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A Survival Guide for Small Businesses: Avoiding the Pitfalls in International Dispute Resolution

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During the last two decades, international trade has expanded by leaps and bounds. With this growth, opportunities for small businesses to jump into the international business environment have increased. To facilitate the entrepreneur's transition from Main Street to the global village, entities such as the U.S. Department of Commerce and the Small Business Administration have initiated programs and provided resources to promote the entry of small businesses into international trade.² As a result of these programs and resources, entrepreneurs have made massive strides into the global marketplace. According to the Small Business Administration's *America's Small Businesses and International Trade: A Report*, the number of small businesses exporting outside the United States has tripled and the dollar amount of these exports has soared.³

Small businesses are learning the same hard lesson that multinationals learned about the global marketplace. Even in a successful international transaction, there is a risk that the honeymoon will end and commercial partners will find themselves at odds. These disagreements have dynamics different from purely domestic disputes. In a challenging economic climate, every dollar, pound, yen, and euro counts. Small businesses need a fair, flexible, and reliable dispute resolution process to ensure that their international commercial disagreements are resolved effectively. When dealing with their international counterparties, small businesses should contract for an effective dispute resolution mechanism.

This article shows small businesses how to avoid pitfalls in international dispute resolution in order to minimize commercial risks and maximize commercial gains. Focusing on dispute resolution options at the beginning of a transaction maximizes the chances of securing the

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² http://www.commerce.gov/trade_opportunities.html [last visited Sept. 17, 2004].

³ <http://www.sba.gov/library/oitreport/archive/oitnov99report.pdf> [last visited Sept. 20, 2004].

most beneficial terms, which will pay off in the event of a commercial dispute.

A fundamental question small businesses should ask is which mechanism will be the most effective mechanism to resolve a dispute. Options range from informal procedures such as negotiation to binding and enforceable mechanisms such as litigation. While negotiation or mediation might be initially appealing, these methods typically are done informally, before a dispute escalates. The major downside of these options is that they do not result in a final, binding, and enforceable result. There are options that *can* result in an enforceable decision.

Expert determination is a contractual mechanism for the resolution of disputes without recourse to litigation or arbitration where a single “expert” resolves a technical dispute based upon the facts before her and often without reference to the applicable law. This mechanism has been used in the grain, IT and construction industries. Expert determination has the benefit of being relatively fast and cheap.

The downside to this choice for general commercial disputes is that there is often a sense that expert determination is “rough and ready justice.” Expert determinations must be enforced through separate litigation on the award wherever enforcement is sought. This process can consume as many resources as traditional litigation.

As these options – negotiation, mediation, and expert determination – are typically unsatisfying, small businesses are left to answer the question of whether arbitration or litigation is the best method for resolving their dispute.

Litigation may be appealing as a familiar option in the unfamiliar world of international trade, particularly as it creates precedent for future cases that businesses can use to guide their future commercial conduct. When all is said and done, however, commercial parties from one country will rarely agree to submit their disputes to the courts of their foreign commercial partners.

A basic rule for selecting an effective dispute resolution mechanism: Contractually agree to a single, exclusive forum for the final resolution of all disputes arising out of or related to the transaction.

Choose Arbitration

International commercial arbitration is superior to traditional court litigation and serves modern businesses by satisfying four core needs.

1. *A Neutral Independent Forum.* Arbitration provides a neutral forum for resolving the substance of a dispute. The forum is largely independent of the influence of local courts. In countries where there may be concerns about the impartiality of the judiciary or local protectionism, the need for a neutral forum is critical. It offers both parties the chance to feel like they are on equal ground, without one party receiving an unfair “home field advantage.” This can actually facilitate the negotiation of commercial transactions.

2. *Autonomy and Flexibility.* Arbitration gives small businesses both the autonomy and flexibility to resolve their disputes in a manner that suits them. In arbitration, parties can create their own rules about how disputes will be resolved and even pick the person who will resolve the dispute. This control is attractive and may even permit small businesses to select arbitrators who are sensitive to their unique business activities.

3. *Confidentiality and No Publicity.* Arbitration typically provides parties with confidentiality and avoids the publicity, which accompanies court proceedings. Where there is an ongoing commercial relationship or sensitive intellectual property, this benefit could be critical.

4. *Enforceability.* Enforcing a court judgment in a foreign country requires separate litigation on the award, which often enquires afresh into the merits of the dispute and is typically more time consuming and costly than enforcing an arbitration award. There is no treaty on the enforcement of civil judgments, but there is the New York Convention, which requires its signatory states to enforce arbitration agreements and decline to litigate disputes subject to an arbitration agreement. This makes arbitration awards easily enforceable in most countries throughout the world.⁴ Particularly for small businesses anxious to conserve litigation costs and focus on their core business, having a single award that can be easily enforced creates a streamlined procedure for enforcing their rights in many different countries, which results in significant savings of time and money.

