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Litigation or arbitration in cross-border outsourcing: what is the better fit?

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INTRODUCTION

Structure of cross-border outsourcing projects and agreements

The decision to outsource business processes or certain IT functions is generally the result of a variety of operational, financial and technological issues that a business can no longer manage reasonably or on appropriate terms. Businesses are met with the following issues:

- A growing demand to innovate in a globalised business environment.
- Pressure from stakeholders requesting high returns on their investment.
- Lack of availability of skilled personnel that ensures long-term smooth and cost-effective operation of the relevant systems and processes.

As a result, it is an attractive option for many businesses to outsource relevant group-wide functions and processes into countries where skilled specialists are available at comparably favourable terms.

If group-wide functions and processes are outsourced, the customer and the provider typically enter into a master outsourcing agreement that sets out the generally applicable terms and conditions. However, a subsidiary within the customer's group may also have to enter into a separate agreement with the provider or one of its subsidiaries on a local or domestic level, due to either mandatory local law, tax or other business considerations. This separate agreement may provide specific conditions that apply on a local level and between the subsidiaries. If many local agreements have been concluded, contract management can become complex, particularly if a dispute arises between the parties.

To manage the complexity of cross-border outsourcing structures, the parties to the master agreement should agree that their subsidiaries or group members refrain from any kind of dispute resolution on a local level and, instead, escalate any potential issue for resolution by and between the parent entities under the master agreement. The subsidiaries may be involved in the ADR, if required. If this structure is adopted, the parent entities must enforce this rule within their group of companies by using their group-wide governance mechanisms.

In practice, when undertaking an outsourcing setup, the parties can include express wording in the master agreement providing that the two parent entities will ensure their involved subsidiaries submit any disputes between one another for resolution at a parent company level. While this obligation in the master agreement technically binds the two parent entities only, non-compliance amounts to a breach of contract under the master agreement and subjects the breaching party to liability for damages. This may incentivise the parent entities to use their corporate control of the subsidiaries to ensure the subsidiaries comply with the parent entities' obligation.

For a further discussion of the accession mechanism, see below,

Accession of subsidiaries or group members to dispute resolution mechanism

When discussing an adequate dispute resolution mechanism, consideration must be given to the parties' intent in the underlying outsourcing setup. The outsourcing setup described above is driven by the general notion that, while the implementation and performance of certain contractual duties may have to be performed by subsidiaries, the general framework governing the contractual relationship will remain the master agreement between the two parent entities.

As subsidiaries are separate legal entities and, as a rule, are not bound by any dispute resolution mechanisms agreed by their parent entities, the parent entities must enforce the subsidiaries' compliance with the agreed dispute resolution structure by using appropriate group-internal governance tools. Further, it may also be helpful to create an adequate accession mechanism to the dispute resolution clause agreed between the parent entities. An accession mechanism that is binding on all parties involved, including the subsidiaries, can increase legal certainty regarding the resolution of disputes in outsourcing setups that occur on the level of the two parent entities.

The most comprehensive means of accession requires that both in the master agreement, as well as in any related local agreement, express wording is included confirming the parties' intent that in case of a dispute between entities of the two groups of companies on whatever level, the dispute resolution clause featured in the master agreement between the respective parent entities applies. This will also require the inclusion of express wording in the dispute resolution clause featured in the master agreement clarifying that the two parent entities agree to resolve any disputes between their respective subsidiaries on the main level in accordance with the agreed dispute resolution mechanism, with the involved subsidiaries joining if needed.

Out-of-court dispute resolution

If a dispute has arisen on a local level or under the master agreement, the parties must first try to solve the issue amicably, in order to maintain a good business relationship. This can include an escalation of the dispute to different management levels of the parties.

In the event of a dispute, the master agreement must provide detailed provisions regarding dispute resolution and the management levels that will be involved. Only when internal dispute resolution has failed must the parties submit the dispute to the state courts or an arbitral tribunal, as a last resort.

Whether the dispute is resolved through state court proceedings or in arbitration is an important decision that the parties make when they negotiate the master agreement. For further discussion of the potential advantages and disadvantages of both court proceedings and arbitration, see below,

DISPUTE RESOLUTION IN AN OUTSOURCING: A COMPARISON

Arbitration: a formidable fit to resolve disputes in outsourcing setups

The subsidiaries must accede to a dispute resolution mechanism agreed between two parent entities in both litigation and arbitration. Whether the parties choose one or the other is mainly a question of personal preference. However, one of the key factors generally considered is the aspect of time.

