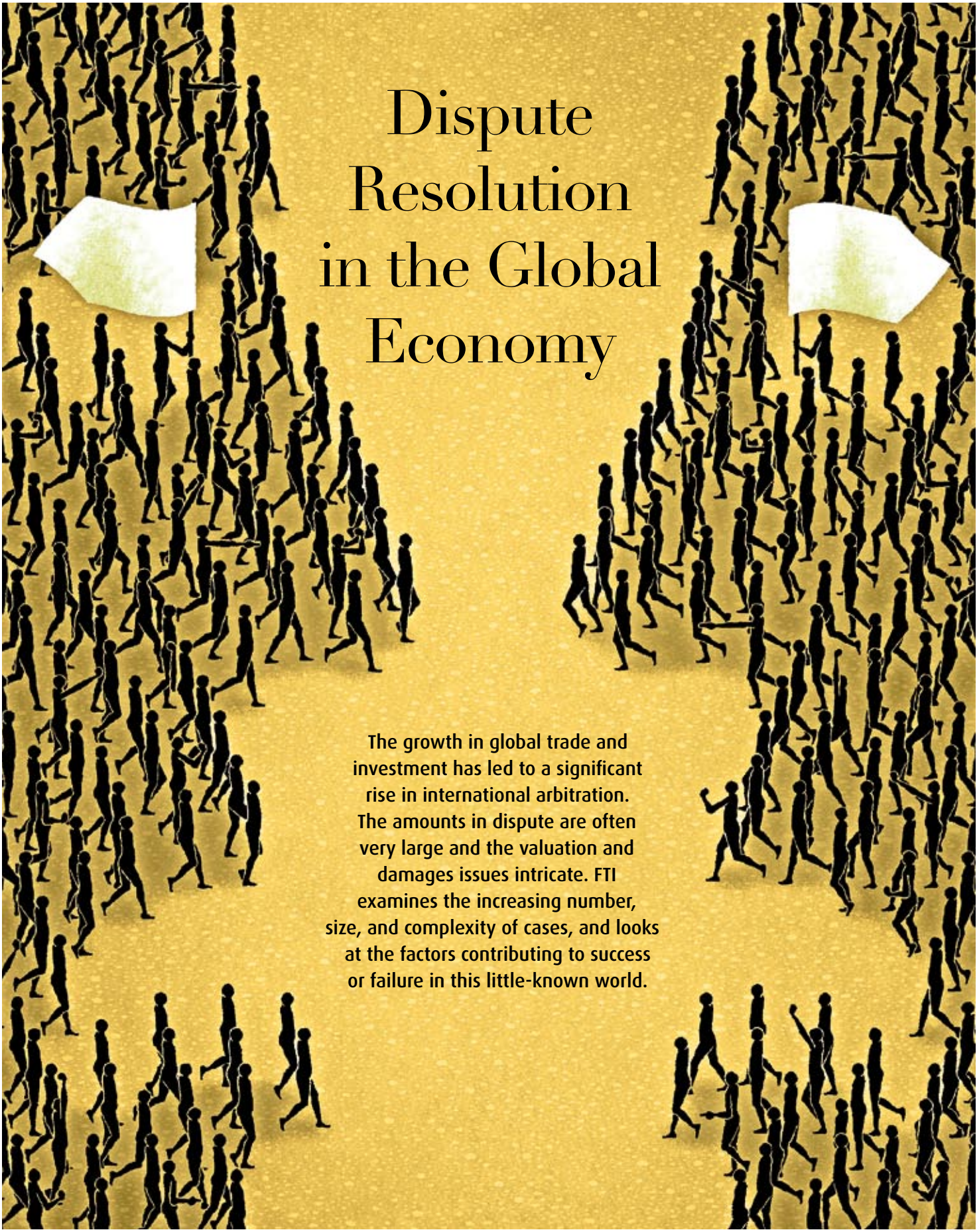

Dispute Resolution in the Global Economy

The growth in global trade and investment has led to a significant rise in international arbitration. The amounts in dispute are often very large and the valuation and damages issues intricate. FTI examines the increasing number, size, and complexity of cases, and looks at the factors contributing to success or failure in this little-known world.

Illustration: Matt Kenyon

Summary

Increased global trade has meant a steady rise in international arbitration cases, and developing parts of the world are providing alternatives to the traditional Western arbitration venues. FTI's experts look at what executives should know about arbitration, how it compares with other legal actions, and what to expect if your company does find itself involved in a case.