⁴ <http://www.uncitral.org/english/texts/arbitration/NY-conv.htm> [last visited Sept. 24, 2004.]

Don't Mix Dispute Resolution Mechanisms

This is the easiest and most important pitfall to avoid in choosing a forum. Make a clear choice of a single, exclusive forum to resolve disputes finally and stick with it. Large businesses sometimes pay dispute resolution specialists to draft highly complex clauses that combine multiple forms of dispute resolution. These provisions are often unnecessarily sophisticated, costly, and untested. Most businesses are best served by the more conservative commercial approach of having a single standard dispute resolution mechanism that minimizes litigation risk and maximizes the predictability of the dispute resolution process.

In countless international transactions, businesses often overlook simplicity and include clauses that require both arbitration and litigation without a clear indication about *where* disputes must be resolved. Whether this lack of clarity is due to negligent drafting or inadvertent error caused by improper cutting and pasting of boiler-plate provisions, it has important ramifications.

First, a small business could end up fighting a war on two fronts – fighting the substance of the dispute and fighting about where and how to resolve the dispute. Second, this failure may mean both parties end up with an invalid and unenforceable clause. Third, a small business can find itself in the worst of all possible worlds – litigating all over the globe rather than deciding disputes in one pre-selected forum.

If small businesses want streamlined and effective dispute resolution options, they should prevent excess litigation costs caused by fighting about procedural issues that are contractually avoidable.

Don't Be Too Greedy

Some businesses, particularly lending institutions and franchisors, have become fond of unilateral dispute resolution agreements that leave the party with the stronger bargaining position the right to pick litigation or arbitration at its sole discretion. While courts in many common law countries have enforced these types of clauses, the courts of some international trading partners may not feel the same way. For example, courts in Eastern Europe and Asia have found this inequality sufficiently noxious to void the dispute resolution agreement for violating public policy.⁵ This means that an award rendered pursuant to such a dispute resolution mechanism is probably unenforceable. A business is not well

⁵ <http://www.freshfields.com/practice/disputeresolution/publications/pdfs/8287.pdf> [last visited Sept. 18, 2004].

served by agreeing to a lop-sided dispute resolution agreement that exposes it to the loss of considerable time and money to procure an unenforceable award.

Maximize the Benefits of Arbitration

This is a crucial issue for small businesses, given arbitration's significant advantages. The plethora of options generated by arbitration's flexibility can sometimes leave business people and their lawyers feeling like proverbial "kids in a candy store," without a firm guide as to what options are best for the businesses. When trading with international counterparties, there are answers to five key questions that will help businesses decide which arbitration mechanism will best suit their needs.

1. Ad hoc or institutional arbitration?

Ad hoc arbitration resolves a dispute without the oversight and administrative assistance of an institution. The tribunal and the parties are essentially left to fend for themselves. It may be cheaper than institutional arbitration because the parties do not pay fees to an institution. And there may be marginal utility in not being bound by a particular institution's procedural rules. In practice, parties do not often realize these benefits.

In some countries, like the People's Republic of China, *ad hoc* arbitrations are not advisable because the requirements are so onerous as to make arbitration agreements unenforceable. According to the Article 16 of the Arbitration Law of the People's Republic of China, "The following contents shall be included in an arbitration agreement:

1. the expression of the parties' wish to submit to arbitration;
2. the matters to be arbitrated; and
3. the Arbitration Commission selected by the parties."⁶

In institutional arbitration, parties consent to resolve their dispute before a panel of arbitrators at a particular institution, under the specific rules of that institution and the administrative support of that institution. With institutional arbitration, parties can work within

⁶ <http://english.sohu.com/2004/07/04/78/article220847885.shtml> [last visited Sept. 26, 2004].

the ambit of an institution's rules and vary them to suit their needs. And institutional arbitration has a central benefit – it enlists the assistance of an internationally recognized arbitral institution to provide administrative support to your arbitration. This support can take the form of assisting with, even expediting, the appointment of arbitrators, evaluating a challenge to an arbitrator's impartiality, reviewing awards for errors of content and clerical errors, and providing general administrative coordination. Relatively minor administrative fees are an invaluable investment as they provide an opportunity to monitor and promote the efficient resolution of disputes.

