The Privatization of Dispute Resolution in International Business Transactions

By:
Dr. Stefan Kröll, LL.M.
Visiting Lecturer, Bucerius Law School

The importance of dispute resolution in international transactions
In international business transactions the question of how and where disputes are resolved is of much greater importance than in purely national transactions. First, there is obviously a greater potential for disputes and misunderstandings. The parties come from different cultural and legal backgrounds resulting often in different expectations as to the conduct and content of their business relationship. In addition they communicate in a language which is at least for one of them not the mother tongue. Second, and even more important, are the differences in the various national approaches to dispute resolution in general. Greatly diverging procedural laws, the quality of the court system, national bias and the enforceability of decisions in other countries can pose considerable problems in practice. As a consequence in international transactions the mode and the place of dispute resolution is often one of the decisive factors in determining whether a party can enforce its rights or not.

These particularities of international transactions in relation to dispute resolution have long since been recognized. Legislation and courts in many countries have treated agreements pertaining to dispute resolution in international transactions different from those in pure national transaction. The US-Supreme Court for example held in Mitsubishi Motors Corp v. Soler Chrysler – Plymouth Inc., its landmark decision on the arbitrability of statutory antitrust claims, that

“…we conclude that concerns of international comity, respect for the capacity of foreign and transnational tribunals, and sensitivity to the need of the international commercial system for predictability in the resolution of disputes require that we enforce the parties’ agreement, even assuming that a contrary result would be forthcoming in a domestic context.”

The quote alludes to both, the major problem of dispute resolution in the international arena and the best possible answer to it – the lack of predictability, resulting from the existence of numerous fora with jurisdiction to hear the case on the one hand and the need to strengthen party autonomy on the other hand.

Increasing role of party autonomy
In light of the above it is not surprising that most important and overarching trend in international dispute resolution over the last decades has been the increasing importance of party autonomy. This trend has been supplemented and reinforced by the continuing efforts to reach a certain harmonization of the legal framework of dispute resolution. The latter have been particularly successful in the area of “privatized” dispute resolution, i.e. arbitration. There the UNCITRAL Model Law, emphasizing party autonomy in

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arbitration, has been more or less adopted in over 50 jurisdictions and has influenced the legal developments in numerous other countries which have not adopted it.\(^2\) The increasing role of party autonomy is the result of two closely related and interconnected developments. First, and quasi as a necessary prerequisite, courts and legislators have constantly enlarged the room given to party autonomy over the years. The endorsement of party autonomy in the above statement by the US Supreme Court is not limited to the issue of arbitrability or arbitration in general but also extends to other ADR mechanisms and forum selection agreements. Legal or practical obstacles to such agreements have been gradually removed by the courts or statutes. Previously existing reservations or hostility in particular towards binding out of court dispute resolution have vanished or are in the process of vanishing. Arbitration and other forms of ADR such as mediation, adjudication or expert determination are promoted not only for international disputes but also for national disputes.

Second, and in part also driving the first development, parties are making increasing use of their newly gained freedom in dispute resolution. At least the major players in international business take a much more active role in pre-planning the resolution of their disputes. Two of the most obvious signs for that are the increasing use of multi-tier dispute resolution clauses and the adoption and implementation of internal dispute resolution policies by numerous companies which operate internationally. These multinationals are also no longer willing to accept perceived pitfalls of previously preferred dispute resolution mechanisms and thereby become themselves driving forces in the further developments of such dispute resolution mechanisms.\(^3\) There are numerous examples for the first element of the above described trend, in particular in relation to the treatment of arbitration. One of the most obvious developments in this context is the increasing number of disputes which are arbitrable, i.e. may be submitted to arbitration by the parties. Other fairly recent examples of this trend are provided by the treatment of arbitration agreements and multi-tiered dispute resolution clauses by the English courts. For the second element of the trend, the German multinational Siemens provides a very good example.

### Developments as to the arbitrability of disputes

A very good indicator of the general approach of a given legal system to party autonomy in dispute resolution is what limit it imposes to the parties' freedom to contract out of the state court system and to provide for binding private dispute resolution, the results of which will be enforced by the courts. The less faith the legislator or the courts have in the adequacy of chosen private mechanism, in particular arbitration, the more disputes will be reserved for the courts and vice versa.