When ConocoPhillips invested in major heavy-crude projects in the Orinoco basin, no one expected that Venezuela would subsequently restructure its entire energy sector, nationalising the assets and denying the company its anticipated return. Nor could they have predicted the protracted dispute that ensued, a complex arbitration with a $30 billion claim at stake.

This may be a striking example of international investment gone wrong, but three factors are contributing to an increasing number of companies having to engage in disputes abroad. First, today's global economy demands greater participation in foreign markets, sometimes involving investment into those markets; second, these foreign markets often have dispute resolution processes and practices unlike those that companies are familiar with in their domestic markets; and third, many cross-border investments are protected by international treaties that stipulate that any associated disputes will be resolved via a particular form of international arbitration.

Success or failure – should arbitration be required – depends on a number of factors: the governing law, the seat of arbitration, and the legal precedent or contractual mechanisms for defining and calculating damages specified in the arbitration clauses of contracts or investment treaties. Company executives and boards of directors would be advised to treat arbitration clauses that establish the protocols for resolving commercial disputes as key business terms and to familiarize themselves with processes of international arbitration.

The statistics speak for themselves. There has been a steady rise in international arbitration during the past 20 years but the current climate marks a spike in new cases, sparked by the prolonged global economic crisis. At the London Court of International Arbitration (LCIA), new claims filed increased by 55% between 2007 and 2008, and again by over 14% in 2009 to 243 cases. Statistics from the Paris-based International Chamber of Commerce (ICC) and the Swiss Chambers' Court of Arbitration and Mediation (SCCAM) tell the same story. ICC new cases increased 11% in 2008 and a further 23% in 2009, to 817 new claims. New SCCAM claims rose 15% in 2008, before leaping 53% in 2009 to 104 requests for arbitration (the majority of which involved non-Swiss parties). The Dubai International Arbitration Centre reported a doubling of cases in 2009 compared with 2008, as the economic crisis finally caught up with the Middle East. Similar trends have also been observed in Asia. In response, major law firms around the world are expanding their specialist teams to cope with the demand and

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The confidential nature of arbitration means its practices are not widely known.

relocating arbitration specialists to emerging economies and centers of arbitration, principally in the Middle East and Far East.

What Is International Arbitration?

International arbitration is often used instead of litigation conducted through domestic courts when resolving cross-border commercial or investment disputes. These disputes are often large and complex, and the amounts in dispute regularly run into hundreds of millions or even billions of dollars. According to statistics from the LCIA, 25% of the claims filed with it in 2008 included damages claims valued at more than $5 million. The ICC reported a sharp rise in the number of high-value claims in 2008, with 31 new filings for damages of more than $100 million and four for amounts in excess of $1 billion.

National laws are of limited relevance to warring parties from different jurisdictions, with their contrasting legal systems and procedures. As a result, international arbitration operates beyond national borders, where parties have significant influence over the identity of their arbitrators, can often choose in advance the law and procedure under which any cases will be heard, and can agree to convene in a neutral venue.

Unlike litigation, there are no judges, juries, public courtrooms, or intrusive media. There can be limited formal procedure, and extensive discovery and electronic discovery are rare (in contrast to jurisdictions such as the U.S.). Instead, arbitration is flexible, decisions are often confidential, and cases, in principle at least, are cheaper and quicker than litigation in courts of law. The confidential nature of arbitration means its protocols and practices (which can vary between different arbitration forums) are not widely known and there are comparatively few legal and subject matter experts who are familiar with the ways in which particular issues have been treated.

An arbitration panel can consist of a single arbitrator. More commonly, and certainly for the larger disputes, the panel typically consists of three people – one appointed by each party, and a chairman selected by the two party-appointed arbitrators. The arbitrators may be selected for their expertise in specific areas of law or industry (greater specific expertise than might be the case with a trial judge assigned to a case), depending on the issues. Getting the right chairman can also be crucial given the need to manage the complex procedure adroitly and, as a result, the world's top arbitrators are in high demand. In practice, given the calls on the leading arbitrators' time, assembling a three-person panel for procedural rulings, hearings, and preparing judgments can add significantly to the timetable for resolution of the dispute.