2. What institution best serves the business' interests?

There are several major and internationally recognized arbitration institutions:

- London Court of International Arbitration (LCIA)
- International Chamber of Commerce (ICC)
- American Arbitration Association's International Centre Dispute Resolution (ICDR)
- Stockholm Chamber of Commerce (SCC)
- Hong Kong International Arbitration Centre (HKIAC)
- China International Economic and Trade Arbitration Commission (CIETAC)

As arbitration law throughout the world has harmonized, institutional rules have also become standardized. The rules and administrative capacities of the major institutions have been tried and tested in major international commercial disputes. Awards from these institutions have an established international currency. Some national courts may be more likely to enforce awards from established institutions such as the ICC, LCIA, and SCC. Small businesses may wish to opt for a recognized institution and avoid local ones, which may be susceptible to parochial influences or lack a track record of recognized success.

Even among the major institutions, however, there are important variations. No business should choose an institution without reading its rules. Turning a blind eye to an institution's rules minimizes the chances that the selection will promote a business' commercial objectives.

Some institutional rules might even subject a business to unexpected burdens. For example, while CIETAC has taken great strides to modernize its arbitration procedure, there are still critical restrictions on the parties' freedom to choose arbitrators. Parties are limited to a single list of arbitrators, two-thirds of whom are China, Hong Kong or Macao nationals.⁷

There are other institutional variations that businesses ignore at their peril. While most institutions like the ICDR have confidentiality obligations related to documents during the proceedings or the hearings, the ICC does not.⁸ Yet, in contrast to most other institutions, the ICDR has a presumption in favor of publicizing "sanitized" awards, decisions and rulings, which remove certain details including parties' names.⁹

The LCIA has a special provision which permits the joinder of third parties where one party to the arbitration consents. If businesses are not aware of this provision, they might unwittingly find themselves in the middle of a larger dispute, which can delay and increase the cost of resolving their dispute.¹⁰ By the same token, it might also be a useful mechanism to bring in an indispensable third party.

There are also benefits that can be overlooked by ignoring institutional rules. For example, if a transaction involves significant intellectual property issues, a small business may prefer to arbitrate under the auspices of the World Intellectual Property Organization (WIPO). WIPO has specific rules and significant institutional experience to deal with those issues.¹¹

Parties arbitrating under the auspices of the ICC Rules have recourse to an internal procedure that permits the ICC Court to review and evaluate draft arbitration awards before they are final.¹² This reduces the risk of a tribunal rendering an unenforceable award as the ICC Court can suggest clarification of issues or correction of errors prior to an ICC tribunal rendering a final award.

Picking the right institution does not involve only analysis of rules and institutional competence – there is also a question of cost. Small businesses should try to avoid the pitfall of having an overly expensive

⁷ <http://www.cietac.org/> [last visited Sept. 18, 2004].

⁸ <http://www.iccwbo.org/court/english/arbitration/rules.asp> [last visited Sept. 18, 2004].

⁹ http://www.adr.org/index2.1.jsp?JSPssid=15732&JSPsrc=upload\LIVESITE\focusArea\international\AAA175current.htm#Intl_Arbitration [last visited Sept. 18, 2004].

¹⁰ <http://www.lcia-arbitration.com/download/rules.pdf> [last visited Sept. 18, 2004].

¹¹ <http://arbitrator.wipo.int/arbitration/rules/index.html> [last visited Sept. 25, 2004].

¹² <http://www.iccwbo.org/court/english/arbitration/rules.asp> [last visited Sept. 18, 2004].

arbitration by evaluating during the contract negotiation phase what disputes are most likely to occur and the potential value of those disputes. Institutions generally have one of two approaches to the issue of cost: (1) fees are charged at an hourly rate and (2) fees are based upon the amount in dispute. LCIA arbitrators, for example, have an hourly basis that must be within a fixed range set by the LCIA; the ICDR, in contrast, allows arbitrators to set their own hourly fees. The ICC, however, fixes its fees on the basis of the amount in controversy. What this means is if a small business is likely to have highly complex, low value commercial disputes, the ICC may provide the best value for money. If there are likely to be high value, straightforward disputes, however, the LCIA may provide a more cost-effective service.

Ultimately, the major institutions resolve international commercial disagreements effectively and the best choice will depend, in part, of the specific facts of your transaction.

3. Where should the arbitration be located?

Choosing the place of the arbitration is a fundamental step toward ensuring that your dispute resolution mechanism is effective. While an international arbitration can generally be held anywhere in the world, including in one of the parties' home country, selecting place is a tactical choice that can either help or hinder small businesses in ways they might not anticipate.

