

DEALING EFFICIENTLY WITH DISPUTES IN
INTERNATIONAL COMMERCIAL TRANSACTIONS
—AVOIDING AND SETTLING DISPUTES OUT OF COURT—

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I. *Introduction*

Commercial transactions, the parties and countries involved are never 100% identical. So one has to allow for certain leeway in dealing with persons and transactions as experience and knowledge are good guidelines but not necessarily perfect ones.

Additionally, it is important to stress that each and every commercial transaction is usually a compromise negotiated between the parties unless one has a monopoly and can choose customers and prices at will.

Moreover, there is always a better deal and better goods/products somewhere on the market. Commercial transactions are meant for making money here and now. Emotions and consumers have to stay off. National and international commercial law rules are strict and designed for professionals not amateurs.

Therefore each and every international commercial transaction requires an analysis as to its prospective gains, risks and efficiency.

Diverging legal rules in different countries are just another factor like the risk of loss in transit or the default of the contractual partner that need to be taken into consideration when entering into a commercial contract.

Even after the advent of internet, chat-room, facebooks, video-conferences etc., there is

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still no better way to enter into any kind of international commercial transaction but to start with face-to-face negotiations, even if this entails long-distance flights and considerable expenses. These expenses usually pay off very quickly, for instance by saving huge sums after realizing that the future contractual partner is far from being the reliable, top-quality manufacturer as advertised via a flashy website.

The following approach in dealing with disputes in international commercial transactions is based on **the economic analysis of law**, i.e. by using legal rules for allocating efficiently economic assets.¹

The focus of this analysis is on disputes in commercial contractual relationships.

This begs the question whether there have to be always disputes in international commercial transactions. “No” is the clear answer followed by a “but”:

International transactions involve parties with different mindsets and cultural backgrounds. Money is, as always, not the only important issue. And contracts often contain (deliberate) gaps or ambiguous wording in need of interpretation. If this happens in a purely domestic set-up attorneys and courts will already have some difficulties to agree on a common approach. But is much more difficult this is in the international scenario with different languages and cultural backgrounds involved.

The common law for instance does not know a statutory interpretation looking into the historical background (parliamentary debates etc.) of a statute². Moreover, in the common law tradition any oral side agreements or amendments may not be heard in court contradicting any written contractual rule (so-called “*promissory estoppel*”).

The best option for dealing efficiently with future contractual disputes is to avoid them completely.

But contracts involve different expectations and therefore also a potential for disputes, let alone simple misunderstandings as the parties are rarely fully trained lawyers. Often there is also the temptation of a unique business opportunity letting the parties rush into a quick, unreflected agreement, sometimes even just orally over the phone. Additionally, factual or legal setting change absolutely unforeseeable to the parties at the time of concluding the contract, e.g. a new statute gets promulgated or an earthquake occurs etc.

Therefore the second best option for dealing efficiently with future contractual disputes is a well-balanced and well-drafted contract that takes into consideration the three main focus areas of international contracts:

1. The commercial transaction itself, i.e. its business goals, risks and technical details.
2. The legal background, i.e. options, default rules, choices of law and jurisdiction.
3. The parties to the contract with their individual expectations and different personal and cultural backgrounds.

When dealing with the choice of law and choice of jurisdiction clauses in an international commercial contract, the aforementioned three main focus areas have to be dealt with, i.e. the legal experts have to reconcile them. This presupposes that the parties are almost in the same

¹ See in detail *Posner*, *Economic Analysis of Law*, 4th ed, 1992; *Cooter/Ulen*, *Introduction to Law and Economics*, 3rd ed., 2000.

² See *Maxwell*, *The Interpretation of Statutes*, 12th ed., 1980, p. 1 et seq.; *Walker&Walker*, *The English Legal System*, 6th ed 1985, p. 112 et seq.

bargaining position and have some time at hand to enter into negotiations. If one party has superior bargaining power, e.g. through a quasi monopoly, then it will most likely dictate the other (potential) contractual party its (pre-fabricated) terms and conditions.

In any case, it is important to distinguish between different forms of commercial transactions or contracts.