Over the last decades one could witness in many legal systems a development of a constant increase of the number of disputes which could be submitted to arbitration. Particularly obvious was that development in the US in relation to disputes arising out of

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\(^3\) See for example the article by three counsel of Siemens, Hobeck/Mahnken/Koebke, Time for Woolf Reforms in international construction arbitration, [2008] Int.ALR 84.
securities transactions. In 1953 the US Supreme Court had held in Wilko v. Swan⁴ that claims under the Securities Act 1933 were not capable of being resolved by arbitration and had to be referred to the state courts, despite the existence of an arbitration agreement. The underlying rationale was that arbitration offered the parties less protection of their statutory rights than court proceedings. Since then the legal position has changed completely. In 1974 in Scherk v Alberto-Culver Co⁵ the US Supreme Court recognised the arbitrability of federal securities claims with an international element, to extend these to purely national transactions in Shearson v McMahon.⁶ Finally two years later, in 1989, in Rodríguez de Quijas v Shearson/American Express Inc,⁷ the Wilko rationale was overruled, and all federal securities claims were declared arbitrable regardless of the nature of the transaction.

Comparable developments took place in other areas, such as competition law and antitrust law and in other countries.⁸ The German legislator, for example, when largely adopting the UNCITRAL Model Law in 1998 has extended the already broad scope of arbitrable disputes to an extent which has even led some authors to question the constitutionality of the extension in light of the limits to party autonomy.⁹ Section 1030 (1) of the German Code of Civil Procedure, containing the arbitration law, provides under the heading of “Arbitrability”:

> Any claim involving an economic interest ("vermögensrechtlicher Anspruch") can be the subject of an arbitration agreement. An arbitration agreement concerning claims not involving an economic interest shall have legal effect to the extent that the parties are entitled to conclude a settlement on the issue in dispute.

As a consequence that nearly all claims in business transactions involve an economic interest, very few disputes are exclusively reserved for the state courts while all the others may be referred to arbitration.¹⁰ The underlying rationale of that, reiterated in the legislative commentary,¹¹ is that in principle arbitration is considered to be a true and equal alternative to court proceedings offering the same amount of legal protection to the parties involved.

**Construction of arbitration agreements**

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⁵ 417 US 506 (1974); as justification the Supreme Court held that …” a parochial refusal by the courts of one country to enforce an international arbitration agreement […] would damage the fabric of international commerce and trade and imperil the willingness and ability of businessmen to enter into international commercial agreement”
¹¹ See Bundestagsdrucksache 13/5274 p. 34.
Another example of the above described trend to strengthen party autonomy is provided by the developments in relation to the construction of narrowly worded arbitration agreement. For a long time courts in England and other common law countries have construed such clauses restrictively. This reflected to a certain extent the scepticism with which arbitration agreements were seen, as they “ousted” the jurisdiction of the courts. The Australian Supreme Court, for example, adopted such a narrow interpretation in *Hi-Ferty Pty Ltd v Kiukiang Maritime Carriers* in relation to an arbitration clause contained in charter party referring to all disputes which “arise from the charter”. The case concerned a contract for the shipment of fertilizer from the US to Australia. When the Australian Quarantine Inspection Service denied unloading for contamination the claimant initiated court proceedings for negligence, breach of contract and a violation of section 52 Australian Trade Practice Act in respect of misleading and deceptive conduct. The defendant challenged the jurisdiction of the court invoking an arbitration clause which provided for arbitration in London. The Supreme Court held that only the claims for breach of contract were covered by the arbitration clause and had to be arbitrated in London. The other pre-contractual and non-contractual claims did not “arise from the charter” and therefore could be determined by the Australian courts.12

In its recent decision in *Premium Nafta Products Limited and others v. Filli Shipping Company Limited and others* the English House of Lords, at least for the English law, broke this tradition of narrow interpretation. The case concerned several charterparties which allegedly contained very favourable terms for the charterers. According to the owners these charterparties were only entered into because the latter had bribed one of the senior officials of the owners. According to the relevant dispute resolution clause in the charterparties “any dispute arising under this charter” could be referred to arbitration. The owners applied to the English Courts for a declaration that the charterparties had been validly rescinded for the alleged bribery. The charterers in turn applied for a stay of proceedings under section 9 of the English Arbitration Act 1996. For the stay to be granted the courts had to decide two questions: first, did the reference in the arbitration clause to “disputes arising under the charter” also cover disputes as to whether the charters were procured by bribery? Second, could the arbitration clause also be rescinded for bribery? The owners had alleged that without the bribe they would never have entered into any charterparty with the charterers and thus would never have concluded the arbitration clause.

