The Transactional Side of the International Arbitration and the Role of Corporate Counsel

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Introduction

In the business community, almost 100% of arbitrations are initiated by companies. For them, arbitration\(^1\) is clearly an appropriate way to solve disputes when breaches of contracts or treaties are evident and it is clear that the other party does not care about damage caused to the opposing company.

But, even if it remains a popular choice in practice, arbitration also has limits for international business players. The mixed results of arbitration for companies arise from a number of known factors that are common in court litigation but are even more relevant in arbitration proceedings: the length of proceedings, high external expenditures, a significant amount of internal work in coordination and case strategy,\(^2\) a controversial interpretation of international public laws rules, the risk of annulments, and a high risk of retaliation in the event or arbitration against a government, especially in investment arbitration. Disadvantages such as procedural complexity, legal challenges to jurisdiction or competence of proceedings, unpredictability and challenges to enforceability of decisions are not specific to arbitration.

Given that arbitration is in a sense "private justice" and that business prefers negotiated dispute resolution in good faith, the possibility to reach a successful conclusion of the dispute without pursuing the arbitration to its ultimate conclusion is an attractive and natural option for companies.

Therefore, the question is how and when the company should attempt a possible negotiated solution.

1) Do companies need to raise the question of a negotiated solution?

The answer is definitively yes, and the sooner is the better. The point can be raised at any stage of the proceedings, whatever the position of the company may be (claimant or respondent). It can be raised either by company executives or by in-house counsel.

In some circumstances, the matter is crucial, i.e. where maintaining the relationship between the parties is equally as important as the resolution of the dispute or when the proceedings are too long\(^3\) and the outcome highly uncertain and politically or socially under the scrutiny of the media or shareholders.\(^4\)

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\(^1\) We refer here to both commercial and state-investor arbitration, even if the latter follows different rules and is conducted before different type of arbitral tribunals.

\(^2\) As far as the Western practice of arbitration is concerned, see Cost of international Arbitration Survey 2011 published by the Chartered Institute of Arbitrators (CIABrb) and, 2010 International Arbitration: Choices in International Arbitration, published by White & Case and Queen Mary – University of London.


\(^4\) One example which shows the difficulty of some cases is that started in 1993, involving TexPet, indigenous Ecuadorian tribes (as plaintiffs), plaintiffs’ lawyers and the Ecuadorian State, before Ecuadorian and U.S. jurisdictions and an arbitration panel from the Permanent Court of Arbitration and which is still underway. This case doesn't relate to arbitration only but it shows the crucial legal and non legal issues of long and complex proceedings.
Whether or not to negotiate is one of the more difficult issues for companies and in-house counsels to resolve.

In day-to-day business, the executives of companies (financial departments but also top management) who oversee international arbitration frequently ask in-house counsels the usual questions: How long will the proceedings last? How much will the legal costs be? What chance of success does the company have? How many employees does the company need to mobilize to handle the case? Such questions are valid, as companies exercise rigorous financial control over the conduct of the international arbitration.

In-house counsel can naturally put the matter of negotiation on the table. At the end of the day, the company will rely on the in-house counsel’s experience and judgment to assign a percentage of success to the outcome of each option; not only to look at the next legal steps and to assess strengths and weaknesses of the company's legal position, but also to appreciate non-legal factors of the company's position (political, social, financial, technical, commercial) as an organization insider.

By anticipating the negotiation issue or suggesting it to the management, the in-house counsel fulfills a task which is in line with the management’s interests, as she or he has to deal with service providers (attorneys and experts), internal teams (other in-house counsel and employees from commercial, technical and controlling departments), legal budgets, and management advising.

When the legal department advocates a negotiated solution, it acts on the "transactional side" of the case, despite his work on the "litigation side" of the arbitration.5

2) Crucial economic topics to take into account

To companies, the following four topics are crucial when they decide what to do when faced with an international arbitration, whether it is imminent or already in progress.