II. *Different Forms of Commercial Transactions*

1. **One-off Transactions**

These are transactions that are not designed for a continuous legal or business relationship. Sometimes the parties do not envisage a longer relationship between themselves, sometimes the transaction as such is unique, e.g. the sale of an original painting or a classic car which both exist just one time; or building a wooden log-house abroad etc.

Very often these one-off transactions can be found in over-the-counter contracts in retail business, e.g. buying a new motorbike, milk or a TV-set, i.e. goods are being immediately exchanged against cash .

In these cases it is very unlikely and also economically inefficient that the parties draft elaborate contracts. So either standard forms of contracts (“the small print”) are being exchanged or everything is left to the default rules of the generally applicable law for that transaction.

This legal approach makes economically sense because the amount in controversy is often small and the payment is being made almost instantaneously. If, however, higher amounts are involved or even credit, parties might consider a more elaborate legal approach because of the higher risk in the case of non-performance.

2. **Short Term Transactions**

These are agreements where the parties depend on each other for a short, foreseeable period of time. Therefore these transactions are in the middle between the necessity to take almost no contractual precautions like in one-off transactions where the performance is being done almost instantaneously and long term transactions that require elaborate contract.

Examples of short term transactions are fixed term lease agreements for up to a year, sales contracts with a fixed amount and time frame.

3. **Long Term Transactions**

Long term transactions carry quite different weight because of different interests involved.

Here the parties clearly wish to establish a long term legal and factual/business relationship. Usually these aforementioned transactions run for an indefinite period of time. The calculation of both parties depends on a continuous performance of the mutual obligations. So they have to be flexible to accommodate future changes in external factual, legal or personal factors.

Examples are sales contracts for delivery by installments, long term lease agreements for

commercial property or dwellings, credit agreements, software agreements including maintenance or just-in-time delivery agreements, etc.

Here much more elaborate contractual terms are needed because the default rules relating to contracts in most EU countries do only contain very few specific norms for long term contracts. The most important issues here are how and when the parties may terminate the contract. Additionally, provisions for *force majeure* or other external changes should be inserted into the contract to render it as far as possible waterproof in the long run.

Long term transactions could also be established in the form of a joint venture, partnership or small legal entity, e.g. a Ltd.

III. *The “ADR-Toolbox” for Dealing with Disputes in International Commercial Transactions*

The following overview stresses methods of alternative dispute resolution (ADR). ADR is generally favored over state court proceedings as it is being done privately behind closed doors in a friendly set-up that lays the foundations for continuous future co-operation between the parties despite the original dispute. Nevertheless, there are a number of disputes and parties for which ADR is not suitable. Therefore ADR has to be viewed as just one tool out of the toolbox for dealing with international commercial disputes efficiently.

The main strategies to deal with a dispute arising out of an international commercial contract are the following:

1. Avoiding the Dispute
2. Ignoring the Dispute
3. Re-Negotiating the Contractual Agreement (ADR Step 1)
4. Mediation (ADR Step 2)
5. Arbitration (ADR Step 3)
6. Court Proceedings including Interlocutory/Interim Measures (injunctions)

The first two steps are advisable if the dispute does not cause a major disruption in the performance, i.e. does not amount to a fundamental breach of contract (see Art. 25 CISG). The sixth step is the traditional approach, also guaranteed by fundamental human rights and constitutional law as access to justice³.

In a professional assessment of a dispute it is important to analyze all legally feasible options in settling the dispute most efficiently. So ADR should be taken first into consideration before any confrontation in court takes place.

Court proceedings are already costly and lead to hardened position. Therefore it is less likely that the parties will opt for ADR once a statement of claim was filed. Although sometimes filing a statement of claim also works as a wake-up call for the defendant and shows the serious intentions of the plaintiff. In the aforementioned case, there might be still some leeway left for ADR.

There are certainly more forms and variations of ADR, e.g. mixed and hybrid forms⁴, but

³ As to the fundamental right of access to justice see Art. 13 European Convention of Human Rights and Art. 19 IV, 103 I the German constitution (German Basic Law/“Grundgesetz”).

in this context just the major three steps of ADR shall be dealt with regarding their efficiency:

- a) **Re-negotiation** in good faith (!) can take place at any time provided the parties voluntarily agree on that once the dispute has arisen. Alternatively, a re-negotiation clause can be inserted in the original contract.