A business should avoid choosing a place of arbitration that is not a signatory to the New York Convention.¹³ Choosing to have arbitration in a country that is a signatory to the New York Convention means that the award can be enforced under that treaty. While most countries are signatories, several are not – Bermuda, the Cayman Islands, Taiwan, and the United Arab Emirates, for example.

Ignoring the local arbitration law of the place of arbitration is another pitfall to avoid. In most cases, the law applicable to the arbitration will be the governing law of the country where the arbitration takes place. Local law will affect the opportunities for the local court to assist with – or potentially interfere with – the arbitration proceedings.

For example, many laws permit courts to assist with issues such as interim measures, the arbitration's relationship to parallel proceedings, the appointment of arbitrators, challenges to arbitrators, securing the attendance of witnesses or the disclosure of documents, and the local

¹³ <http://www.uncitral.org/english/status/status-e.htm> [last visited Sept. 18, 2004].

grounds upon which an arbitration award can be vacated.¹⁴ Local arbitration law might also affect variables such as the minimum number and qualifications of arbitrators. Obtaining legal advice as to the local arbitration law can sensitize businesses to their risks, so that they can make informed choices as to the best place of arbitration.

A business should also consider practical questions when choosing the place of arbitration.

- How far will potential witnesses have to travel to give evidence?
- Where will the majority of the documentation be?
- Is there faith in the integrity of the local courts?
- Is there sufficient experience with international arbitration issues on the local bench and bar?
- Are there facilities and administrative support for oral hearings?
- Is it a geographical location where the parties and their lawyers will be comfortable spending several weeks?

A small business that is able to answer these questions will pick a strategic location that is advantageous and minimizes potential arbitration costs.

Conventional arbitral seats – New York, London, Paris, and Zürich – are preferable, because their judiciaries have established track records of effectively handling international arbitration issues. Also, there is a variety of skilled local lawyers in a variety of price ranges. Miami and Vancouver are also gaining popularity as venues.

On the other hand, if the jurisdiction where enforcement is likely to be sought finds it significantly more straightforward to enforce a domestic award (e.g. Brazil), small businesses may be better off agreeing to arbitrate in a country where assets are located. Again, this is an issue where local law advice provides crucial insight.

Some businesses negotiating international agreements are more concerned with having the dispute administered by their national arbitration institution than the place of arbitration. Given the uniformity of institutional rules and parties' ability to modify most rules

¹⁴ <http://www.uncitral.org/english/texts/arbitration/ml-arb.htm> [last visited Sept. 18, 2004].

by agreement, the more important tactical issue is the place of arbitration.

While small businesses should use the issue of an arbitral institution as a bargaining chip, they should bargain away the place of arbitration with due care. Place of arbitration has a more dramatic impact upon the integrity of the arbitration process and is more likely to create a distinct advantage. While a foreign counterparty is likely to be sensitive to this point and request a more neutral venue for resolving commercial disputes, small businesses should not hesitate to use what bargaining leverage they can to secure a venue that is favorable both legally and tactically.

4. Who will resolve the dispute and what qualifications should they have?

One of the significant benefits of international commercial arbitration is the parties' ability to control who will be resolving their dispute. There is commercial utility in picking an arbitrator who is likely to understand your business, the context in which the dispute arises, and who will view your arguments favorably while still adhering to her obligation to be independent and impartial.

The major pitfall to avoid in answering this question is defining too narrowly the attributes that an arbitrator must have. During negotiations, it is not certain what commercial disputes, if any, will arise in connection with the transaction. It is prudent not to restrict a business' option to choose an arbitrator in its ultimate best interests.

Classic miscalculations involve parties agreeing to appoint an arbitrator who dies or requiring qualifications that narrow the pool of potential arbitrators but are irrelevant to the dispute. In each of these cases, prescribing attributes for arbitrators at the contractual stage does a disservice to a business' commercial objective to have a flexible and enforceable dispute resolution mechanism.

Another problem arises if the arbitration agreement requires broad, uncertain, or undefined qualifications. Requiring an arbitrator to have qualifications, which are subject to interpretation, opens the door to an argument that the arbitrator lacks the requisite background. This could be a basis for non-enforcement of the award. While there is utility in selecting an arbitrator with a background that may be helpful in resolving the dispute, nothing prevents a small business from doing this after a dispute arises when facts and issues have crystallized. If there is a need to provide some minimal qualifications, a small business should consider the most likely types of disputes and the background strictly necessary to address those issues effectively.

5. *Are there issues unique to the transaction that require modification of a model dispute resolution mechanism?*

This is the final issue that small businesses should consider when drafting an effective dispute resolution provision. If businesses can identify these issues, they can consider whether it is appropriate to modify the default institutional rules or, if possible, the law of the law of the place of arbitration.

