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The benefits of an arbitration clause

The first article in our series of articles on standard clauses looked at the types of contractual terms which can be used to govern the parties' conduct when a dispute arises and in particular ADR clauses.

This second article follows on to look at the choices open to the parties if they are unable to resolve their dispute by negotiation and how these choices can be incorporated into the contractual documentation. Apart from negotiation, there are a number of means by which a dispute can be decided by a third party which include expert determination and arbitration as opposed to litigation. This article considers all three options but focuses on the advantages and disadvantages of arbitration compared to litigation, all of which should be considered when deciding whether or not to include an arbitration clause in your contract.

Expert determination

In summary, expert determination is a process in which an independent third party, acting as an expert rather than judge or arbitrator, is appointed to decide the dispute in accordance with criteria set down by the contracting parties. There is no right of appeal, apart from in limited cases when the expert has asked himself the wrong question or decided the wrong issue. An expert determination is confidential.

Expert determination is suited to single-issue disputes requiring specialist expert knowledge in any one particular field; such as the valuation of shares, a rent review, the interpretation of a provision in a contract or technical issues. However, it is not suitable for the resolution of disputes which involve many disputed issues of fact as well as matters, which will ordinarily require an expert's opinion or involve a point of law.

Arbitration or litigation?

The advantages and disadvantages of arbitration compared to litigation.

1. Confidentiality

One of the main reasons commercial organisations prefer arbitration to litigation is that arbitration proceedings are private and confidential. The parties are obliged to keep confidential and not to disclose information that they obtain as a result of the arbitration proceedings. The hearing is held in private. As a result, highly valuable or sensitive commercial information does not become public, as it may do in litigation. A party who acquires documents from his opponent in litigation is not permitted to use those documents other than for the purpose of the litigation. However, once a document has been read out in court, it ceases to be confidential and of course the trial itself is held in public.

Confidentiality also avoids the outcome of any dispute becoming public and setting a precedent that can be used by other claimants who may have a similar claim (although of course the winning party may want to set a precedent).

Of course, an arbitration (although not all the facts relating to it) may cease to be confidential if it is necessary to apply to the court in relation to arbitration proceedings; e.g. to enforce an arbitral award or appeal against an arbitral award.

There are of course occasions where one of the parties may wish to publicise their dispute for tactical reasons.

2. Cost

The costs of arbitration may be significantly less than litigation. Much depends on whether the parties avail themselves of the greater flexibility of arbitration.

The volume of documents required may be less. There may be no need for expert evidence given the expertise of the arbitrator. The relevant arbitral rules may not require oral testimony and argument to be given. Even if they do, the parties may agree to dispense with oral testimony and argument. The arbitrator may decide to make an award based entirely on written submissions.

Where, however, (as is often the case) arbitration mimics court procedures, the costs of arbitration are likely to be higher than litigation as not only do the parties have to pay their own costs, they also have to pay the costs of one or three arbitrators and the administrative cost of the hearing, such as the venue. (This may of course change if, as threatened, the Department of Constitutional Affairs implement hourly charges for court hearings.)

Additional costs may also be incurred in arguing over the appointment of the arbitrator(s) and arranging hearings.

3. Speed

Although the pace with which litigation is dealt with has increased substantially following the introduction of the Civil Procedure Rules in 1999, arbitration may still be quicker than litigation as it permits the parties/arbitrators to adopt certain procedures to speed up the process (see flexibility below). Often, however, arbitration follows the same stages as litigation: pleadings (usually called points of claim and points of defence), disclosure, witness statements, expert evidence and a hearing. Indeed arbitration is often described as privatised litigation.

Arbitration may take longer than litigation, as delays can be incurred in appointing the arbitrator(s) and arranging the arbitration hearing. Much depends on the availability of the arbitrator(s). This potential problem is obviously often exacerbated when there are three arbitrators. (In some cases arbitrations in commercial cases have been known to take so long that life insurance has been taken out in respect of the arbitrator's life because, unlike litigation where a judge can be replaced, it is harder to replace an arbitrator during an arbitration and there are cost implications.)

4. Finality

There are very limited grounds on which a party can appeal to the court against an arbitrator’s findings, even on points of law. It is even possible for the parties to agree to exclude appeals to the court. The finality of an arbitral award is attractive as it avoids the uncertainty, cost and delay caused by appeals.

Although the grounds on which a party can appeal to the Court of Appeal are limited, arbitration is preferable to litigation, where a final binding decision is desired with a minimum, or no, right of appeal.

Conversely, arbitration is not appropriate where the parties want to retain a right of appeal, which would otherwise be prohibited in arbitration.

5. Party choice

In arbitration, the parties are, as described in more detail below, free to choose who will decide their dispute and to a large extent the procedure. Selecting the arbitrator may of course give the party confidence that they will win or at least that the adjudicator will understand the issues.

6. Flexibility

The parties and the arbitrator(s) are, with limited exceptions (as set down in the Arbitration Act 1996), free to decide the procedure for resolving their dispute; and accordingly the procedure can be tailored to the circumstances of each case. Innovative procedures can be adopted which may not be available in the courts.