Despite arbitration's less formal structure than traditional court proceedings, awards are binding and typically easier to enforce internationally than court judgments. This is due to mechanisms embedded in the international treaties underlying the main types of arbitration.

Abbreviations

- BIT: Bilateral Investment Treaty
- ECT: Energy Charter Treaty
- DIAC: Dubai International Arbitration Centre
- ICC: International Chamber of Commerce
- ICSID: International Centre for Settlement of Investment Disputes
- LCIA: London Court of International Arbitration
- SCCAM: Swiss Chambers' Court of Arbitration

Commercial Arbitration and Investment Treaty Arbitration

There are two main types of international arbitration. Commercial arbitration has close parallels to litigation. Cases arise when the parties to a dispute have a pre-existing agreement, often enshrined in the contract giving rise to the dispute, to settle any difficulties by arbitration rather than litigation. The parties to commercial arbitration are mostly private companies and, to a lesser extent, state-owned enterprises.

Investment treaty arbitrations on the other hand arise out of one of the various existing investment treaties. Some such treaties are well known – the North American Free Trade Association (NAFTA) treaty being the best example – or have recently risen to prominence, such as the Energy Charter Treaty (ECT), under which Russia faces claims of many tens of billions of dollars from former investors in the Yukos Oil business.

Many of this second category of disputes, however, arise out of Bilateral Investment Treaties (BITs), under which pairs of countries have agreed to reciprocal obligations toward investors from each other's jurisdictions. There are as many as 3,000 such treaties in existence. Some international investors have made investments via subsidiaries established in countries other than the parent's jurisdiction but which are considered to have more favorable BITs with the investee country than the parent company's jurisdiction. Little known to the public, BITs are also attracting attention for two reasons. First, due to the increasing number of claims they generate – seven new investment arbitration cases were registered each year with the International Centre for

Number of International Cases Administered by Arbitral Institutions – New Filings Per Year

Institution	Country	2000	2001	2002	2003	2004	2005	2006	2007	2008
AAA-ICDR	U.S.	510	649	672	646	614	580	586	621	703
ICC	France	541	566	593	580	561	521	593	599	663
HKIAC	China	298	307	320	287	280	281	394	448	602
CIETAC	China	543	562	468	422	461	427	442	429	548
LCIA	UK	87	71	88	104	87	118	133	137	213
SCC	Sweden	66	68	50	77	45	53	64	81	74
SIAC	Singapore	41	44	38	35	48	45	65	70	71
BAC	China	11	20	19	33	30	53	53	37	59
KCAB	South Korea	40	65	47	38	46	53	47	59	47
VIAC	Vietnam	23	16	19	16	32	22	23	21	n/a
JCAA	Japan	8	16	8	14	15	9	11	15	12
BCICAC	Canada	3	4	4	4	4	2	5	3	n/a
KLRCA	Malaysia	20	3	3	5	3	7	1	2	8
PDRC	Philippines	0	1	2	0	0	0	1	1	0
Developing World Sub-Total		984	1,034	924	850	915	897	1,037	1,082	1,347
Developed World Sub-Total		1,207	1,358	1,407	1,411	1,311	1,274	1,381	1,441	1,653
Grand Total		2,191	2,392	2,331	2,261	2,226	2,171	2,418	2,523	3,000

Source: Arbitration institutions identified

Settlement of Investment Disputes (ICSID), the main institution hearing such claims, on average between 1995 and 1999, compared with 26 new cases a year on average between 2005 and 2009. Second, due to the size of some claims and awards. FTI's International Arbitration team was recently involved in a claim pending against a South American government worth up to $12 billion and also in an award of more than $125 million – the largest made by the ICSID Tribunal to an individual claimant – against a Middle Eastern country in connection with an expropriated leisure development.

Arbitral bodies are raising their profiles in developing regions.

Venues for Arbitration

Arbitrations are organized by a number of institutions. The Washington-based ICSID hears the majority of investment treaty disputes, including most BIT disputes, as well as ECT and NAFTA disputes. The leading commercial arbitration bodies include the ICC, the LCIA, and the SCCAM. Arbitral bodies are raising their profiles in rapidly developing parts of the world – for example, Dubai's DIAC was established in 1994 as the "Centre for Commercial Conciliation and Arbitration" (the LCIA opened in the Dubai International Financial

The proportion of cases handled by Western-based arbitration bodies has fallen.