While at least the first question directly only deals with the construction of an arbitration agreement, Lord Hoffmann indicated, in his speech, that the whole decision is also about the “attitude of the courts to arbitration”.14 Concerning the issue of construction, Lord Hoffmann after briefly describing the previous authorities referred to, which largely favoured a narrow interpretation, held that

“...the time has come to draw a line under the authorities to date and make a fresh start. I think a fresh start is justified by the developments which have occurred in

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12 *Hi-Ferty Pty Ltd et al v Kiukiang Maritime Carriers Inc et al* (1999) 159 ALR 142, 12(7) Mealey's IAR C-1 (1997) (Federal Court of Australia); excerpts also in XXIII *YBCA* 606 (1998) which do not, however, include the relevant part; but see the more recent decision of Federal Court of Australia in *Comandate Marine Corp. v Pan Australia Shipping Pty Ltd.* (2006) FCAFC, paras. 164 et seq., favouring a more liberal approach to interpretation.


14 Ibid, para. 5.
this branch of law in recent years and in particular by the adoption of the principle of separability by Parliament in section 7 of the 1996 Act”.15

At first sight the fresh start suggested seems to be nothing more than the recognition of commercial reality when Lord Hoffmann says that in his opinion

“…the construction of an arbitration clause should start from the assumption that the parties, as rational businessmen, are likely to have intended any dispute arising out of the relationship into which they have entered or purported to enter to be decided by the same tribunal”.16

The different starting point, however, also reveals a different attitude of to arbitration, as also indicated by Lord Hoffmann. The previous narrow construction was based on the underlying concept that the natural forum for all disputes is the national court system while arbitration constituted an exception. As a consequence the parties had to more or less explicitly contract out of the court system for every single dispute they wanted to refer to arbitration. Arbitration clauses were to a certain extent treated like “exemption clauses”. By contrast the new approach is based more on the idea that arbitration is just an alternative to court proceedings, if not even the natural forum for international disputes. Therefore, once it has been established that the parties in principle wanted dispute resolution by the parties there is a presumption that all disputes should be referred to arbitration.

Use of party autonomy by the parties: multi-tiered dispute resolution clauses and dispute resolution policies
The above described developments of increasing legal recognition and endorsement of party autonomy by courts and legislators go hand in hand with a greater use of the possibilities offered by the parties.
Not long ago the contractual clauses dealing with dispute resolution were largely limited to more or less standard arbitration clauses or forum selection clauses. In recent years, however, with increasing emphasis on the various ADR modes, contracts contain more and more sophisticated dispute resolution clauses. They are often no longer limited to a single mode of dispute settlement but provide for the use of different forms of ADR at different stages. Such multi-tiered clauses or escalation clauses can take different forms. Their common feature, reflected by the name “escalation clauses”, is that the same dispute is submitted to a sequence of different modes of dispute resolution with an increasingly binding nature for the parties.17 In general, the parties are required to have first fulfilled one stage before they can make use of the mechanism at the next stage. Such clauses can require the parties to negotiate for a certain time before they can and must then resort to mediation, followed by expert determination and then arbitration.

15 Ibid, para. 12.
16 Ibid, para. 1
17 For such clauses see only Melnyk, The Enforceability of Multi-Tiered Dispute Resolution Clauses: The English Law Position, [2002] Int. A.L.R. 113; Lew/Mistelis/Kröll, (Fn 8), paras 8-62 et seq.
These clauses are already long since used in the construction industry, in particular for international projects but also on the national level.\(^\text{18}\) Due to the frequency of disputes and their peculiar nature there was always a considerable need for sophisticated and tailor made dispute resolution provisions. As a consequence, the internationally widely used FIDIC Model Contracts from their early beginnings provided for multi-tiered dispute resolution. Disputes firstly had to be referred to the engineer, in later editions replaced by disputes review boards, whose decision could then be appealed to an arbitral tribunal.\(^\text{19}\) Today such clauses can also be found in other types of contracts which are particularly prone to disputes.

