INTERNATIONAL COMMERCIAL ARBITRATION: ADR IN CROSS-BORDER BUSINESS DISPUTES

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International commercial disputes are increasingly resolved out of court, in private tribunals run by arbitrators who are chosen by the parties. Arbitrations are conducted world-wide, and it is important that businesses and their legal advisors are well-versed in the operation arbitration and alternative dispute resolution.

This essay reviews the principal mechanisms for resolving international commercial disputes and the advantages and disadvantages of each. It discusses arbitration, mediation and litigation.

While each method is preferable in certain circumstances, arbitration is often better at resolving international commercial matters because of its binding enforceability across borders, cross-cultural and procedural flexibility, cost effectiveness, confidentiality, and the opportunity it may provide to preserve business relationships.

Arbitration: The Agreement, Mechanics and Process

Arbitration is a voluntary and binding form of alternative dispute resolution.[1] The parties, typically by prior written agreement, place a dispute before a designated person or panel rather than a court. The parties may initiate arbitration without a prior agreement by submitting a claim to an arbitral organization.[2]

Arbitration is similar to an adversarial trial. Although less formal than a trial, procedurally and functionally, the arbitration panel acts as a neutral judge. The arbitral panel, often referred to as a tribunal, hears evidence and decides the case presented. Typical panels are comprised of one or three arbitrators.

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[1] "Alternative Dispute Resolution" ("ADR") describes a variety of methods used to resolve conflict out of court, including negotiation, mediation and arbitration. Part of the impetus for ADR is to make it as easy as possible for adversaries to resolve their conflicts. *See, generally,* Luther T. Munford, "The Peacemaker Test: Designing Legal Rights to Reduce Legal Warfare," 12 *Harvard Negotiation Law Review* 377 (Spring 2007). The number and percentage of lawsuits decided by trial has fallen dramatically over the past several decades. This decline seems at least in part attributable to the high cost and delay entailed by trials (and U.S. litigation's discovery and motion practice), as well as attendant risks, uncertainties, and adverse impact on business and professional relationships. Marc Galanter, "The Vanishing Trial: An Examination of Trials and Related Matters in Federal and State Courts, " 1 *J. Empirical Legal Stud.* 459, 460 (2004).

[2] The principal statutes governing arbitrations are the Federal Arbitration Act, 9 U.S.C. §§ 1, *et seq.*, and the (Illinois) Uniform Arbitration Act, 710 ILCS 5/1, *et seq.*

Selecting qualified arbitrators is the first requisite of a satisfactory arbitration.[3] An unbiased, experienced and knowledgeable arbitrator is crucial to the integrity and fairness of the arbitral process.[4] Moreover, in light of the relatively nuanced, trial-like process which often involves complex transnational legal issues, it is important to select arbitrators sophisticated in the areas of law and commerce applicable to the dispute. This enhances prospects for understanding of the business issues at stake, as well as accurate application of substantive law and avoidance of mistake.

In presenting the case to the panel, the parties are usually represented by counsel. The attorneys present their client's case to the arbitrators in an effort to win a favorable arbitral award. Subject to modification by the parties' agreement, the court-like process of opening statements, direct and cross-examination and closing arguments are usually followed.

The parties agree on how the evidence may be offered. Frequently, depositions, interrogatories and requests for admissions may not be available. Such a limitation on discovery reduces the costs commonly associated with litigation, yet may also restrict access to and admission of compelling evidence.[5]

An important difference from trial is that binding arbitration is a purely private alternative. It is completely confidential. Arbitration is governed by contract law, and is not subject to public proceedings or judicial and legislative rules of procedure and evidence.

The parties execute a written agreement that governs most aspects of the arbitration process. This may include agreement on the applicable law, choice of a forum, the scope and timing of discovery and the nature (administered or ad hoc) of the arbitral proceeding itself. Important considerations include: site of the arbitration, official language of the hearing, law to interpret and govern the contract, the scope and means of the enforcement of the award, administrative rules to be followed, qualifications and selection method of panel, and discovery methods.