Centre to operate free from influence of the local government). And others are forming – for example, a new arbitration institution has just been announced in Australia. Arbitral institutions each have their own procedural rules, and their secretariats coordinate the selection of arbitrators and the handling of cases.

Unlike litigation, hearings can take place at locations selected by the parties, not necessarily in the country of the arbitral institution. Although many ICC hearings are heard in Paris, they are also held in London and other cities. Popular cities for conducting hearings generally are New York, Washington, London, Paris, Vienna, Geneva, and Stockholm – locations perceived as neutral, well resourced, easily accessible, and attractive to parties and arbitrators alike.

The Appeal of Arbitration

A major factor in the growth of international arbitration is neutrality. It's one thing to bring a claim for breach of contract in one's home jurisdiction, it's quite another to tackle the laws, language, and perceived limitations of foreign jurisdictions. This is particularly challenging in the developing world, where legal systems and legal precedent may be at earlier stages of development, and where dispute resolution may be more susceptible to political or other influence.

If the contract is with a national government (or equivalent), resolving the dispute locally may be particularly problematic given the potential immunity issues and enforcement challenges. If relations with a foreign party turn sour, no multinational would want the other party to have "home advantage." In one recent case involving our experts, a contract between a Japanese supplier and an Indian sales and marketing company contained a dispute resolution clause stipulating arbitration in London through the LCIA.

What Are the Trends?

As the table on page 39 shows, the total number of new international arbitration cases across a representative set of major arbitration forums fluctuated in the range 2,100 to 2,400 between 2000 and 2005. The number of cases began to rise in 2006 (+11%), ahead of the credit crunch, and accelerated in 2008 (+19%). On the basis of the available statistics, this trend appears to have continued in 2009. The increase has been observed across nearly all forums but the proportion of cases handled by Western-based arbitration bodies has fallen steadily from a high of around 62% in 2003 to around 55% in 2008.

We expect this drift towards Middle and Far Eastern arbitration centers to continue, in part because of the relocation of some resources to these regions by leading law firms, increasing their ability to handle such disputes locally rather than in the European or U.S. arbitration centers. We might also expect most of the major disputes to continue to be handled by the Western-based bodies, at least in the medium term, given their greater experience of such cases.

Historically, many investment treaty cases have related to large infrastructure investments in utilities and disputes over natural resources. In 2009, 25% of all ongoing ICSID cases related to oil, gas, and mining, with disputes relating to electricity and energy generation (13%),

Foreign Direct Investment Flows – Inbound Investment Flows Over Time

Annual Investment Flows (2009 $ million)

	Developing Economies	Transition Economies	Total
1980	7,477	24	7,501
1990	35,087	71	35,158
2000	256,833	6,998	317,706
2008	620,733	114,361	735,094

Stock of Investments (2009 $ million)

	Developing Economies	Transition Economies	Total
1980	303,532	-	303,532
1990	529,593	1,652	531,245
2000	1,736,167	60,873	1,797,040
2008	4,275,982	420,414	4,696,396

Note: values are in 2009 U.S. dollars and use current exchange rates.

Source: United Nations Conference on Trade and Development

In 2009, 25% of all ongoing ICSID cases related to oil, gas and mining.

transportation (11%), and water and sanitation (8%) also prominent. Commercial cases also often relate to natural resource issues – for example, in 2009, around 30% of LCIA referrals related to commodities contracts, presumably fueled to a certain extent by recent volatility in commodity prices.

It is tempting to ascribe the recent surge in claims solely to the global economic crisis, with the total number of cases falling off once economies and companies recover. However, the underlying economic trends may suggest a different view. One illustration of the scale of investments, and hence the potential for cross-border disputes, is the Foreign Direct Investment (FDI) dataset compiled by the United Nations Conference on Trade and Development.

The tables below and left set out FDI statistics for developing economies globally and transition economies (the latter term refers to the former Soviet Union and Central and Eastern Europe). They show investments in enterprises (via equity, loans, and retained profits) both on an annual basis ("flow") and the estimated cumulative total ("stock"). Inbound and outbound investments are shown. Many of the investments in enterprises in developing and transition countries will be in strategic industries potentially exposed to expropriation by governments, or to unexpected revisions to regulatory, fiscal, or tariff regimes. Other investments will be via joint ventures with a local partner. The FDI statistics therefore provide a guide to the scale of the exposure to cross-border disputes under both investment treaties and commercial arbitration.

