Where and How Arbitration Costs are Incurred? How to Mitigate Costs?

Presented by : Nabeel Khokhar, Istanbul 8 October 2013.

Your Excellency Ambassador Scarante,

Your Excellency Ambassador Castellaneta,

President of the Chamber of Commerce of Rome, President Cremonesi

Vice-President of the Istanbul Chamber of Commerce on Turkey,

Learned and esteemed guests, Good morning!

It is an honour to be here and I would like to take this opportunity to thank the Istanbul Chamber of Commerce, ASPRAMED, the Italian Embassy here in Turkey, UNCITRAL and the United Nations, all the generous sponsors and in particular Mr. Stefano Azzali for inviting me here to speak before you.

The topic of my talk today is "Where and How Arbitration Costs are incurred? And how to mitigate these costs?"

Before diving into Arbitration costs and their mitigation, I would like to take a little time to look into the development of international arbitration itself. For if one wants to understand how the costs of this legal procedure are incurred, then one needs to look into the background of arbitration and its development over the course of time.

Over the last half century, international arbitration, as a form of dispute resolution has begun to gain more and more support, as a viable option to litigation.

It is an undeniable fact that resolution of commercial disputes through litigation is lengthy and hence extremely expensive. Depending on the jurisdiction, the length can vary but regardless of this, costs still remain disproportionately high.

The advent of arbitration as an alternative resolution procedure to litigation provided parties with a choice of resolution methods. And it came with a label of being more efficient in terms of both time and cost. The exact opposite to what made litigation so unattractive.

In 1965, Professor Philippe Fouchard, a former leading commentator on international arbitration described arbitration as

"an apparently rudimentary method of settling disputes, since it consists of submitting them to ordinary individuals whose only qualification is that of being chosen by the parties."

Nearly 50 years on, this seems a rather simplistic description of the arbitral process, but this was in fact the essence of arbitration. A simple form of dispute resolution that was to be cheaper than its litigation alternative.

However, as disputes became more and more complex and the amounts in dispute became larger and larger, this simplistic approach began to become more complicated.

David Rivkin, an American arbitration commentator and specialist, updated Professor Fouchard's description with his own and coined the term "The Town Elder Model" and stated arbitration as,

"two business people taking their dispute to a wise business person in whom they both trusted, describing their respective claim and then asking the arbitrator to provide them with the best solution to their dispute."

Both these descriptions are suitable to define the concept of arbitration, but taking the Rivkin description, one could say that the two business people are now highly sophisticated multinational conglomerates, who take their multi million or billion Pound, Euro or Dollar dispute to an arbitrator or panel of three wise business individuals and ask him, her or them, via highly expensive lawyers, to render a decision under the rules of an institutional body, that also charges the parties.

One can see the simple process has now become a rather more complicated one, largely due to the more complex nature of the disputes being arbitrated requiring robust rules and regulations administered by governing bodies and requiring litigation lawyers.

So our simple arbitration alternative to litigation is now hardly recognisable. It has developed as global business has. And to serve this market, it has had to become more complex as the disputes became larger, arbitrators became professional in their own right and parties began being represented by specialist arbitration lawyers who have taken control of the arbitral process, so much so that the actual users now feel out of control once the process begins. This has commonly become known as 'JUDICIALISATION OF ARBITRATION' and is one of the reasons cited for an escalation of costs.

It is not disputed that the costs of international arbitration have sky rocketed in the last decades, but if we are to ultimately control such costs, then any attempt to bring them under down must first look into and understand where and how such costs arise.

In 2011 the Chartered Institute of Arbitrators held a conference in London entitled 'Costs in International Arbitration'.

Some of the findings of research conducted by the Institute were:

- that the typical amount spent by a party going through the entire arbitral process, from pre-commencement to post hearing, excluding enforcement, was in the region of £1.5m, where the median claim was just under £10m.
- In 25% of the cases of between £10 to £50m, the costs exceeded £5m.
- And in over 50% the cases where the dispute exceeded £100m, costs exceeded £5m.
- Of the costs incurred by a party, nearly 75% were for external legal representation.

The findings of the Chartered Institute's research are of course open to the usual statistical scrutiny, but it does demonstrate that arbitration is an expensive process and also provides a valuable indication into where arbitration costs are incurred, and hence where savings can be made.

Other areas of the arbitral process where significant costs are expended are at the commencement of the process, at the exchange of pleadings and the hearing itself. It is not a coincidence that these points in the process are those where the lawyers are at work.