Depending on applicable rules, the arbitral tribunal may be empowered to determine issues of legal privilege and interim relief.[6] The power of the tribunal is defined by the parties' agreement and the applicable rules used in administering the proceeding.

The Dispute Resolution Clause

Arbitration clauses can be a single sentence or can include a detailed protocol for dispute resolution. Below is a checklist of topics to be considered:

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[3] *See, generally,* David W. Rivkin and Carolyn B. Lamm, 317 Alternative Dispute Resolution: The Litigator's Handbook (American Bar Association, Section of Litigation, 2000).

[4] Id.

[5] The arbitration panel may issue subpoenas for witnesses to be present at a hearing, yet may not receive testimony outside the presence of the tribunal. *See, e.g.,* Title 9 U.S.C. § 7 Federal Arbitration Act.

[6] *See, e.g.,* www.adr.org (Rule R-31, American Arbitration Association's Commercial Arbitration Rules, governing the introduction of evidence at arbitral proceedings, which states "[t]he arbitrator shall take into account applicable principles of legal privilege, such as those involving the confidentiality of communications between a lawyer and client").

1. Written agreement to arbitrate; affects parties and joinder, consolidation.
2. Scope of contract issues covered; usually broad.
3. Site of arbitration; location of parties, subject of contract, neutral third country.
4. Arbitration rules; administered versus ad hoc.
5. Provisional remedies; injunctive relief jurisdiction, venue.
6. Language; English, other.
7. Arbitrators; number, appointment, qualifications, neutrality of party-selected.
8. Final, enforceable (FAA, Uniform Arbitration Act, New York Convention for international); limited judicial review.
9. Consumer arbitration; FINRA, employment, unconscionability, class actions, congressional legislation.
10. Mediation/conciliation, other procedures.
11. Choice of law; substantive law of contract, CISG.
12. Choice of forum; dispute resolution, arbitral/judicial venue.

After the Arbitral Award: Appeal, Modification and Third-Party Issues

After the case is presented, the arbitrators decide the matter. The tribunal renders a final, binding award. An arbitral award may be "bare" or "reasoned." An award is bare when it simply identifies the prevailing party and the amount of the award. A reasoned award is more complete, discussing the rationale and evidence supporting the award.[7]

Appealing either type of arbitral award is difficult, controversial and disfavored. The use of an appellate mechanism or remedy undermines the central advantages of speed, finality and the reduced costs often associated with arbitration. Appealing an award is discouraged even by administrative arbitral institutions. These institutions may provide for an alternative to judicial review through an Arbitral Appellate Procedure.[8] The U.S. Supreme Court recently held businesses cannot contract for court review beyond that provided by statute, remanding the case for further proceedings in the trial court.[9]

The losing party can appeal. The appellant must initiate court action, seeking to "vacate" the award, or the prevailing party may petition for enforcement of the arbitral award. In the United States, however, the power to vacate an arbitral award is sharply narrowed by statute and case law.[10]

Under Section 10 the Federal Arbitration Act, for example, an arbitral award may be vacated only for very limited reasons, including: arbitrator bias ("evident partiality") or showing

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[7] Under a "high-low" or "bracketed" agreement, the parties may limit the arbitrator's ability to award an amount in a specified range.

[8] *See, e.g.* CPR http://www.cpradr.org/arb_appeal_intro.asp?M=9.2.2.7 (discussing CPR Arbitration Appeal Procedure, which operates outside the court system).

[9] Hall Street Associates, L.L.C. v. Mattel, Inc., 128 S.Ct. 1396 (2008).