Independently of the legal issues, the costs and margin of success are fundamental to the company’s decision-making process. Even in cases where the company acts to enforce the business’ rights or for non-legal reasons, the analysis of the arbitration is at the end of the day strictly financial.

In practice, in-house counsel and other employees involved will sooner or later have to determine the economic value of the main cost components, which are roughly the following:

a) Judicial costs (fees of arbitrators, attorneys, experts, arbitration centers), hereinafter “JC”;

b) Wages of employees (including executives) involved in the analysis of the facts, preparation of the request for arbitration, responses or rejoinders and other documents, due diligence issues, and preparation of the hearings, hereinafter “WC”, and

c) Cost of a possible settlement agreement, hereinafter “SC”.

The costs analysis becomes crucial in certain key stages of the proceedings in which the cost of the arbitration and the number of working hours, become evident to the company (i.e. when the arbitration center fixes the costs of arbitration and asks the parties to pay provisional fees or when the tribunal sets the procedural timetable).

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d) The chances of success, hereinafter “COS” and the amount of an eventually favorable award depend very much, but not exclusively, on legal and administrative factors.

The factors that directly affect the chances of success are:

- The level of legal and economic knowledge of the arbitrators about the case;
- The level of comprehension of the case by the attorneys and the arbitrators;
- The capacity of the attorneys to identify, develop, present and explain arguments in favor of the company in crucial topics related to the law facts and procedure;
- The room for dispute regarding the facts, the applicable rules, the position of the company and the reasoning of the arbitrators; and
- The way the company presents its arguments and evidence to the tribunal.

The factors which have an indirect impact on the chances of success are:

- The capacity of the arbitration center to manage the case in the best conditions; and
- The political and economic context (domestic and/or international) in which the proceedings take place.

To determine to what extent it is suitable or not to initiate, continue or complete arbitration proceedings [X], the following formula can be used:

\[ X = \frac{JC + WC + SC}{COS} \]

The higher the value of X, the higher the costs (JC + WC + SC) exceed the COS and, accordingly, it may be in the best interests of the company to explore the opportunity of a settlement arrangement.

A low X means that the JC + WC + SC are low compared to the COS and that, in such a situation, the company may therefore envisage pursuing the arbitration.

In practice, the costs (JC, WC and SC) are independent of each other although one category of cost can impact the others (i.e. a low SC can neutralize a high JC or WC and a high SC can be compensated by a low JC or WC). However, all these costs should be assessed as a whole.

It should be noted that, in some cases, a settlement in which SC is equivalent to the COS may be acceptable.

3) Truth of the protagonists and truth of the process

One of the most important tasks of in-house counsel is to reconstruct the facts of the case and to establish, as far as possible, the foundation of the decisions taken by the company at the time of occurrence. Such reconstitution must be undertaken in the most exhaustive and objective manner possible. To this end, in-house counsel needs the input of other employees of the company.

In general, the dispute can be summarized in a few crucial facts that the in-house counsel has to identify in order to effectively advocate the position of the company.
It is frequently the case that the people involved in the dispute believe in facts which are not supported by contractual terms and/or available evidence. The reconstitution can be jeopardized by the following factors:

- The facts took place in a distant past;
- The files of the company are incomplete or non-existent;
- The protagonists are no longer in the company;
- The protagonists who are in the company do not cooperate; and
- Management does not compel the people involved to cooperate.

The reconstitution of facts and a subsequent case assessment should contain:

- A detailed description of evidence supporting the alleged facts and decisions taken by the company;
- A legal assessment of the weight of the above matters in support of the position of the company;
- A comparison of these factors with those brought forward by the adverse party or by the company itself during the proceedings; and
- The options for the company indicating an estimate of the X.

In-house counsel must avoid building a case assessment based only on the subjective opinions or facts related by the protagonists in order to avoid creating unrealistic expectations that could cost the company time and money. The case assessment made by in-house counsel is a sensitive matter within the company and it should be carried out on a neutral and objective basis.