The product of a successful re-negotiation is an amended original contract, a new contract or even a termination of the original contract upon mutual consent.

Re-negotiations usually take place in private behind closed doors in a neutral venue.

Private international law determines the applicable contract law of a state unless the parties had chosen the applicable law under the Rome I-Regulation⁵.

- b) **Mediation** is a voluntary procedure where the parties appoint an independent third party (the mediator) to assist them in finding a solution for their dispute. This mediator does not possess any legal qualifications as long as he or she is independent and regarded as competent and suitable by the parties. The parties have to enter into a contract with the mediator defining the content, procedure and fees.

The product of a successful mediation is ideally a new enforceable contract between the parties. Mediation should also take place behind closed doors, in a relaxed, protected neutral venue. Confidentiality is of paramount importance.

Also here, the private international law of the court determines the applicable contract law of a state unless the parties had chosen the applicable law under the Rome I-Regulation.

The *EU Mediation Directive for International Mediation*⁶ might lead to new statutes or rules in existing statutes regulating mediation in the EU Member States. Austria, for instance, has already had for years a statute for national mediation⁷. In Germany there is still the discussion going on whether any special rules need to be enacted.

Additionally, most professional mediators work pursuant to the (voluntary) *European Code of Conduct for Mediators*⁸. This Code lays down fundamental ethical and procedural rules, e.g. the independence of the mediator, equal treatment of the parties. Therefore this Code should also be agreed upon by the parties to prevent any unforeseen factual or legal complications.

- c) **Arbitration** is the most advanced form of ADR and the closest to state court proceedings. Its legal basis therefore can be found in the national laws of civil procedure of the EU Member States and in the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards⁹, to which all EU Member

⁴ See Pretorius, Introductions and Overview, p. 3 et seq., in: Pretorius (ed.), *Dispute Resolution*, 1993.

⁵ "Rome I-Regulation" (Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations), OJ L 177/6, 4.07.2008. Available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32008R0593:en:NOT>. Last visited 20 March 2011.

⁶ Directive 2008/52/EC of the European Parliament and of the Council of 21 May 2008 on certain aspects of mediation in civil and commercial matters, OJ L 136, 24.05.2008. Available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32008L0052:en:NOT>. Last visited 20 December 2011.

⁷ As to the 2003 Austrian mediation Act (*Zivilrechtsmediationsgesetz/ZivMediatG*) see http://portal.wko.at/wk/format_detail.wk?angid=1&stid=362257&dstid=0&titel=Austrian%2CMediation%2CAct. Last visited 20 December 2011.

⁸ The European Code of Conduct for Mediators can be found at http://ec.europa.eu/civiljustice/adr/adr_ec_code_conduct_en.pdf. Last visited 20 December 2011.

⁹ The text of the 1958 Convention can be found at <http://www.uncitral.org/pdf/english/texts/arbitration/NY-conv/>

States belong.

The parties seek a private resolution of their dispute by referring it to an arbitrator or an arbitration tribunal consisting of three arbitrators. This can only be done by a written agreement. Sufficient is actually a contractual clause containing the arbitration agreement. The effect of such an arbitration agreement is that a state court does not have jurisdiction (see e.g. § 1032 (1) German Code of Civil Procedure).

State courts, however, retain their jurisdiction for interim measures (injunctions) and at a later stage to set aside an arbitral award if fundamental principles of substantive or procedural law were neglected or the enforcement of the award is contrary to the public policy of the court (see § 1051 (2) German Code of Civil Procedure and Art. V 1958 New York Convention). But as a state court in civil proceedings will not act on its own (*ex officio*) the parties to the arbitration agreement have always the burden to bring an action for interim measures or setting aside an arbitral award.

Arbitration procedures can generally be distinguished as follows:

- 1) **ad hoc** if the parties themselves appoint an arbitrator or a tribunal including the applicable rules, or
- 2) **institutional** if the parties choose an institution providing arbitrators and procedural rules, e.g. ICC, DIS, IEMS.