[10] *See,* First Options Chicago v. Kaplan, 514 U.S. 938, 115 S.Ct. 1920, 131 L.Ed.2d 985 (1995) (citing Wilko v. Swan, 346 U.S. 427, 74 S.Ct. 182, 98 L.Ed. 168 (1953) (parties bound by arbitrator's decision not in "manifest disregard" of the law), overruled on other grounds, Rodriguez de Quijas v. Shearson/American Express, Inc., 490 U.S. 477, 109 S.Ct. 1917, 104 L.Ed.2d 526 (1989).

the award was procured by fraud, corruption or undue means.[11] The common law adds additional grounds for reversing arbitral awards, including: (1) manifest disregard for the law; (2) an irrational, arbitrary or capricious award; (3) or violations of public policy. The federal circuit courts apply these grounds with some variations.[12]

In any court, however, a mistake of law or fact is not sufficient to set aside an arbitral award.[13] The "clearly erroneous" standards applicable in civil disputes do not apply to arbitration awards. Therefore, a significant advantage to arbitration is that an arbitrator's award is more "final" than a trial verdict on the merits.

Moreover, another advantage is that a private arbitral award does not generally determine the legal rights or obligations of a third-party. Arbitrations usually determine only the rights and obligations of the arbitrating parties. In contrast, a court judgment may have third-party implications. Such a judgment may have preclusive *res judicata* or collateral estoppel effect, or may simply be a public precedent leading to additional litigation.

Enforcement of Arbitral Awards

In resolving commercial disputes, the enforceability of an arbitral award is an enormous advantage. In contrast court judgments, which depend on enforcing a bilateral treaty between the forum state and the state where the assets are located, arbitral awards enjoy nearly universal, world-wide enforcement through national courts. (The U.S. has recently ratified the Hague Convention on Choice of Court Agreements, which allows contracting parties to designate the court systems of state parties to the Convention through a choice of court clause. It will be some time, however, before enough countries ratify this Convention for it to be a significant practical alternative to nearly universally-enforceable agreements to arbitrate.)

Longstanding multilateral treaties render foreign arbitral awards enforceable in the United States, as well as signatory countries around the world. The 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards ("New York Convention") renders arbitral awards enforceable in signatory states.[14] Presently, including the United States, 142 countries are parties to the New York Convention.[15] The Inter-American Convention on Commercial Arbitration ("Panama Convention") applies, similarly, in South and Central America.[16]

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[11] Title 9 U.S.C. § 10 (a)(1), *et seq.*

[12] *See, e.g.,* Thomas E Carbonneau, The Law and Practice of Arbitration, 368-386 (Juris Publishing, Second Edition, 2007).

[13] B.L. Harbert Intern., LLC v. Hercules Steel Co., 441 F.3d 905 (11th Cir. 2006) (citing *Montes v. Shearson Lehman Bros., Inc.,* 128 F.3d 1456, 1461 (11th Cir. 1997) (arbitrators cannot be reversed for errors or misinterpretations of law).

[14] Convention on the Recognition and Enforcement of Foreign Arbitral Awards ("New York Convention"), June 10, 1958, entered into force June 7, 1959, 21 U.S.T. 2517, T.I.A.S. 6997, 330 U.N.T.S. 3 implementing legislation codified at Title 9 U.S.C §§ 201-208.

[15] *See* http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/NYConvention_status.html.

[16] *See, e.g.,* Inter-American Convention on Commercial Arbitration ("Panama Convention"), Title 9 U.S.C. § 301 (approved in 1975).

To enforce an arbitral award, the party either applies to the court specified by the parties or the place where the award was entered. The court's judgment on the award is enforced like any other final court judgment.

Under the New York Convention, however, there are seven exclusive grounds for refusing enforcement of arbitral awards rendered in foreign jurisdictions: incapacity, inadequate notice, award beyond the scope, composition of arbitral authority, award not yet binding, subject matter not arbitrable, or the award is against public policy.[17]

Prior to the New York Convention, parties had difficulty enforcing arbitral awards outside the country where the arbitration occurred. Many foreign tribunals were reluctant to recognize arbitral awards rendered against their own nationals. Such legal protectionism and perceived local favoritism foreign businesses unwilling to voluntarily submit to national court proceedings or arbitrations out of their home jurisdictions.

