4. Any dispute, controversy, or claim arising out of or relating to this contract, or the breach, termination, or invalidity thereof, shall be settled by arbitration under the United Nations Commission on International Trade Law (UNCITRAL) Arbitration Rules in effect on the date of this contract. The appointing authority shall be the International Centre for Dispute Resolution. The case shall be administered by the International Centre for Dispute Resolution under its Procedures for Cases under the UNCITRAL Arbitration Rules.

The first provision from the AAA is fairly simple, while the second attempts to be more expansive. The first provision limits arbitration to the AAA, and the second gives the opportunity for non-American arbitration. There is a slight difference in language – using the same rules, but going to different institutions for arbitration, using a regional dispute resolution body as opposed to an American one. In cases where parties feel that an American institution would be biased towards an American party, invoking non-American institutions such as CAMCA may be more appropriate. In fact, one goal of international arbitration is to reduce the bias that exists or is perceived to exist in domestic situations.

In the third example from the AAA, the difference is more obvious, and allows for the “breach, termination, or invalidity” of a contract. It provides for unforeseen circumstances at the time of the dispute, and refers disputes to yet another institution, the Inter-American Commercial Arbitration Association (whose arbitrations are administered by the AAA). This clause addresses a situation where the Rules of Procedure may have changed over time, and invokes those rules as they stand at the time of the dispute rather than at the time of contractual agreement.

The fourth model is similar to the third but invokes the UNCITRAL Arbitration Rules. Established in 1976, these rules are in many ways the precursor of what has become the vibrant international arbitration that we see today. UNCITRAL rules are put forth by the United Nations for public use. These rules are often appropriate for *ad hoc* situations and are also often used in institutional arbitrations as well.

International Court of Arbitration of the International Chamber of Commerce (ICC)

All disputes arising out of or in connection with the present contract shall be finally settled under the Rules of Arbitration of the International Chamber of Commerce by one of more arbitrators appointed in accordance with the said rules.

This clause gets to the point: the parties will go to the ICC for international arbitration. Everyone knows (or can learn) what the rules are, and all the details will

be worked out by the ICC. It is clear in its simplicity about how problems will be solved, but it does not allow the parties much influence over decisions to be taken in the arbitration process. Parties using this kind of a clause would most likely amend it to better address specific needs.

London Court of International Arbitration (LCIA)

- Any dispute arising out of or in connection with this contract, including any question regarding its existence, validity, or termination, shall be referred to and finally resolved by arbitration under the LCIA Rules, which Rules are deemed to be incorporated by reference into this clause.
- The number of arbitrators shall be [one/three].
- The seat, or legal place, of arbitration shall be [city and/or country],
- The language to be used in the arbitral proceedings shall be [].
- The governing law of the contract shall be the substantive law of [].

This clause addresses situations where the very agreement to arbitrate – arbitrability – is in question. The phrase ‘and finally resolved’ is designed to ensure that there is no appeal process once an award has been issued. The intent of arbitration is exactly that a decision will be final, but problems often arise when one party feels that an unfavorable or improper decision has been made.

The other elements of the clause are examples of the types of things that must be considered when drafting an arbitration clause, and which in this model are presented right up front. This is not to say that this model could not be further negotiated or changed to more specifically address the needs of the parties drafting a dispute resolution clause however.

Other important factors to consider include selecting the applicable law, discovery, limitations on costs, and anything else the parties might be able to agree on. Deciding which law of which country will apply substantively and procedurally will provide the parameters for the arbitration and the issuance of the award is especially significant – by nature these are international agreements. The parties may even choose

a jurisdiction in a third country. Discovery is one of the things that make the process of domestic litigation so expensive and burdensome – parties rarely agree on what documents need to be produced. In arbitration, discovery is not generally used to the same extent, and can be limited by the parties in the dispute resolution clause. As arbitration results from the consent of the parties, it will inevitably reflect whatever the parties included or left out of the agreement. Likewise, parties can put limitations on the cost of arbitration, by limiting either the amount to be paid to the arbitrators or the amount of time in which the arbitration must be resolved.

Each of the above model or example clauses from the AAA, the ICC, and the LCIA referenced rules by which the arbitration would take place. In addition to the UNCITRAL Rules (www.uncitral.org), there are also the ICSID Rules of Arbitration (www.worldbank.org/icsid), the ICC Rules (www.iccwbo.org), and the LCIA Rules (www.lcia-arbitration.com). The ICC also publishes Incoterms (www.iccwbo.org/incoterms). Incoterms attempts to address problems arising from disputes of definition. While two parties may agree on the terms of an agreement, they may have different ideas of what those terms actually mean. By referencing Incoterms, parties can be sure that they agree to the same idea, not just the same words. This is particularly relevant to international agreements where the parties might speak different languages or have different cultural and business interpretations of the same words.

Conclusion

In practice, international arbitration is developing at a varied pace throughout the world. One significant trend to watch is in Latin America, where an increasing number of arbitrations are either being threatened, negotiated, or otherwise appear to be forthcoming. In many instances, the sources are different sides of the same coin. For example, in some places there are waves of privatizations and at the same time, in other places, waves of expropriations. These are the kinds of things that lead to difficulties in the functioning of the rule of law yet at the same time create new opportunities to develop stronger rule of law systems.

The increase in globalization means that there is an increasing need for international dispute resolution, and this is not necessarily a bad thing. If there are international disputes that need to be resolved, it means people are crossing national boundaries, business is happening, investment is occurring, development is increasing, and things are moving forward. There would not be a need for lawyers and the international dispute resolution mechanisms if these other processes were not taking place. This is not to say, however, that more should not be done to further facilitate international business transactions. While international arbitration can play its role in reducing uncertainty in business dealings, governments can also contribute by improving the legal and regulatory climates in their individual countries.

Researching International Arbitration Decisions

Private Subscription Databases

LexisNexis
Westlaw

Intergovernmental Organization Websites

ICSID: www.worldbank.org/icsid
UNCITRAL (CLOUT database): www.uncitral.org

Government Websites

NAFTA Arbitrations (on the Department of State website): www.state.gov

General

Alan Redfern and Martin Hunter, *Law and Practice of International Commercial Arbitration*, (London: Sweet & Maxwell Publishers).

David Baron is a partner at McDermott Will & Emery LLP in Washington, D.C., where he specializes in international trade and dispute resolution. He has been involved in numerous cases before the International Court of Justice, international and domestic arbitral tribunals, and U.S. federal district and appellate courts. Mr. Baron is also an Adjunct Professor of International Law and International Dispute Resolution at American University's Washington College of Law.

This article is adapted from remarks given by David Baron at a roundtable discussion at the Center for International Private Enterprise. The views expressed by the author are his own and do not necessarily represent the views of the Center for International Private Enterprise. The Center for International Private Enterprise grants permission to reprint, translate, and/or publish original articles from its Economic Reform Feature Service provided that (1) proper attribution is given to the original author and to CIPE and (2) CIPE is notified where the article is placed and a copy is provided to CIPE's Washington office.

The Center for International Private Enterprise is a non-profit affiliate of the U.S. Chamber of Commerce and one of the four core institutes of the National Endowment for Democracy. CIPE has supported more than 1,000 local initiatives in over 100 developing countries, involving the private sector in policy advocacy and institutional reform, improving governance, and building understanding of market-based democratic systems. CIPE provides management assistance, practical experience, and financial support to local organizations to strengthen their capacity to implement democratic and economic reforms. CIPE programs are also supported through the United States Agency for International Development.