The parties can save considerable costs in arbitration by agreeing the procedure, in particular as to:

- the level of representation;
- the extent to which oral argument and evidence may be permitted;
- subject to the tribunal's availability, the time of the hearing;
- the language of proceedings; and
- documents to be used in the course of the proceedings.

While the parties are able to agree how their disputes are to be resolved, in reality parties have their own agendas and often do not agree on simple procedural issues. In those circumstances, it will be for the arbitrator(s) to determine the procedure. However, too often the procedure adopted in arbitrations mimics that of the local court. Arbitration may not, therefore, be appropriate where one party is likely to be deliberately obstructive. The parties also need to be conscious of the fact that, once appointed, the Arbitrator does have the ability to set his own procedures even if the parties disagree, unless the parties have taken steps to over-ride this from the outset.

Arbitration may also not be appropriate where the court procedure is likely to confer a particular advantage in the actual or anticipated dispute; for example full disclosure often does not take place in arbitration and one of the parties may require documents created by the other party. Often in arbitration, the parties identify only the documents they rely on. Although each party can seek specific documents from the other, the fact that there is no obligation to disclose relevant documents, which are harmful to their own case, may enable a party to keep their skeletons buried. However, the reduction in the volume of documents disclosed, of course, reduces the costs of arbitration.

7. Expert adjudicator

The arbitrator does not have to be a lawyer. The parties can nominate a person with expertise in a different discipline to determine the dispute, thereby avoiding for the need for independent experts to be appointed by both parties. The expertise may either be of a technical nature or of the industry concerned. Although the parties may still want to retain their own experts as advisers, the appointment of an arbitrator with knowledge of the issues in dispute can save considerable time and cost as they do not need to be taught the technicalities of the dispute during the course of a long trial.

Thus, where expertise in the subject matter of the dispute is an important attribute for the person who is to decide the dispute, arbitration may be preferable to litigation.

8. Neutrality

It is often said that one of the advantages of arbitration is that it provides a forum for disputes to be heard by a neutral tribunal in a neutral location. This can be helpful if one of the parties thinks that the Courts, which might otherwise have jurisdiction, are inadequately developed, may not be truly independent of the other party, or may be logistically inconvenient.

The parties can, however, chose a neutral court for this purpose and indeed many parties choose the English Courts for this purpose.

9. Enforcement

One of the major advantages of arbitral awards is that they can be enforced in far more countries and with far less cost and delay than court judgments. Over 130 countries have ratified the New York Convention 1958, which requires their courts to enforce foreign arbitral awards, except in very limited circumstances. There is no scheme (with the same geographical scope) for the enforcement of foreign judgments.

Thus, where the decision will not be made in the same place that the debtor's assets are located, arbitration may be preferable to litigation.

10. Injunctions

One of the disadvantages of arbitration is that the arbitrator has no power to grant an injunction. Thus, arbitration is not appropriate where an interim or final injunction is required. However, this problem can be overcome by providing in the contract for the parties to be able to apply to court for an injunction, by way of an exception to their agreement to arbitrate. The courts of a number of countries will grant injunctions in aid of arbitration proceedings.

11. Multi-party disputes

Another disadvantage of arbitration is that an arbitrator does not have the power to join third parties to an arbitration. Thus, arbitration is not appropriate where proceedings might involve more than two parties in connection with disputes arising out of related contracts, unless these related contracts have specific provisions for such arbitrations to operate in tandem/parallel.

Drafting the arbitration clause

If the parties decide to refer their dispute to arbitration, they should also decide which arbitral institution should administer the arbitration, as that institution will have rules, which will govern the arbitration process. Some of the most well known institutions are the International Chamber of Commerce, the London Court of International Arbitration and the American Arbitration Association. If the parties decide on an arbitration administered by such an institution, the safest approach is to adopt the standard arbitration clause of the arbitral institution concerned.

The parties will need to consider carefully the institution chosen to administer their arbitration; as each institution has its own rules and procedures. The differences between the various institutions concern matters such as when particular documents have to be produced, the number of arbitrators and whether the institution’s administration costs are calculated by

reference to a percentage of the claim or according to the time spent by the institution in the administration of the arbitration.

Consideration should also be given to agreeing such matters as the number of arbitrators, their expertise, a system for their appointment, the place of the arbitration and the language of the arbitration.

Conclusion

Arbitration can and should be a flexible and efficient procedure for determining disputes. However, arbitration users often do not take advantage of this flexibility and so do not reap the full benefits of arbitration. At its best arbitration will be cost efficient and quick. At its worst, it will be more expensive and slower than litigation but without an effective right of appeal. Which of these outcomes prevails is in the hands of the tribunal and the parties.

The choice between arbitration and litigation is not one that can be made in a vacuum. The identities of the parties, the location of assets, the nature of the dispute (potential or actual) and the Courts, which might otherwise have jurisdiction, are only a few of the many factors, which may have to be considered. Such a decision should of course be made with the benefit of legal advice.

Contact

Mark Lewis
Partner
Email mark.lewis@ibblaw.co.uk
Tel 01895 207938

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