The growth in both annual flows and the cumulative stock of investments, since 2000 in particular, is clear. This recent body of investment could prove significant for future levels of international arbitration as recent LCIA statistics indicate around 30-40% of new cases each year relate to contracts signed between seven and 10 years earlier. Importantly, these data exclude contract-based arrangements such as agency agreements, distribution agreements, and intellectual property licenses. We would expect these forms of cross-border commercial arrangement to increase over time as developing countries mature, and the services component of their economies grow along with the demand for Western goods and services. The potential for future cross-border disputes may therefore be even greater than suggested by the FDI statistics.

Although international arbitration is often thought of as relating to investments by North American or European parties in developing economies, the growth of outbound FDI by the emerging economies themselves is also significant (such as recent commercial investments announced by Chinese and Middle Eastern investors and sovereign wealth funds in various African countries). We would expect this trend to continue as these territories' share of the global economy grows.

It is important, as well, to recognize that the future of international investment treaty arbitration is not solely about emerging economies. For example, in 2009, Swedish power generator Vattenfall brought an ECT case against the Federal Republic of Germany. The action also illustrates the possibilities (and the complexities) presented by the different strata of

Foreign Direct Investment Flows – Outbound Investment Flows Over Time

Annual Investment Flows (2009 $ million)

	Developing Economies	Transition Economies	Total
1980	3,153	-	3,153
1990	11,909	-	11,909
2000	134,799	3,192	137,991
2008	292,710	58,496	351,206

Stock of Investments (2009 $ million)

	Developing Economies	Transition Economies	Total
1980	71,730	-	71,730
1990	145,179	560	145,739
2000	862,358	21,345	883,703
2008	2,356,649	225,387	2,582,036

Note: values are in 2009 U.S. dollars and use current exchange rates.

Source: United Nations Conference on Trade and Development

national laws, regional law (such as European law), and international law such as the ECT.

Commercial cases have historically been more diverse in nature than investment arbitration, arising from disputed contracts across a wide range of industries. FTI experts have recently been involved in commercial disputes in mining, construction, hedge funds, telecoms, chemicals, and ports. In the current economic climate, disputes arising out of troubled M&A deals are particularly widespread. Commercial disputes are pursued through arbitration, rather than through the courts, only if both parties have assented via an arbitration clause in their contract or at the time the dispute arises. Accordingly, certain types of claims, which do not rest on an underlying contract, are less frequently arbitrated. Such claims include patent infringements, most antitrust claims brought by companies, and many product liability claims.

In response to this complex picture, many leading international law firms are increasing their commitments in selected markets. For example, law firms have reinforced their local presence in Hong Kong in response to the rapidly rising number of cases in the region. However, the level of resources based in Asia is still less than in Western cities.

An informal review of law firm websites confirms that despite the recent relocation of international arbitration specialists to the Middle East and the Far East, firms continue to concentrate the large majority of their practices in traditional centers such as New York, London and Paris. Although the strategies vary, it also appears that the leading UK law firms have moved somewhat faster than their U.S. counterparts to establish international networks of arbitration practitioners.

The Shortcomings of International Arbitration

Of course, international arbitration is not without its detractors. While its flexibility and limited discovery – certainly compared with U.S. norms – should mean shorter hearings, less preparation, and significantly lower costs, participants sometimes complain that in practice it can be as expensive and time-consuming as litigation. Take the battle for Poland's leading mobile operator, PTC, between Vivendi, Elektrim, and Deutsche Telekom, which has mushroomed into a complex web of litigation and arbitration in various tribunals across Europe. One of the challenges has been the interaction between the rulings of different domestic courts in Poland and various arbitral panels. Then there's the ongoing saga of the €50 billion claim brought against the Russian Federation by former shareholders of Yukos Oil. Running since 2005, this is the largest arbitration claim to date and one that is unlikely to be resolved for many years.

Getting the arbitration clause right can avoid costs and delays at a later stage.

Arguably, with such significant amounts of money at stake, parties are not anxious to rush proceedings. Such cases involve multiple parties disputing sophisticated issues, and doing so takes time. However, due to the widespread binding consent given to arbitration in many commercial contracts and investment treaties around the world, international arbitration is here to stay for the foreseeable future. Moreover, experts in the field agree that, until a better system is devised, parties will continue to incorporate arbitration clauses into their contracts and to agree on arbitration as a mechanism for resolving investment treaty disputes.