Institutional fees and arbitrator costs are also areas where parties have to spend large sums of money. However, in these areas there is reasonably accurate estimation of what these costs will be, or are likely to be.

What makes parties nervous is when the level and extent of the costs have a high degree of uncertainty and therefore effective cost planning cannot be carried out and budgets cannot be set for future planning.

In recent times the area of the arbitral process that has given parties most sleepless night is the overall time-span of the arbitration. Most parties feel that once the Request for Arbitration has been served, there is absolutely no control over how long it will be until the tribunal renders its award. This is despite the fact that at Case Management meetings there is a timetable that is discussed and agreed between the parties and the tribunal. Inevitably there are delays to the dates agreed and the time taken for submissions to be filed can drag on. Even more costly can be the discovery of documents stage and huge amounts of costs can be spent in discovery and disclosure of documents between the lawyers.

The most common growing complaint of the arbitration process, is that it has become increasing inefficient. And the promise of it being a more cost effective approach to dispute resolution is being clouded and lost in increasing lengthy arbitrations that are costing more and more as time-spans get longer and longer.

Benjamin Franklin in 1748, is commonly attributed to have stated that "Time is money".

This can be directly applied to international arbitration; as the time taken for resolution of disputes through arbitration is becoming longer, the costs incurred by the parties is becoming higher.

In McIlwrath and Savage's 'International Arbitration and Mediation : A Practical Guide, 2010' it is stated that the time for an international arbitral panel to render its award is generally in the region of one to two years and sometimes even longer.

In 'International Arbitration and Forum Selection Agreements: Drafting and Enforcing' 3rd Edition, Gary Born states that international commercial arbitration takes between 18 and 36 months.

In my own experience, I attended a case management hearing last month in a arbitration where the amount claimed is around US$ 150m with a counterclaim of approximately US250m and the hearing has been scheduled for early 2015, 2 years after the Request for Arbitration having been served.

So on the face of it, the solution to reducing the increasing cost of international arbitration is to streamline the process, to make it more efficient and hence more cost effective.

In 2012, the International Chamber of Commerce published its report on 'Controlling Time and Costs in Arbitration', within which the ICC defined how and where in the arbitral process the procedure could be made more efficient and how. Suggestions such as:

- More care and thought being taken in the actual drafting of the arbitration clause itself,
- More careful selection of counsel,
- Considerably more thought into the selection of arbitrators,
- Establishing a more robust framework for the proceeding within the initial Procedural Order,
- Clearer and more accurate Terms of Reference,
- The requirements and methods of treating witnesses of fact to be more clearly established,
- The roles of experts being more clearly defined,
- More effective and efficient hearings to be conducted;
- And that the tribunal play an active role in promoting a settlement.

I do not wish, nor am I going to now list out all the methods, techniques and ways in which the ICC recommended that their suggestions and proposals be implemented. This would most likely result in me simply reading out the ICC report to you, which would result is many bored faces, yawns and sleeping participants.

No, what I would like to propose is to tackle the problem at its root, and not to treat the symptoms.

We have seen that the problem itself is the huge costs that are incurred due mainly to high legal costs, due largely to an overtly long process.

But, are there ways to mitigate the costs of arbitration, even before the inevitable dispute has occurred?

Is there work that can be done by the parties during the project's early stages that could reduce the length of any subsequent future arbitration, or arbitrations?

Are there procedures, processes and strategies that can be put in place within the party's respective structures that could also reduce the overall cost they each will have to expend as and when a dispute makes its way to arbitration?

I would be bold enough to say "YES" to all three of these last questions.

Could I be bold enough to say that, to mitigate the costs of arbitration, one needs to look at the processes and procedures on the project that could lead to a speedier and cost efficient arbitral process? Processes and procedures such as, and in no particular order of importance:

- Giving the possibility of serious disputes occurring on the project more recognition at the contract drafting stage and during the project. And so, at the time of drafting the contract, the arbitration clause is not, as often happens, completely neglected when it comes the wording of it. I myself have had personal experience where no effort is made to propose amendments to poorly drafted arbitration clauses despite in house counsels flagging them up at tender stage. The reason, more often than not, is that comments made here may demonstrate to the Client that the contractor is thinking about arbitration even before it has signed the contract. This is deemed to be a sign that this particular contractor may not be one for this project. I would say that this is an excellent sign and illustrates that the contractor in question is giving the possibility of arbitration some constructive thought and not burying its head in the sand and taking the approach that disputes will not escalate. To do this, is naivety and not the sort of contractor I would want to contract with.