Arbitration like mediation usually takes place at a convenient, neutral place behind closed doors. Confidentiality is also here a very important feature and advantage over state court proceedings. So just those arbitration proceedings reach the eye of the general public where the parties expressly agreed on going public.

The result of arbitration proceedings is either a compromise/ settlement out of court in the form of an enforceable contract or an arbitral award. The arbitral award can directly enforced with the assistance of state courts almost worldwide without any extensive court proceedings because of the 1958 New York Convention. The enforcement of national and international arbitral awards through state courts is in general an exceptional event. The standard is usually that the party ordered to pay or perform by the arbitration tribunal also does so in due time. The exception, to be sure, can be found if insolvency proceedings have started or the defeated party tries to gain time by trying to hide behind complicated local procedural rules.

The applicable rules in arbitration proceedings are determined by the parties' choice of law and/or the procedural rules are laid down by the chosen institution. Moreover, the arbitration tribunal is in most jurisdictions deemed to be generally empowered to act as *amicable compositeur* or act *ex aequo et bono*. This means that the arbitration tribunal is not bound by the local statutes where the proceedings take place as long as the award remains enforceable. But the parties can exclude this extensive competence as it leads to legal uncertainty because of the unpredictability of the outcome. Moreover, under German law the arbitration tribunal does not possess the competence to rule *ex aequo et bono* but has to apply pursuant to § 1051 (2) ZPO the law with the closest connection to the case, unless explicitly empowered by the parties decide otherwise.

In addition, it has to be pointed out that there is no second instance or appeal in arbitration

proceedings. An arbitral award is always a final ruling on the case and between the parties¹⁰.

However, arbitration has become quite unpopular in business circles in Germany, Japan and elsewhere due to its impressive costs and inherent risks, in particular the lack of a second instance, i.e. appeal¹¹.

IV. *Finding the Most Efficient Rational Form for Dealing with Disputes*

The parties to an international commercial dispute are usually unable to find the most efficient form for dealing with disputes because they are affected by the heat of the battle and do not act rationally (anymore).

So the first professional step is to call in an unaffected third person for an independent advice. This can be a lawyer or also psychologist or even accountant. Ideally, all three positions should be taken care of, provided the amount at stake is high enough. If the amount in controversy is less than EUR 10.000,00, it will be only in exceptional cases worthwhile to engage in any sort of professional dispute analysis.

However, in all other international commercial disputes it is important to have a combined analysis of the economic, psychological and legal side of the dispute to find an efficient solution. But here the initial caveat holds true: Every dispute is unique because simply the parties, countries and transactions will be different.

So it is of prime importance for the parties to obtain a timely, individual and professional dispute analysis before embarking on a costly and inefficient kind of international dispute resolution.

Such a dispute analysis in international commercial law (but also domestic commercial law) has to take the following into consideration:

- a) The financial, strategical and personal position of all parties involved (facts).
- b) The kind of commercial transaction with all its technical details (facts).
- c) The jurisdiction of various state courts (law).
- d) The applicable procedural and substantive law (law).
- e) The options available under ADR (facts/law).

The last point is, unfortunately, only available if the parties were or are able to agree on ADR at all. Therefore the most efficient way is always to have a mixed ADR-clause in the original agreement leaving all options in ADR open to the parties once the dispute has arisen¹². Mixed forms of ADR refer to a “staircase — step-by-step” application of (re-)negotiation, mediation and (maybe) arbitration. This must not be confused with hybrid forms of ADR, e.g. med-arb, arb-med, where the parties are limited to one mediator or arbitrator who assumes different roles as mediator or arbitrator as the parties go back and forth in the different proceedings¹³.

¹⁰ See *Diedrich*, Grundlagen der Schiedsgerichtsbarkeit, JuS 1998, p. 158 et seq.

¹¹ See *Masasuke Ishibe*, Das Schlichtungswesen aus rechtshistorischer und rechtsvergleichender Sicht, in: Marutschke (ed.), Beitrage zur modernen japanischen Rechtsgeschichte, Berlin 2006, p. 154, 175.

