Controlling Business Risks With International Commercial Arbitration

Kluwer Arbitration Blog
November 22, 2013

Philip W. "Whit" Engle (Philip W. Engle, Attorney at Law – Solicitor – Arbitrator)

Please refer to this post as: Philip W. "Whit" Engle, 'Controlling Business Risks With International Commercial Arbitration', Kluwer Arbitration Blog, November 22 2013, http://arbitrationblog.kluwerarbitration.com/2013/11/22/controlling-business-risks-with-international-commercial-arbitration-2/

The objective of this post is to help in-house and outside counsel communicate better with each other when addressing the topic of international commercial arbitration. While both may be (highly) conversant on the topic, the perspectives of each are potentially very divergent and true communication between them may be incomplete and ineffective. My desire here is to help bridge the communications gap – with a four letter word no less. The idea is to provide common ground for communicating about disputes and how to best manage them. If done right, the end-user client is better served.

1) Competing approaches

The adage "Where you stand is where you sit" may have no better application than when considering the differing mindsets between in-house counsel and outside counsel on the topic of international commercial arbitration. Ostensibly, they are both on the same page in that they both represent the same end-user client; however, their individual perspectives might be in direct conflict. For one thing, in-house counsel will naturally be focused on damage containment, while outside counsel will want to avoid a malpractice suit or, at least, being second guessed which leads him/her to "leave no stone unturned" necessitating increased legal costs to the client (and profits to the firm). Competing interests!

As between them, discussions of strategy will be tempered with discussions of cost because this topic seems to be within the comfort zones of both in-house and outside counsel. While cost may be a common denominator, it is only a partial one. Indeed, as just discussed, there may well be a conflict of interest if cost is the only factor in play, which may lead to a dissatisfactory approach to management of outcomes.

2) A fresh perspective – managing risk, not just cost

Both in-house and outside counsel are better aligned by considering not cost, but a different four letter word: r-i-s-k. Or even better, the panoply of risks facing the client that will be in the forefront of the executive, the board and other stakeholders of any corporation – and therefore important to the General Counsel. When viewed through the prism of risk, the client's objectives come into much clearer focus with cost being only one of several risks to be managed.

The better understood the risk equation; the better international commercial arbitration can be leveraged to benefit the corporation. Indeed, understanding and managing risk enables a merging and alignment of interests and actions between in-house and outside counsel at all relevant stages of a dispute – even before one has arisen!

To outside counsel, who is not immersed in the culture of the particular corporation or the business world in general, the prospect of wrapping one's mind around the client's risk equations might seem a bit daunting – after all this is not standard law school fodder. Yet a few simple tools may be helpful to both in-house and outside counsel to triangulate the risk quotient of any client: business risk, financial risk, and operational risk. There are a host of other risk sets and subsets, but a grasp of these three is fundamental.

Here, of course, I am leaving out a large and obvious risk set – legal risk – which is more easily understood between in-house and outside counsel, and which is the subject of countless articles and presentations and beyond the scope of this posting.

I briefly address each of business, operational and financial risk in turn. Outside counsel is cautioned not to make presumptions of a corporation's position on any specific risk factor without at least some client input.

3) Business Risk

This is risk that is confronted by the enterprise as a whole, when challenged by a high profile dispute. Examples of business risk are brand dilution or loss of reputation (stirred by unfavorable press, for example), business distraction (diverting assets of the business away from more productive activities to support the arbitration fight), and stakeholder anxieties which may include those of employees, investors, board members and more.

International commercial arbitration can offer some appealing strategies to help mitigate business risks. For starters, it helps to have an arbitration clause in form agreements, especially those that have cross-border relationships with counterparties (yes, this is elementary, but worth repeating). This helps in keeping the risk genie in the bottle even before a dispute arises.

A well-crafted confidentiality provision within the arbitration clause will help address brand dilution or loss of reputation risks.

Business distractions occasioned by full-tilt common law discovery practices can be significantly reduced by pre-agreement on exactly which set of disclosure (discovery) rules will apply, such as the "IBA Rules on the Taking of Evidence in International Arbitration".

Another way to leverage international commercial arbitration to reduce business risks is to establish a fast track procedure for smaller cases: this allows for festering issues to be quickly managed into resolution before they blow up into something that creates a serious or even existential threat to the enterprise.

Adjudication is another option for preserving relationships while resolving disputes.

4) Operational risk

These are risks that are addressed at an operational level when a major dispute arises. Examples of operational risk are the loss of a major customer or vendor, layoffs (production grinds to a standstill), the shutting down of a product line, or the withdrawal from a certain geography. International commercial arbitration can offer strategies to mitigate operational risks. A key lever is time management.

For example, the enterprise may wish to exercise flexibility in the length of time it takes to resolve a dispute, to allow it to design and execute operational work-

arounds. Rather than rely on filibustering legal techniques after a dispute has arisen, the corporation can proactively bake into the dispute resolution provisions a greater handle on time management such as a tiered approach to ADR, or by pre-setting time windows to ensure reporting quarters or years will be straddled.

The converse of time flexibility may be a corporation's desire to prioritize business certainty by putting a prescribed timeframe into the dispute resolute provision (say, for example, the award must issue within 18 months of the constitution of a tribunal).

5) Financial risk

Financial risks are those that have financial implications for the enterprise. Examples of financial risk are a sudden financial hit (surprise loss of a dispute), a miss of targeted financial projections (unplanned for scale of loss of a dispute), or ongoing viability of the business (an unmanageable, catastrophic, loss). International commercial arbitration can offer strategies to mitigate such risks, and embed them into how any dispute will be handled.

For example, in the international arbitration clause the parties can agree on allocating fees and costs of a dispute so that neither side will be overwhelmed by unexpected cost allocation practices in a final award. A proactive company and its counsel can also take steps to ensure that decisions on venue (and venue costs) are carefully made in advance, perhaps even adopting a strategy of centralizing or regionalizing the venue for all disputes occurring with all business relationships (a move which will have the effect of avoiding duplication of effort and uncertain outcomes arising from deployment of untested local counsel).

Another risk mitigation strategy is to limit remedies by depriving the tribunal of jurisdiction to make punitive or exemplary awards, or those involving incidental or consequential damages.

6) Timing

Although the best time to think through and manage some of these risk factors is in the contract formation phase of a business relationship between a client and its counterparty, these don't always get optimum handling in the proverbial 3:00 a.m. final draft of the deal. This does not foreclose other options:

They can be addressed after contract formation as “amendments” or “modifications” to the ongoing relationship (perhaps explained as “policy changes” and/or bolted onto the relationship along with other business adjustments).

Another time to manage risk factors is after a dispute arises – either by one or both of the parties or by the tribunal acting proactively:
• A submission agreement is one example of where the parties can work out at least some of their respective approaches to risk management.
• The first procedural or organizational hearing is an ideal time to tie up some of the loose ends. The tribunal should encourage the parties to agree on as many of the issues as possible. The UNCITRAL notes on Organizing Arbitral Proceedings contain a helpful punchlist, even if not framed in a risk-centric manner.
• The tribunal should at least be alert to overtures from the parties that seem to address risk factors at all stages of the proceeding and be prepared to act within its scope of authority.

7) Summary

A basic understanding, and management, of risk at all stages of a business cycle from contract formation through post claim has the potential to drive a far greater value for the end-user corporate client. Greater value, well communicated, translates into repeated resort by the business community to International Commercial Arbitration as a way to achieve business goals. And the more business the better, right?