Time management is a major concern for commercial players. They have generally little interest in spending more time than absolutely necessary in resolving disputes. This particularly applies in outsourcing setups. In an outsourcing there can be many types of dispute, which, despite being in need of resolution by a judicial or quasi-judicial authority, must not result in a complete rupturing of the entire contractual relationship. That is, following (or even in parallel to) the resolution of the dispute, the contractual collaboration will continue. In cases such as these, the need for swift dispute resolution is paramount.

Consequently, the prospective duration of judicial proceedings is key. This is a key advantage that arbitration has over litigation in Switzerland. Arbitration provides the parties with a great degree of flexibility in terms of the duration of proceedings. There are various tools that parties may choose to speed up the arbitral process. For example, the Swiss Rules of International Arbitration of the Swiss Chambers' Arbitration Institution (Swiss Rules) provides for "expedited proceedings", which under the Swiss Rules generally apply for disputes with values of below CHF1 million. However, the parties are free to agree that regardless of the value in dispute, the arbitral proceedings will be conducted by way of expedited proceedings. This can be agreed in advance in their arbitration clause, or on a dispute arising.

The "expedition of the proceedings" that the Swiss Rules provides is achieved by means of the below three features:

- First, the dispute will be decided by a sole arbitrator instead of a three-member panel. This not only saves the costs of two arbitrators, it also speeds up the decision making process and the arbitral process as a whole.
- Second, proceedings are conducted with one round of written submissions only, that is the:
  - Statement of claim filed by the claimant party;
  - Statement of defence filed by the defendant party (which may include, if relevant, a counterclaim in which case the claimant party can respond to it in a further submission).

  No reply or rejoinder submissions are filed, which not only saves lawyers' fees charged for the preparation of these submissions, but also significantly shortens and speeds up the schedule of the arbitral proceedings. It also saves the sole arbitrator time in his review, which may further expedite the decision-making process.
- Third, and related to the sole arbitrator's decision-making process, arbitral awards rendered in expedited proceedings must contain a summary reasoning only, which also saves further time and cost.

In addition, parties to an arbitration can agree that the proceedings should be decided based on documentary evidence only (separate to the expedited process). The deletion of oral witness hearings constitutes a further tool that parties may choose to significantly reduce the duration of arbitral proceedings and the related costs incurred.

Expedited proceedings conducted under the Swiss Rules must generally be concluded within six months from the date on which the secretariat transmitted the file to the sole arbitrator. The deadline provided by the Swiss Rules does not take into consideration the option of having a case decided based solely on documentary evidence. If the latter is agreed, arbitral tribunals conducting expedited proceedings may even be expected to render their decisions well within less than six months from receipt of the file.

While the tools described above were extracted from the Swiss Rules, parties preferring ad hoc proceedings or arbitral proceedings conducted under other institutional rules can also incorporate these tools into their arbitration agreement, either in advance or once the dispute has occurred.

The option to agree on fast-track proceedings, paired with the fact that appeals proceedings are limited to one instance only, rendering its appeals decisions generally within six to eight months from filing, cater to the need of a fast and efficient dispute resolution mechanism that parties to outsourcing setups demand.

Litigation: is the quality of the decision a factor?

Litigation cannot compete with the flexibility of the arbitral process in general, and the tools available for parties to expedite proceedings in particular. While arbitration does have its advantages, litigation should not be discarded as a valid alternative option just yet.

Litigation in Switzerland, contractually agreed on the basis of a forum prorogation clause, may be more than a reasonable option to consider. Switzerland is composed of 26 cantons and governed by a federal system. The judiciary in the 26 cantons is organised by each respective canton on its own. Four of the 26 cantons have used their right to establish a specialised court as the sole cantonal instance to hear commercial disputes, whose decision can only be appealed to the Swiss Federal Tribunal (that is, Zurich, Berne, Aargau and St Gallen).

While it is not possible for parties to determine the subject matter jurisdiction of a commercial court (in one of the four cantons), if the competence of the courts in a canton with a commercial court in place is agreed, in many cases it will be the commercial court that will have subject matter jurisdiction, if the parties are incorporated entities and if the value in dispute exceeds CHF30,000. In the case of an outsourcing, the parties will generally be incorporated entities.

In an outsourcing setup, the following features of the commercial courts may be of interest when considering which dispute resolution mechanism to choose.