¹² As the various forms and facets of ADR see *Pretorius*, Introduction and Overview, *as above*, p. 3 et seq.

¹³ As to hybrid forms of ADR see *Pretorius*, Introduction and Overview, *as above*, p. 5 et seq; sometimes hybrid forms may even include state courts if the procedural law allows for a stay of proceedings in favour of ADR.

Commercial circles at least in Germany and Japan found out already a long time ago that arbitration is often being praised by certain associations or professionals because it generates their income but does not necessarily yield cost-effective solutions for the parties of an international commercial dispute¹⁴.

V. *Summary and Outlook*

Avoiding and dealing rationally and efficiently with disputes always starts with a contract.

Without any agreement between the parties there is just the door open to address state courts with solving the dispute.

This is because of the fundamental human right of everyone to have efficient access to an independent judicial review as can be found in Art. 13 European Convention of Human Rights and most constitutions in the EU member states, e.g. Art. 19 IV, 103 I German Basic Law (“Grundgesetz”). Therefore the state has to provide for an independent system and even financial aid to enable everyone to pursue his or her alleged individual rights also in civil cases not just as against infringements by state institutions¹⁵.

The German Federal Constitutional Court (“Bundesverfassungsgericht”) additionally established a constitutional right for everyone being entitled to efficient access to justice (“Gebot effektiven Rechtsschutzes”)¹⁶.

Any deviation from this fundamental human right requires a valid contract. And, ultimately, the door of the court house will remain always open even if the parties agreed on ADR. However, because of the contract the parties are bound to try ADR first. In the case of arbitration, the arbitral award is even expressly equal to a final court decision and can be immediately executed nationally and abroad by virtue of domestic civil procedure law and the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards.

It is imperative for an efficient international transaction to look more closely into a properly drafted contract with a mixed ADR-clause if it is a long term transaction and/or high financial or personal risks are involved. But even if this was not done when entering into the original agreement, there is always time to do so at a later stage. This, however, presupposes that the parties remain on speaking terms. So the parties in international commercial transactions are well advised to try to keep the ball rolling at all times. Otherwise there is just a limited, if not stripped, toolbox available for resolving any dispute. And this is hardly economically in international commercial disputes, unless it is a one-off transactions and/or one party possesses superior bargaining power, i.e. a (quasi) monopoly. The latter case is in practice

¹⁴ See e.g. *Masasuke Ishibe*, *Das Schlichtungswesen aus rechtshistorischer und rechtsvergleichender Sicht*, as above, p. 154, 175

¹⁵ See German Federal Constitutional Court, BVerfGE 37, 132, 148; 49, 252, 256 et seq.; 51, 150, 156.

¹⁶ The German Federal Constitutional Court has derived this procedural guarantee not just from Art. 14 (Property, inheritance, expropriation) but also from the other substantive constitutional guarantees in Art. 5 (Freedom of expression: BVerfGE 35, 79, 115 et seq.; 148, 151), Art. 12 (Occupational freedom, prohibition of forced labour: BVerfGE 37, 67, 77; 48, 292, 297; 52, 380, 389 et seq.), Art. 2 I (Personal freedom: BVerfGE 50, 1; 52, 203, 206 et seq.); Art. 2 II (Guaranteed of life, physical integrity: BVerfGE 51, 324, 343; 53, 30, 51, 57 et seq.); Art. 16 (Citizenship, extradition: BVerfGE 52, 391, 407; 56, 216, 244); Art. 4 (Freedom of faith, conscience: BVerfGE 79, 69 in connection with Art. 19 IV and 33).

rather the rare exception which opens the door in all other cases to a rational and efficient approach to settling disputes via ADR and/or state courts as the parties and their unique case require.

In short, there is no one single, magical legal formula available that will solve all kinds of international commercial disputes in the most efficient, optimal way. Nevertheless, a rational analysis of the dispute (as described above) enables the parties and their advisers to see their options clearer. Such a dispute analysis should be done, however, rather before (!) entering into an international commercial contract than having to face the harsh reality of very limited options afterwards because of a missing agreement on ADR.