

Global survey sheds light on perceptions of international arbitration

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International arbitration is increasingly becoming part of global trade. This consensual, binding method of dispute resolution offers a highly effective means of resolving cross-border disputes away from litigation in national courts. It provides clear benefits to all parties, provided corporations and their legal advisers are equipped with the right knowledge, tools and tactics to conduct international arbitration proceedings, and the parties are wary of the pitfalls. Demand is growing. But is the arbitration community positioned to meet the challenges presented by this opportunity?

Identifying international arbitration is a significant international global trend. PricewaterhouseCoopers (PwC) wanted to understand how corporations use international arbitration to manage risk and preserve shareholder value.

In 2007, PricewaterhouseCoopers LLP commissioned a study by the School of International Arbitration, Queen Mary, University of London. The independent study tested the various perceptions of international arbitration among in-house counsel at leading corporations around the world. The study included responses from 103 online respondents and 40 face to face and telephone interviews for up to three hours on their experience and perceptions.

“We want our clients to understand and realise all the strategic benefits of using international arbitration to successfully settle cross-border disputes, and as a consequence we believe this study to be a worthwhile exercise to gauge the level of corporate knowledge about international arbitration.

Effective dispute resolution mechanisms are a valuable tool in the process of investment appraisal and risk management. Transnational litigation can entail high costs, delays, an unpredictable or possibly biased process leading to a “bad” result or an unenforceable award. If the smart use of arbitration can enable an investor to reduce those risks, the payback could be substantial; it could determine whether a transaction is viable.

The study can be found at: www.pwc.com/arbitrationstudy

Top 10 findings from the research

The top ten findings of the study are:

- 1) A significant majority (73 per cent) of corporations prefer to use international arbitration to resolve their cross-border disputes rather than transnational litigation.
- 2) The advantages of international arbitration clearly outweigh the disadvantages. The main reasons cited for choosing international arbitration were the flexibility of procedure, the enforceability of awards and the privacy afforded by the process. Expense and the length of time to resolve disputes were the two most common disadvantages. Arbitration can be more expensive than litigation, particularly outside some common law jurisdictions. Other disadvantages included the risk of court intervention in the arbitration process and the difficulty of joining third parties to the proceedings.
- 3) A clear dispute resolution policy is an important strategic asset when negotiating dispute resolution clauses for cross-border contracts and 65 per cent of the online respondents said they maintained a policy. Close to one-fifth (17 per cent) said it produced significant direct cost savings while a further 69 per cent indicated it helped minimise the escalation of disputes. There should be lessons in this for just over one third (35 per cent) of corporations without a policy.
- 4) Including an arbitration clause in a contract can give a tactical advantage in the event of a dispute. The clause determines the form and legal basis of the arbitration and a party can shape how proceedings are conducted. Well crafted, an arbitration clause can enable a party to include advantageous terms, such as the choice of seat and composition of the tribunal. However, it requires knowledge of international arbitrations to ensure those advantages are anticipated and then included in the negotiations. Worryingly, over 60 per cent of counsel interviewed said, with hindsight, that their corporations had conceded important tactical advantages in negotiating arbitration clauses.
- 5) Over three-quarters of corporations opt for arbitrations conducted under the auspices of an arbitration institution. These offer parties a reputable institution, an established process and an understanding of costs and fees. The most popular institutions were the International Chamber of Commerce and the London Court of International Arbitration. However, there was noticeable support from non-European corporations for the development of stronger regional arbitration centres that are closer to the location of the disputes and less expensive than established institutions.
- 6) There were mixed messages on the importance of tactical considerations when choosing a venue. The legal consequences of the "seat" of arbitration was the most important reason for the choice of venue. However, the convenience of a location was a surprisingly close second, which suggests that the significance of the choice of seat may not be fully

appreciated. The four most popular venues were England, Switzerland, France and the United States.

7) Corporations overwhelmingly favoured the finality of arbitration awards. Nearly all (91 per cent) rejected having an appeals mechanism.

8) There was concern about the availability of the relatively scarce resource of experienced arbitrators and calls for arbitrators to be drawn from a wider pool, preferably with relevant industry or regional expertise.

