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CORPORATE COUNSELLOR

Arbitration: A viable alternative for resolving commercial disputes

Published: 27/12/2013 at 12:00 AM
Newspaper section: Business

'Begin with the End in Mind" is the second habit in The Seven Habits of Highly Effective People by Stephen R Covey. In a lawyer's mind, everything must end badly. This is not because we truly believe that all transactions are destined to fail, but because we owe it to our clients to consider and prepare for the worst, so they can focus on the future potential of the deal at hand.

The worst possible ending for a contract is when it winds up in court. This means that the agreement has been breached, the subsequent negotiations have broken down, and both parties have spent substantial resources mobilising their legal teams to "wage war" inside (and out) of the courtroom.

The litigation "war" has very particular procedural and evidentiary rules that can result in the exclusion of important facts. Litigation lasts at least a year, and in exceptional cases, a decade or more including appeals. The other party can go to court with little or no warning, forcing you to respond or face a one-sided judgement against you. Lawsuits are often publicised, which can negatively affect uninvolved business interests.

The court system is overburdened and the judge assigned to any particular case may or may not have knowledge, experience or expertise in the industry of the litigants. When the case reaches judgement, the winning party's costs and legal fees may be only partially reimbursed, if at all.

There is an alternative to litigation: Arbitration.

If litigation is war, think of arbitration as a duel. In contrast to litigation, arbitration is voluntary, it's private, and it happens in a place and at a time that is mutually agreed between the parties. It is also left to the parties' own determination as to who will decide their dispute. It is important to note that arbitration is not a panacea and courts are often either better poised or required by law to resolve a dispute.

Arbitration requires one thing that litigation does not: beginning with the end in mind. Arbitration is a deliberate choice you need to make before you sign the contract. While you can drag someone into court, you cannot compel arbitration unless it has been previously agreed. In order to arbitrate, there must be an arbitration clause in the contract. And if you want a court to respect the decision to arbitrate, the clause must be correctly drafted.

Agreeing to arbitration is the first step. It is critically important to then design the arbitration so it makes sense to the parties in light of the underlying deal. For example, it would make little sense to arbitrate a supply contract worth A$50,000 between a Thai garment company and its Australian distributor in Luxembourg, under Japanese law, with a panel of five arbitrators from the Brazilian construction industry.

While such an example may border on absurdity, it is commonplace for contracts to include arbitration clauses that have apparently been lifted wholesale from other agreements, thus making them unenforceable or ineffective. In these cases, the parties may end up in court, the very place they were intending to avoid, or locked into an overly elaborate (i.e. expensive) process designed to resolve a different type of dispute.

Among the many factors to be considered when deciding on an arbitration clause, you should keep in mind the following points:

- Pre-Arbitration Negotiations. Do you want good-faith negotiations to precede the filing of any arbitration? (Should there be a face-to-face meeting among the decision-makers?)

- Location. Do you want to resolve the dispute in the home jurisdiction of one of the parties or in a "neutral" location? Does the value of the contract support travelling abroad to enforce it? (Arbitration is available in Thailand, while some common "neutral" locations include Hong Kong or Singapore.)

- Choice of Arbitrator(s). How many arbitrators do you want and what qualifications must they have? (Parties commonly appoint either one or three arbitrators and require them to be recognised experts in the industry.)

- Costs. Do you want the winner to have their costs reimbursed? (Parties typically pay their own costs and legal fees and authorise the arbitrator to reapportion them in the award.)

- Choice of Law. Do you want the law of the home jurisdiction of one of the parties or the law of some other jurisdiction to apply? (The location of the proceedings does not necessarily impact the law applying to the arbitration.)

Arbitration, if properly implemented, can offer an attractive, efficient, and less-costly alternative to litigating in court. The success of arbitration as an effective tool to resolve a dispute lies in the parties acknowledging potential problems and proactively deciding how to manage them. As Jim Collins espouses in his book Good to Great, we need to "confront the brutal facts". The brutal fact here is that not all contracts end with the beginning we had in mind.

This article was prepared by David Lawrence, a consultant in the Dispute Resolution Department at Tilleke & Gibbins. Please send comments to Andrew Stoutley at andrew.s@tilleke.com