- Promoting the use of simple and clearly drafted arbitration clauses which avoid uncertainty and ambiguity. This in turn minimises the time and cost of proceeding from the very start of any dispute, where parties could be left arguing about the location, seats of arbitration, language, prevailing law governing the process and number of arbitrators and their jurisdiction. It is amazing how a simple omission as to the number of arbitrators, for example, can add months to the procedure. The ICC, in their Commission report on controlling time and costs in arbitration, highlight this very point and suggest that a simple and simply worded clause such as the ICC arbitration clause is best. And revisions to this clause can lead to a cascade of problems that result in longer and costlier proceedings. Money spent at this early stage on recognition that disputes will arise and preparations for them, via well drafted clear and accurate arbitration

clauses will ultimately make the arbitral procedure shorter and more efficient and cost effective in the long run.

- More effective contract management by both parties on site is required. It is surprising to note that many large international contractors still do not see the commercial value of an experienced Contracts Manager and their team. Knowledge of, and adherence to, its contractual requirements and obligations, from both parties, during the construction phase can be key to future disputes either not escalating into fully blown arbitration or if they do, then clear and concise claims can result in more streamlined processes.

- One of the most time consuming and costly areas of the arbitral processes is the discovery and disclosure of documents phase, which has the potential of spiralling out of control from a time and cost perspective. One way in which this can avoided is for an effective, accurate and modern method of project document management to be implemented on the project from the very start. I have had personal experience in numerous arbitration cases where documents from the construction phase are poorly managed, filed and documented. Even basic filing systems are at the time non-existent and when documents are requested to be disclosed, parties are either not able to produce them or a relatively straightforward part of the process becomes an inordinately long and time consuming and costly exercise. Discovery and disclosure is even more costly when there is the need, at times, to introduce a document management system into the arbitration, which was not there at the time of the dispute and this results in unnecessary time being allocated to work that should not have been needed if effective document managements systems were already in place.

- Disputes often flair up into arbitrations when something as simple as communications between the parties has broken down. Parties become entrenched in their position not based on their strengths but on ignorance of the other's position or even stubbornness. Open channels of communications throughout the life of the relationship of the parties can result in dialogue and discussion which can illustrate that the parties are actually not so far away from a settlement as they originally envisaged they were. Therefore it is important that there are channels of communications open between the parties during the arbitral process and that at any stage the parties feel that there are opportunities open to settle the case instead of it dragging on longer that it needs to. The arbitrators have a very important function here, wherein they can encourage the parties to consider settlement of the dispute at various points in the process. The ICC in their Commission report on controlling time and costs in arbitration also highlight this point and suggest that the tribunal give this serious consideration.

- The parties themselves, all too often, consider the process to be overwhelming and do not realise that they can, at any stage in the proceeding, request tribunal to suspend the process and beginning some sort of settlement talks. As mentioned earlier, judicialsation of arbitration can result in the parties having a feeling of being led by the lawyers and having little control over their disputes. However strong in house legal counsels or positive senior management should be implemented and control over the dispute should be taken back.

- Alternative Dispute Resolution techniques and methods available to the parties should be looked into at any stage of the arbitration process. The FIDIC suite of contracts, call for Dispute Adjudication Boards to be initiated at the beginning of the project, either as standing boards or ad-hoc when a dispute arises, the former being the much preferred

approach to take, however all too often their requirement is removed by the Employer. By crossing out the clause in the contract that states that DABs are the first port of call for the parties in the event of a dispute, the parties are forced to initiate costly time-consuming arbitration for relatively minor claims. Or worse still, submit global claims to the tribunal for their decision. A standing DAB, formed at the correct time and properly utilized by the parties is an extremely powerful tool to reduce the costs of arbitrations, as they usual resolve many of the matters prior to them becoming fully blown arbitration proceedings.

Arbitration is here to stay, of that there is little doubt. And therefore the costs of it will also always be here. However the arbitral process needs to evolve and take a look at itself if it is to remain a credible avenue open to parties to resolve their disputes, particularly in the light of alternative dispute resolution techniques. Notwithstanding these ADR procedures, arbitration will still hold the top spot in the league table of dispute resolution techniques for some time to come. And it can fulfil its promise of being a more cost effective alternative to litigation if the time-span of the proceedings is controlled thereby ultimately mitigating its costs.