9) Corporations retain specialist arbitration counsel rather than their usual external litigation lawyers. Corporations are seeking law firms who have a proven record of conducting international arbitrations, who specialise in the subject matter of the dispute and have access to counsel in the place of the dispute.

10) Close to all (91 per cent) in-house counsel felt well-informed about international arbitration but there was a clear desire to receive more education about the process, opportunities and risks of this process.

In addition to these findings, the study highlights four fundamental features of international arbitration that set it apart from other commercial dispute-resolution mechanisms. They are:

- An effective alternative to a national court;
- A private mechanism for dispute resolution;
- Selected and controlled by the parties;
- Final and binding determination of parties' rights and obligations.

It is the features of international arbitration listed above which have underpinned its exponential growth as a way of resolving disputes since the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards was signed in 1958 under the aegis of the United Nations. 142 countries have now signed the Convention.

A closer look at what the results are telling us

So what are the perceptions about international arbitration, and how do they measure up against the empirical evidence presented in the study? As stated, almost three quarters of corporations prefer international arbitration to transnational litigation. Their concerns about litigation are many and varied; from a lack of familiarity with a foreign legal system to fears about a lack of confidentiality, time and costs.

However, there are many positive features about the arbitration process itself. In particular, three key reasons emerged from the interviewees: flexibility of process, enforceability of awards and privacy. The fact the parties to the dispute are involved in determining and shaping the procedure inspires confidence in the system. But even more important is the fact that an award handed down in an international arbitration can be enforced. And while international arbitration does not automatically guarantee secrecy, proceedings are private and may be confidential.

Not surprisingly, international arbitration is perceived as having downsides. Cost and time head the list with 85 per cent of respondents citing the expense as one of their three top concerns and half as their primary concern.

Going hand in glove with cost is the time it can take from filing to getting an award; 18 months is typical. Although the length of time that international arbitration takes is, more often than not, less than transnational litigation, it remains a negative. This response reflects a concern that international arbitration increasingly simulates court proceedings in the length of time it takes to complete a case, and as such the length of time is now perceived as a disadvantage.

Other disadvantages cited are the possibility of national courts intervening in an arbitration hearing – this meant the decision on where to arbitrate can be critical – and the difficulty of involving third parties after the process has begun.

The perceptions about cost – arbitration costs and counsel's fees – are considered important enough to rate their own series of questions. Nearly two-thirds of respondents (65 per cent) say it's more expensive than transnational litigation and another 23 per cent say it's just as costly. When asked to give a cost estimate of their latest arbitration, just over half (52 per cent) gave a figure ranging between US\$100,000 and US\$500,000; 12 per cent however, had to pay more than US\$5 million.

The issue of cost also throws up an interesting divergence of opinion among respondents; those from developed countries are less fussed about cost than their counterparts in developing countries. No doubt this partly relates to the fact that the cost of litigation in developed countries means these corporations are more willing to accept the cost of arbitration. Counsel in developing countries; however, prefer litigating in their own courts where the costs are more predictable and less burdensome.

Nearly two-thirds of global corporations (65 per cent) have dispute resolution policies, saying it minimizes dispute escalation and has cost advantages. They find it helps with contract negotiations, assists with risk management, and, more generally, inculcates in the corporation

a more positive attitude towards dispute resolution, particularly as it means greater engagement with the legal department.

In our experience, a clear dispute resolution policy provides an important strategic advantage. It ensures negotiators are informed and know the parameters within which they can be flexible during dispute resolution negotiations. A policy can also provide a framework for the drafting of advantageous dispute resolution clauses into contracts.

The vast majority of corporations (95 per cent) have dispute resolution clauses in their cross-border contracts. Two thirds opt for arbitration clauses with slightly less than half preferring to use standard wording in those clauses. However, nearly two-thirds of respondents (60 per cent) say their corporations made concessions when negotiating arbitration clauses. It is only after a dispute arises that the value of a well crafted dispute resolution clause comes to the fore.

The respondents who have an effective dispute resolution process in place in a cross-border transaction say it gives them greater certainty, minimizes delay, delivers a better outcome and is more enforceable – all positives for the bottom line. The corollary, a flawed process, can mean years of litigation in a national court, increased risk and lost value for its investment.