In contrast, the world-wide enforcement of arbitral awards encourages stability and predictability in commercial relationships. In turn, this facilitates the negotiation of international contracts based on the understanding that any dispute will be resolved with finality by a panel of experienced arbitrators selected by the parties. This predictability and control, rather than the uncertainty or perceived bias associated with local courts, is a powerful business advantage.

Ad Hoc v. Administered Arbitrations

Arbitration is either "ad hoc" or "administered." The parties must decide which method is preferred. Each has its own merits.

In an ad hoc proceeding, the parties privately manage their arbitration. This ensures complete privacy and control. In addition, the parties and arbitrators either develop their own rules or use recognized standards to govern their ad hoc proceedings.

A prominent standard, for example, is the widely accepted unanimously approved 1985 United Nations Commission on International Trade Law Model Law on International Commercial Arbitration ("UNCITRAL Model Law").[18] Member countries have subsequently adopted enabling legislation. So have some U.S. states, like Illinois.[19]

Today, as a result, the UNICTRAL Model Law embodies a supranational arbitral standard, recognized and applied around the world. Legislation based on this Model Law has been enacted in dozens of countries and several progressive state legislatures in the United

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[17] *See* Title 9 U.S.C. § 201(Article v); for cases discussing grounds for not enforcing foreign arbitral awards under NY Convention, *see* Yusuf Ahmed Alghanim & Sons v. Toys "R" Us, Inc., 126 F.3d 15, 19 (2d Cir. 1997); *also,* First State Insurance Co. v. Banco de Seguras del Estado, 254 F.3d 354 (1st. Cir. 2001) (confirming awards under NY Convention); Industrial Risk Insurers v. M.A.N. Gutehoffnungshutte GmbH, 141 F.3d 1434 (11th Cir. 1998) (affirming arbitral award and rejecting policy and procedural arguments).

[18] *See,* United Nations Commission on International Trade Law ("UNCITRAL"), http://www.uncitral.org/pdf/english/texts/arbitration/ml-arb/07-86998_Ebook.pdf.

[19] Illinois International Commercial Arbitration Act, 710 ILCS 20/1-1 *et seq.*

States.[20] Consequently, the UNCITRAL Model Law is often used by parties to govern their ad hoc arbitration proceedings.

In contrast to ad hoc proceedings run by the parties, an administered or "institutional" arbitration involves the services of an arbitral agency. In the United States, for example, the largest such administrative agency is the American Arbitration Association ("AAA"). In response to increasing global demand for effective commercial dispute resolution and arbitrations, the AAA established its International Centre for Dispute Resolution ("ICDR").[21]

The ICDR, with offices in New York, Ireland and Mexico, often applies its own arbitral rules and is charged with the exclusive administration of all the AAA's international matters.[22] For a fee, the AAA administers the entire case from initiation to enforcement of an arbitral award.

Other organizations also offer arbitration services. The International Institute for Conflict Prevention & Resolution ("CPR"), for example, provides limited arbitral services and encourages parties to apply its rules. In particular, the CPR adopted the 2000 Rules for Non-Administered Arbitration of International Disputes.[23] The CPR encourages the parties to apply its arbitral rules, yet it does not administer arbitrations. Instead, the parties use CPR services to assist in selecting a panel of arbitrators. The parties then manage their own proceeding.