For a long time the enforceability of the non-determinative stages of such multi-tiered clauses was doubtful. In particular in England, agreements to negotiate were considered to be non-enforceable agreements to agree.\(^\text{20}\) By now, with the increasing recognition of the practical value of structured negotiations with or without the intervention of a third party, the verdict of a non-enforceable “agreement to agree” is rendered less frequent and agreements to mediate are by now enforced as a matter of course.\(^\text{21}\)

In light of these developments and a greater awareness of the various forms of dispute resolution and their benefits, numerous major international companies have even gone a step further. They have adopted particular dispute resolution policies which are intended to ensure that appropriate use is made of all existing forms of dispute resolution before the case goes to arbitration or court proceedings. For example, the dispute resolution circular of Siemens stipulates:

> To avoid lengthy and expensive arbitration/court procedures, the dispute resolution provisions should include a modern conflict management system in which the parties attempt to reach a resolution through negotiation. If no solution is reached through negotiation, the dispute resolution agreement should as a rule provide for an ADR (alternative dispute resolution) proceeding suitable for the respective conflict. In case the ADR proceeding fails, the jurisdiction of a recognized international arbitration tribunal in a (suitable) third country – outside the country of the contract partner – should be agreed on.\(^\text{22}\)

To accommodate that need, most of the leading arbitration institutions have added to their traditional arbitration rules numerous rules for other forms of disputes resolution. The ICC for example has supplemented its arbitration rules with rules for adjudication, for conciliation and for pré-arbitral referees just to mention the most important ones. In Germany, the German Arbitration Association is presently preparing special rules and clauses for multi-tiered dispute resolution after having long since supplemented its arbitration rules by a set of conciliation rules.

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\(^{19}\) For the developments under the FIDIC Rules see Jenkins/Stebbings, (Fn 18), p. 111 et seq.


\(^{22}\) The circular and the annexes to it are attached to the above cited article by the the Siemens Counsel Hobeck/Mahnken/Koebke, Time for Woolf Reforms in international construction arbitration, [2008] Int.ALR 84, 96.
Relevance of these trends for the teaching of dispute resolution

At present, however, the above described active management of dispute resolution is largely limited to multinationals with their own legal departments, such as Siemens or others. In medium size or small companies, which form the backbone of the international economy, knowledge of the various forms of dispute resolution is in general still very limited. In contracting, little attention is paid to the regulation of how potential dispute should be resolved. Companies still live according to the old adage that when you are getting married you should not talk about divorce. As a consequence, either no provisions for dispute resolution are included into the contracts or the clauses included are so pathological, that instead of helping the parties to solve their disputes they lead to new disputes about where and how to solve the main dispute.

The lack of knowledge is to a considerable extent due to the teaching of dispute resolution at law schools. While it may be true that specific contracts are often concluded without the involvement of lawyers, the latter either prepare the models used as a starting point, the general conditions of the companies are at least become involved when a dispute has arisen. Unless there has been a private interest in dispute resolution the “average” lawyer regularly lacks the required knowledge for active dispute resolution management. The exposure of the average student to problems of dispute resolution will often be limited to classes in civil procedure in the national courts and at best conflict of jurisdiction in the area of conflicts of laws. Lectures on arbitration or even other ADR methods will either not be offered at all or not be part of the normal curriculum.

It would probably be exaggerated to postulate that full courses on arbitration or other forms of ADR should become part of the mandatory curriculum of the law schools. However, in light of the above developments, the increasing role and room for private dispute resolution, and the globalization, what should be required is that every student should at least get an overview on the various methods of dispute resolution. Before discussing in depth in classes on national procedural law of how disputes are resolved by the national courts, students should be made aware that court proceedings are not the only way to deal with disputes and definitively not the best in relation to international transactions. An overview about the different modes of disputes resolution and their particular benefits and shortcomings as a separate course or at the beginning of the existing classes on dispute resolution would probably also be beneficial for the students in understanding the existing classes on civil procedure and to put them into the right perspective.