Respondents also prefer institutional arbitration to ad hoc arrangements. A clear majority, 76 per cent, cite a strong reputation for managing arbitration proceedings as the key reason to use an established institution, with a familiarity with proceedings and an understanding of costs and fees ranking second and third. Those that opt for ad hoc arrangements (24 per cent) are mostly big corporations – gross turnover exceeding \$US5 billion – boasting large, sophisticated in-house legal teams.

Many corporations indicated an interest in arbitration institutions closer to the location of the dispute, which might also be less expensive than established institutions. However, most corporations are not yet willing to send their cases to less established regional centres before they have a proven track record.

Legal considerations usually determine where arbitration is held. Corporations also cite a venue's neutrality, convenience and its proximity to witnesses and evidence for influencing their thinking on venue. However, the fact legal counsel rate convenience as an important factor is cause for concern; it suggests some may not appreciate the legal significance of choosing the right venue for arbitration.

Half the respondents say they appoint arbitrators on external legal advice. Of the remainder, one-third says it's on the basis of personal knowledge. Not surprisingly, 90 per cent of

respondents want an arbitrator with an established reputation – what in-house counsel call a “heavyweight”. The relevant language skills, industry knowledge and regional or country experience are also cited as factors.

In-house counsel believes that arbitrators with these skills save their corporations time and money. Most corporations don’t want an appeal system; the finality of an award is seen as a major advantage of international arbitration (and an obvious point of difference with national courts).

The perception that corporations use their retained external counsel for international arbitration is false; 75 per cent of in-house counsel says they employ specialist individuals or firms. But having established a relationship with a specialist firm, in-house counsel say there are benefits to both parties in maintaining it.

In a similar vein, the perception that in-house counsel lack experience to handle international arbitration is only partially true. In large corporations, in particular, many counsel have considerable experience in this process. But many also indicate they want more training in this area of their work.

That’s not surprising. Findings in other parts of the report, such as their corporations’ willingness to negotiate away key terms in arbitration contracts and their apparent failure to appreciate the legal significance of the “place” for an arbitration, suggests further training would benefit in-house counsel.

Certainly the demands on their expertise and time from international arbitration will only grow; the study showed nearly all of the respondents using the process to settle cross-border disputes will continue to do so. And every one interviewed agreed the growth in international trade will see a corresponding increase in international arbitration.

On the supply side, what corporations want to see is a better framework for multi-party, multi-contract and multi-claim disputes, more effective enforcement, lower costs and for more countries to join and adhere to the New York Convention. In-house counsel also wants a bigger pool of experienced arbitrators and strong regional arbitration institutions.

The last point – strong regional arbitration institutions – is perceived as critical in giving corporations greater choice of venues for international arbitration. They want venues outside the traditional big four – England, Switzerland, France and the US – to become genuine options for reasons of cost and convenience.

An Australian perspective

Certainly Australian companies are part of this worldwide trend. Michael Pryles, president of the Australian Centre for International Commercial Arbitration Limited says, "For Australian companies operating in Asia, international arbitration has proved crucial. In some instances they cannot be sure that the court system will be impartial in the country where the commercial dispute has arisen."

"Where an Australian company resorts to an Australian court and gets a ruling in its favor there is no guarantee the court's decision can be enforced. Often the other party will have no assets in Australia and the Australian judgment will be difficult to enforce offshore."

Michael contends there are sound arguments for corporations to use international arbitration. "There is more likelihood of a decision being enforced. For example, a company awarded a decision under international arbitration can apply to seize assets/garnishee turnover of the company found against in a third country where the latter has commercial operations."

Finally

So the growing importance of international arbitration to business worldwide is beyond dispute.

The findings from the study reflect what 143 in-house corporate counsel are saying. Some of the results are surprising, indeed some people around the world have raised more than eyebrows: they have been quite indignant where the findings have been contrary to their own views.

Whether people's opinions are right or wrong, the results of this comprehensive, academically rigorous study on international arbitration reflect that the market talking.

For PricewaterhouseCoopers it is important we understand what the market is saying. We have been involved in many matters where our opinion has been sought as expert witnesses on loss and value. Other clients rely on our advice on how to best use international arbitration to manage risk and preserve shareholder value.