4) **Decision to complete the arbitration**

If the dispute is already a fact, at the commercial, technical or financial level, which the company was unable to halt through its normal commercial relationship, one effective way to put an end to it is by conducting direct negotiations with the other party.

The decision of the company not to initiate arbitration or to seek to finish one already underway must not be a decision based on a whim. It should be the result of a serious, internal discussion within the company in which the financial, commercial and technical analyses are as important as the legal ones.

Besides the X, the company must bear in mind other parameters of the arbitration (i.e. loss of business opportunities, jeopardizing political or business alliances etc)

Not all disputes can be solved by means of direct talks and settlements. It seems to us that the following disputes are more difficult to resolve by means of direct negotiation:

- Those in which the claims against the company are fraudulent or whose aim is to harm the company for purely business or political reasons;
- Those in which the claims are excessively high and for which no technical, commercial, financial or legal applicable standard exists;
- Disputes in which the dialogue between the parties has broken down and where the parties have no wish to protect business relationship;
- Disputes in which the information available within the company is not sufficient to make a serious assessment; and
- Those in which the time estimated to reach a settlement appears too long or equivalent to the total duration of the proceedings.

An arbitration has the advantage of allowing the parties to adjust the timetable of the proceedings by mutual agreement and therefore to stop and start them, depending on the progress of settlement discussions. Negotiations during the arbitration proceedings are
easier compared to those conducted during judicial proceedings before the ordinary courts.

5) Negotiation and control of the proceedings

When the company decides to negotiate, a negotiator must be appointed. The negotiator should have a complete picture of all the parameters of the case (legal, business and technical aspects).

Many international companies prefer direct negotiations rather than using external negotiators because it maintains the commercial relationship between the parties and provides more flexibility when concerning differences or disputes that would be too complex and possibly costly for the company if handled in the judicial arena only.

International companies tend to appoint their own employees as negotiators because in such case, the flow of information and the dialog with the other party can be more fluid and easier than through external negotiators. Often, the negotiator is in-house counsel. This has a triple advantage:

(i) to rapidly adapt the timetable of the proceedings;
(ii) to ensure rapid access to confidential internal information as in-house counsel is by definition allowed to undertake inquiries within the company; and
(iii) to provide a discussion that is less confrontational in nature.

First of all, the negotiators will have to establish an effective information channel and set the frame and timetable of the discussions with the ability to adapt the timetable of the arbitration accordingly. In this way, negotiations can proceed without pressure during the agreed period. Without a clear, agreed-upon framework, the talks will not be able to proceed peacefully because the parties will be distracted and confronted by the on-going arbitral proceedings. For this reason, it is preferable that the companies adhere to the arbitral timetable and not leave it completely in the hands of their attorneys.

When should settlement discussion be considered as an appropriate way forward, before or after receiving or sending the request for arbitration? If the basis of the dispute is already well known to the parties, waiting for the notification of the request for arbitration does not accomplish very much. In the case of unexpected disputes, the only option is to wait to receive the request for arbitration in order to decide whether or not to enter into a direct negotiation.

It is possible to negotiate at any time during arbitral proceedings as long as the award has not been enforced. However, the later the discussion takes place, the less effective the negotiation and the more costly a potential settlement will be.

Conclusion

The transaction side is a sort of hidden side of international arbitration that is directly linked to the internal business reasons that the “litigation side” of the arbitration does not always takes into account. It also implicates the management issues in arbitration from a company’s internal perspective that the specialized arbitration literature does not highlight because, in most of the cases, such literature only approaches topics of procedure and jurisprudence presented by attorneys, arbitrators or arbitration centers.

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Jorge PEREZ-VERA earned his law degree from Universidad Externado de Colombia (Bogotá) in 1986, received a Master Degree (D.E.A.) in International Law and received S.J.D. International Law from University of Paris II.

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