There are many institutional agencies around the world that administer arbitrations or provide rules that can be incorporated into arbitration agreements. Some of these agencies have industry specific expertise and are located in areas active in global commerce. Among them are:

- Chicago International Dispute Resolution Association ("CIDRA" www.cidra.org)
- International Chamber of Commerce Dispute Resolution Services, International Arbitration Court ("ICC" http://www.iccwbo.org/court)
- London Court of International Arbitration ("LCIA" http://www.lcia-arbitration.com)
- China International Economic and Trade Arbitration Commission ("CIETAC" http://www.cietac.org.cn/index_english.asp)
- Hong Kong International Arbitration Centre ("HKIAC" http://www.hkiac.org/HKIAC/HKIAC_English/main.html)
- Financial Industry Regulatory Authority (securities industry) ("FINRA" http://www.finra.org)

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[20] *See,* Status, UNICTRAL Model Law on International Commercial Arbitration, http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/1985Model_arbitration_status.html.
[21] *See,* http://www.adr.org/sp.asp?id=28819.
[22] Id.
[23] *See,* http://www.cpradr.org/arbi-rules.asp?M=9.2.8.7.

- Judicial Arbitration and Mediation Services ("JAMS" http://www.jamsadr.com/welcome/about.asp)

Disadvantages of Arbitration:
Discovery Limitations, Lack of Equitable Relief, No Joinder of Parties

Arbitration has its disadvantages. First, discovery may be too limited. Arbitrators evaluate the relevance and materiality of the evidence offered. However, the arbitration agreement or the parties' choice of applicable rules may restrict the scope of discovery from the outset, so that marshalling appropriate proof may be difficult or impossible.

Second, as discussed above, absent fraud, corruption or excess of authority, the appellate remedies available to vacate an arbitral award are narrow. This limitation expedites the dispute process, but may deprive the parties of adequate review.

Third, hearsay evidence may be offered in an arbitral proceeding. This could prove persuasive, and the arbitrator's use of the evidence is not subject to strict evidentiary rules. Even where the arbitrator relies on only marginally trustworthy evidence, the subsequent arbitral award is likely to be upheld.

As noted, an arbitrator may not manifestly disregard the law (i.e., be conscious of the law and deliberately ignore it). However, an arbitral award will not be vacated where an arbitrator "manifestly disregarded" the evidence.[24] This is unsettling, especially when no substantial appellate review is available.

Finally, arbitration does not impose compulsory or permissive rules of joinder. Thus, a necessary party may not be added to enable a complete resolution of the dispute. The decided issues are only binding as to the arbitrating parties, though they may have issue preclusion consequences beyond the arbitration.

Mediation: Facilitative Alternative Dispute Resolution

Mediation is a non-binding form of facilitative dispute resolution.[25] It is a conflict resolution variant of "thin-slicing," the ability of the human subconscious to identify patterns and make responses based on very quick "slices of experience."[26] Unlike trials or arbitrations, mediations usually take place in several hours or a day. Mediators act as neutrals, assisting the parties in constructing their own solution. Importantly, mediators do not decide the case, and are not concerned with evaluating evidence, proof or liability. Instead, the focus of the mediator is on facilitating and encouraging constructive party dialog.

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[24] *See,* Wallace v. Buttar, 378 F.3d 182, 193 (2d Cir. 2004).
[25] Mediation may be "facilitative" or "evaluative." For more, *see* Hoberman, Robin, "Mediation: A Nonadversarial Alternative to a Win-Lose System," http://www.isba.org/IBJ/nov02lj/p588.htm. For an illustrative statute, see (Illinois) Uniform Mediation Act, 710 ILCS 35/1, *et seq.*
[26] Malcolm Gladwell, Blink! 22 (2005).

In this regard, mediation differs sharply from both arbitration and litigation. Mediation is not adversarial in form. There is not an express winner and a loser. Mediation offers an opportunity to settle matters on an expedited, cost efficient, client-controlled basis. It can be especially useful, if the parties are motivated to reach an agreement. Attorneys can powerfully shape the outcome, but the ultimate success or failure depends largely on the parties.

The mediator's function is fundamentally different from the arbitrator's. The mediator's concern is facilitative, focused on developing party dialogue. The arbitrator concentrates on the arguments made and evidence offered in order to determine the merits of the case.