The focus is therefore on how parties can strike a balance in terms of time and cost on existing cases, and on whether changes can be made to improve the current system. One influential body based in Paris, the Corporate Counsel International Arbitration Group – comprised of 50 leading multinationals such as Exxon Mobil, General Electric, and Siemens – is lobbying hard for reform. Suggestions include encouraging arbitrators to rule on key legal issues as early as possible, and ensuring greater transparency that would allow the performance of individual arbitrators and arbitration institutions to be assessed.

Implications of Arbitration

In order to minimize the likelihood of an undesirable arbitration outcome, businesses must understand the implications of the arbitration

clauses contained in their commercial contracts, as regard both liability and damages. Getting the arbitration clause right can be the key to avoiding costs and delay further down the line. However, some lawyers say that many companies still are not placing enough emphasis in this area when negotiating their contracts; to many, the inclusion of an arbitration provision is viewed as a "boiler plate" clause in an extensive business agreement.

Critical points to consider are the governing law of the contract and the seat of arbitration. The former defines the national laws that will apply should a dispute arise, and that means that a detailed understanding of such laws should be achieved before agreeing to be bound by the laws of a country other than your own. FTI experts were recently involved in an international arbitration involving a leading energy company and an Asian firm over the misuse of confidential technical information. A neutral European country was identified in the contract as the venue for hearing disputes and its law was adopted as the governing law. However, many years later when a dispute arose and arbitration commenced, it transpired there was limited legal precedent (certainly relative to the U.S. or the UK) to establish how to calculate damages for this particular breach.

The seat of arbitration can also crucially affect the outcome of the arbitration. The location of the seat normally determines the *lex arbitri* (or set of procedural rules) that forms a backdrop to the arbitration, as well as the courts that will have supervisory jurisdiction over the conduct of the arbitration and hear any challenges to decisions of the tribunal. The courts of different countries can have significantly different approaches to such issues. When choosing a seat, it is therefore important to evaluate the likelihood that the courts of that jurisdiction will intervene in the arbitration process. A company may wish to choose a "pro" arbitration seat in a neutral venue, and it can do so by reviewing any interventions made by local courts in past cases.

In terms of potential damages, the contract may contain provisions on liquidated damages – for example, stipulating a formula for damages in the event of late completion of a project – or limiting damages to specific pre-agreed sums or categories of loss. Definition of terms can vary by jurisdiction, so it is best to define the compensation of an aggrieved party as precisely as possible in the contract.

If the arbitration proceeds to a hearing, this will typically have the same features as a court hearing: oral presentation of cases and cross-examination of witnesses of fact and expert witnesses. There are, however, important differences. Proceedings are generally less formal than court hearings, and tribunals can be more interventionist than judges, particularly as regards witnesses. Witnesses, including expert witnesses, may find themselves in extended dialogue directly with the tribunal. Another growing feature is expert conferencing, or "hot tubbing," whereby expert witnesses engage in open debate over the issues, sometimes both responding to the same question from the tribunal. This unfettered approach can rapidly highlight the differences between the experts and assist the tribunal in judging which expert has the greater expertise or the more compelling viewpoint. This can be an unnerving process for clients, counsel, and experts who are used to the more structured cross-examination and re-examination processes followed in courts.

Planning for Disputes

It is important for businesses to consider international arbitration as a dispute resolution mechanism when planning and implementing their cross-border activities – either in crafting the dispute resolution clauses in their contracts with overseas partners, or in understanding the level of investment protection that will be afforded in the event of host government actions against investments made.

If companies do find themselves needing to engage in arbitration proceedings, it is important to obtain legal advice from experts in international arbitration, which operates in a different legal and procedural environment from court-based litigation.

Levels of cross-border trade and investment are on a rising trend across the global economy, particularly following the demise of the former Communist bloc and the rising levels of economic activity in parts of the developing world, including China and India. The evidence strongly suggests that, as a result, the resolution of disputes via the mechanisms of international arbitration will continue to grow in prevalence over the coming years. Partly as a result, leading businesses are thinking about ways of enhancing the existing mechanisms and practice of arbitration. This field of dispute resolution, practically unknown even 20 years ago, is set to form an ever-larger part of boardroom agendas in the coming years.