Speed of proceedings. Aside from the fact that there is only one appeals instance for decisions of the commercial courts, the commercial court of Zurich has a known track record of settling cases amicably. In practice, parties litigating before the commercial court of Zurich will, after submission of one round of briefs, be invited to settlement discussions, where the court will present its preliminary views of the case and point out the respective risks of the parties if the proceedings go forward. In practice, the commercial court of Zurich succeeds to settle around 60% of the disputes through amicable settlement. While this prospect may not appeal to some parties, others may feel differently. In particular, commercial players who have a foremost interest in resolving disputes as swiftly as possible, which in outsourcing setups is often the case, may prefer a swift in-court settlement bearing a certain monetary loss over extensive court proceedings, which will cause further costs to the parties and which bear the risk inherent in any judicial proceeding of ultimately losing the case.

In contrast, it is significantly more difficult to reach an in-court settlement between the parties in arbitral proceedings. First, the holding of settlement discussions is only possible with the agreement of all parties involved. While the commercial court may unilaterally invite the parties for settlement discussions and "force" them to sit around the same table, this is not the case in arbitral proceedings. Arbitral proceedings are governed by the principle of party autonomy and therefore, no arbitral tribunal will invite the parties to settlement discussions against their will. This would make the arbitral tribunal prone to a challenge for impartiality. Furthermore, and depending on the background of the arbitrators, arbitral tribunals may not agree at all to hold settlement discussions, even if expressly asked to do so by the parties. This may particularly be the case if the appointed arbitrators have a common law background. While holding in-court settlement discussions, whether at state court or within arbitral proceedings, is a common notion for any civil law trained lawyer, this is not the case in common law jurisdictions, where the purpose of the judiciary is generally seen to resolve disputes by means of a decision rather than to assists parties in finding an amicable settlement. In practice, this legal background then also transpires to common law arbitrators when asked to hold settlement discussions.

Cost. Aside from the real possibility to cut-down on court costs by reaching an in-court settlement, court proceedings are *per se* substantially less expensive than arbitral proceedings. The court costs in the canton of Zurich for a claim with a value in dispute of CHF3 million would amount to around CHF50,000, while the costs of an arbitral tribunal in Swiss Rules' proceedings will range between CHF33,800 and CHF135,000 for a sole arbitrator, and CHF84,500 and CHF337,500 for a three-member tribunal, without regard to the administration cost that will also be charged. This, paired with the fact that arbitral proceedings ordinarily feature more procedural steps causing additional lawyers' fees than state court proceedings (for example, to determine the applicable procedural rules in the arbitration), make proceedings before the commercial court of Zurich attractive from a cost perspective.

Quality of decision-making. Judges at the commercial court normally come with sufficient years of experience under their belt to deal with even the most complex of commercial disputes and render quality decisions. On the arbitration side, one certainly cannot say that arbitrators appointed to review commercial disputes lack the requisite expertise. After all, in three-member arbitral tribunals, the parties have a major role in choosing adequate arbitrators. However, concerns as to the quality of arbitral awards can arise in relation to claims with low values in dispute. As a result, well-qualified and experienced arbitrators choose their appointments carefully and with a commercial interest in mind. Since, at least in institutional arbitration, the arbitrators' fees are generally linked to the values in dispute, in many cases one will find it difficult to appoint an arbitrator with the required expertise and experience for smaller cases. If, for these reasons, the parties will be confined to designating arbitrators with little experience to review a "small" case, valid quality concerns may arise. These concerns may also be exacerbated by the very restricted grounds for appeal against arbitral awards made available by Swiss law, which in principle conform to the grounds on which the enforcement of arbitral awards can be rejected under the UN Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958 (New York Convention).

ConclusionThere is no doubt that arbitral proceedings, subject to the parties' corresponding agreement, permit a swift resolution of disputes, which is presumably one of the most important aspects when assessing the adequacy of a particular dispute resolution mechanism in the context of the outsourcing setup. While proceedings before the commercial courts in Switzerland are not able to match the speed of arbitral proceedings, their efficiency from a cost and quality perspective, in conjunction with the reasonably swift duration, also makes litigation a more than adequate alternative to resolve disputes in the context of outsourcing setups in a commercially acceptable manner.

In most instances it will come down to the personal preferences of the parties whether they will choose arbitration or litigation. The above considerations show that either decision will be commercially sensible, since litigation and arbitration are, on the basis of objective criteria, both great fits to resolve disputes in the context of outsourcing setups.

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