If, for example, time is of the essence, parties can implement time limits and other provisions to provide the arbitrators with an incentive to fast-track the dispute resolution process.

If there are special third-party or confidentiality concerns, specific provisions can address these considerations. If a small business is doing business with a government-related entity, it might be useful to include waivers of sovereign immunity for jurisdiction and execution.

Failure to consider whether there are any unique characteristics of the transaction to justify modification of particular rules can decrease the possibility of having procedures that might otherwise provide tactical benefits. While the parties can always try to agree on additional procedures after a dispute arises, as a practical matter, this is difficult to accomplish, as agreement to additional rules will form part of the overall litigation strategy.

Being able to answer the question of what is special about your agreement is critical to the commercial interests of the small business. It may well be that there are no special considerations, but asking the question will provide an opportunity to maximize the effectiveness of each international commercial transaction.

Once a small business answers these five questions, it will have a better idea about the type of arbitration that is best for the business and will be in a better position to maximize the benefits of arbitration.

Identify the Appropriate Governing Law

Small businesses may be tempted to pick the law of the state that is their principal place of business. This is commercially palatable for a U.S.-based business that is likely to know the law of its home state, organize its commercial activity around the law of that state, and have locally retained lawyers. The foreign counterparty, however, may have radically different ideas and insist on the application of their own national law. It may suggest use of its own law for various reasons,

including familiarity with the local law, protectionism, nationalism, or the burden of having to hire a foreign lawyer.

A small business should insist upon a law which is well-developed, commercial, and predictable, such as New York or even English law. This not only allows the commercial arrangement to be enforced as written but also minimizes risks related to the dispute resolution process, which might otherwise require a secondary dispute about what law is applicable to the transaction.

Before agreeing to the application of a foreign law, however, small businesses should identify all the differences that might have an impact upon their contract. For example, in contrast to their common law counterparts, civil law systems will not necessarily strictly construe the specific terms of a contract and may import terms such as “good faith.”¹⁵ Moreover, civil law systems may require the incorporation of certain statutory terms and may not necessarily have such familiar terms of art such as “arm’s length” or “best efforts.” Similarly, Islamic legal systems have certain prohibitions against traditional business tools such as interest and, if transactions are not structured properly, they could be void.¹⁶

While obtaining legal advice or a legal opinion on the subject of the law of another jurisdiction may add to transaction costs, the price of ignoring choice of law all together or being willfully blind to the potential implications are more significant. Prudent businesses engaging in international transactions must protect their carefully negotiated contracts from attacks that might leave them exposed commercially.

Avoid Eleventh Hour Negotiations

Businesses should not wait until the last minute to negotiate dispute resolution issues. If businesses wait until the end of negotiations, important protections may become tactical bargaining chips, even though it is in both parties’ best interest to have an enforceable and effective dispute resolution mechanism. Delaying negotiations can result in inadequately considered compromises. Last-minute negotiations can also lead to drafting mistakes.

¹⁵ Ole Lando & Hugh Beale (eds.), *Principles of European Contract Law, Parts I and II* xxiii (2000).

¹⁶ John Y. Gotanda, *Awarding Interest In International Arbitration*, 90 *Am. J. Int’l L.* 40, 45 (1996).

Choosing a place of arbitration without adequately reviewing the place's arbitration law may result in unanticipated results. A classic example involves a sophisticated transaction that had an enforceable commercial framework under U.S. law. When the parties opted for "neutral" Swiss law at the last minute, they did not realize that Swiss law would not enforce the framework because there was no Swiss law on point.

In contrast, if the parties address dispute resolution *early*, they can better anticipate what types of disputes are likely to arise and evaluate what mechanisms can resolve those differences. By fleshing out the parties' assumptions about how disputes would best be resolved, they can agree to a procedure that meets the needs of the particular transaction. Early consideration also permits the parties to implement their mutual expectations effectively, avoiding drafting errors and minimizing litigation risks. Early analysis pays off in the end and permits small businesses to get the most "bang for their buck" in the unhappy event of a commercial disagreement.

While no dispute resolution mechanism is perfect, small businesses can avoid possible common pitfalls to ensure that the dispute resolution mechanisms in their international transactions maximize their commercial objectives. One of the best ways to do this is by deciding, at the outset of a transaction, to have all disputes resolved by arbitration tailored to meet the business' needs that will result in an internationally enforceable award. In this manner, small businesses can achieve certainty and reduce litigation risk. They can concentrate on their core businesses activities. Then entrepreneurs and small businesses can then increase U.S. business opportunities in the global village and continue to expand international trade.