Mediation is less "risky" than arbitration or litigation. The parties direct both the process and outcome. They may conclude the mediation in agreement or end it at any time and proceed to arbitration or litigation. As in arbitration, the rules of evidence are relaxed and documents may be submitted to the mediator upon agreement.

To begin the process, the parties select an experienced, neutral third-party mediator. Usually, both sides are given an opportunity to submit written materials to the mediator a short time before the mediation. The parties then present their positions at an in-person several hour or longer conference at which the mediator presides. After initial presentations, mediators typically separate the parties and discuss the issues privately, shuttling between the parties, returning to group discussions as may be appropriate.

The individual sessions, or "caucuses," allow each party to explore and reality test the strengths and weaknesses of their positions in the case. The mediator is then able to facilitate a discussion attempting to stimulate the parties into generating options and solutions.

As a means of dispute resolution, mediation may be the most empowering to the parties. The outcome determinative decisions rest with the parties. Success in mediation is often attributed to such factors as a safe environment with motivated parties, direct communication, and independent mediator appraisal, development of options, and the occasion and reinforcement for needed compromise.

Mediation is not binding. Unless the parties reach a settlement, the mediation remains confidential and cannot be used to determine the parties' respective rights. In a successful mediation, the parties agree to resolve their dispute on mutually acceptable terms.

For best results (borrowing from AAA Chicago's Robert Matlin):

1. Make sure the right client is in the room.
2. Make sure the right attorney (and mediator) is in the room.
3. Be prepared.
4. Communicate with the mediator beforehand.
5. Provide a written submission.
6. Provide the right opening statement.
7. Don't waive the opening session.
8. Engage in small-talk.

9. Understand the other side's point of view.
10. Consider your BATNA ("Best Alternative to No Agreement").

Litigation: Engaging the Wheels of Justice

Litigation is dispute resolution by judicial process. The parties employ the machinery of the court to arrive at a final, binding decision. In the process, strict rules of evidence and procedure apply. The final judgment of the court may be appealed, adding to the time and expense, but also offering more safeguards against unfair result.

Litigation in the United States and certain other established national systems can be the best means of obtaining recourse. The need for immediate equitable relief, a dispute requiring substantial discovery from the opposing party, or the benefit of establishing a judicial precedent may require litigation. But even in these circumstances, lawsuits are expensive and uncertain, and the justice may be slow due to crowded court dockets and expansive discovery. The cost of preparing a claim for trial can be high, sometimes higher than the possible recovery. Finally, the judiciary may not offer the expertise and flexibility necessary to resolve some complex commercial disputes. For these reasons, arbitration and mediation stand out as attractive alternatives.

Arbitration is a Useful Method of Resolving International Disputes

No one dispute resolution mechanism is *per se* superior to any other. Rather, each method has its advantages and disadvantages. When commercial conflicts arise, there may be a need to litigate. Depending on the circumstances, mediation and arbitration may be preferable.

Increasingly, arbitration is the preferred method for resolving international commercial disputes. Arbitration, built on a specific contract between the parties, and governed by experienced arbitrators, is often an effective method of resolving an international commercial dispute.

There are significant advantages in choosing to arbitrate a transactional dispute, including: finality and worldwide enforcement of arbitral awards, neutrality of the arbitrators and venue, confidentiality and privacy of the proceedings, speed of the process, lower cost, and the potential to preserve valuable business relationships.

Resolving disputes is never easy. But an understanding of the alternative mechanisms for resolution is an important foundation for good decision-making.

Final Observation and Injunction

French philosopher Voltaire once wrote: *"I had two negative experiences concerning the law. The first was when I lost a trial. The second was when I won another one."* There is a time for litigation. But there are alternatives that may be better. Arbitration and mediation may be among those alternatives.

Lincoln the Illinois lawyer enjoins us: *"Discourage litigation. Persuade your neighbors to compromise whenever you can... As a peacemaker, the lawyer has a superior opportunity of being a good man [or woman]. There will still be business enough."*

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