

Business Across Borders

Troubled waters: the risks of international commercial disputes

A series of articles written by The Economist Intelligence Unit

ReedSmith

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Business across borders

Troubled waters: the risks of international commercial disputes

One of the perils of doing cross-border business is the possibility of being pulled into business-related legal wrangles. A recent global survey of executives carried out by The Economist Intelligence Unit (EIU) on behalf of Reed Smith, a global law firm, finds that one in four companies has become embroiled in an international commercial dispute in the past two years.

Companies from some sectors and regions are more likely to have been involved in an international commercial dispute. Nearly one-third (30%) of survey respondents from the transport and shipping sector reported experiencing a dispute in the past two years. European companies also reported an above-average number of disputes (29%), compared with just one-fifth (21%) from Asia-Pacific and one-quarter (25%) from North America.

Smaller companies fare better than larger enterprises in this respect, with close to one in five (19%) of respondents from companies with annual revenues of less than US\$250m citing involvement in disputes compared with over one-third (34%) of companies with revenues in excess of US\$10bn annually.

Over the past two years the most common reason behind organisations' international disputes, according to the EIU survey, has been a breach of contract, with 31% saying that this was the case in developed markets, 27% in BRIC countries and 28% in non-BRIC rapid-growth markets.¹

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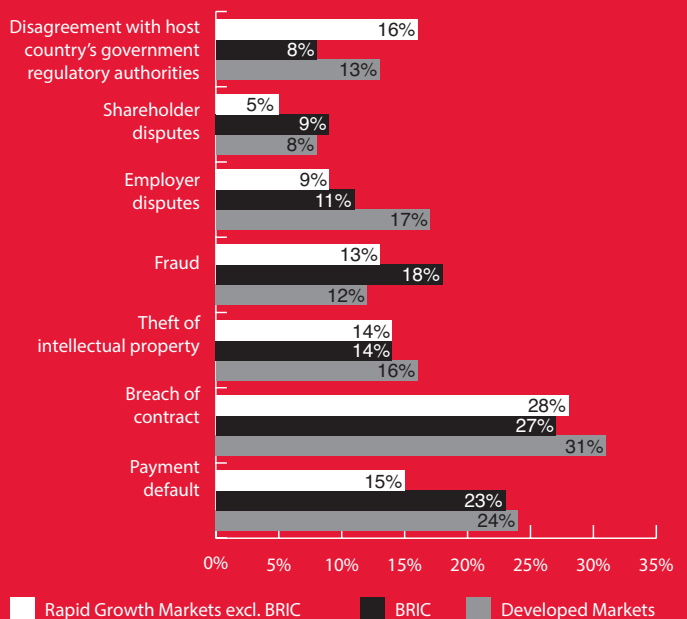
"The disputes that end up taking place include interpretation of contract," says Vishnu Amble, an investment associate with Global Cleantech Capital, a Europe-based private equity firm investing growth capital in clean energy. "That is the risk when you have contracts with local suppliers and distributors, although these types of disputes are far less frequent than they were five to eight years ago."

Payment defaults are the second most common reason for disputes in developed and BRIC markets (24% and 23% respectively), while disagreement with the host government is the second most common reason in non-BRIC rapid-growth markets (16%).

Executives in the EIU survey anticipate similar patterns in international commercial disputes for the next two years. Respondents who have not been involved in a dispute over the past two years say that a breach of contract and payment default will be the most likely cause of an international dispute in the short term in developed and non-BRIC rapid-growth markets.

Chart 1:
What was the nature of your organisation's international commercial dispute over the past two years?

(% of respondents who have been involved in an international commercial dispute)



Source: The Economist Intelligence Unit

¹ Including: Colombia, Indonesia, Vietnam, Egypt, Turkey, South Africa, Mexico, Nigeria, Philippines, Argentina, Chile, Angola, Algeria, Morocco, UAE, Poland, Mongolia, and Kazakhstan.

US\$1trn

valuation of stolen corporate intellectual property worldwide, according to ASIS International

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Michael Fertik, chief executive officer of Reputation.com

Emerging risks to intellectual property

While at the start of the 20th century most commercial disputes centred on infrastructure (typically railroads), the big commercial cases now are more concerned with technology and intellectual property (IP). In fact the value of stolen corporate IP is strikingly high: two surveys conducted by ASIS International, a security-industry body, estimate the value to be US\$300bn for the US alone and US\$1trn worldwide.

“Patent law is in a crucible moment in the US, and by extension it is in a crucible moment around the world,” says Michael Fertik, chief executive officer of Reputation.com, an online reputation-management company that holds six patents and has 30 more pending. “As a society we are still figuring out what the extent of patents in technology should be and can be. And what the enforcement action should be and can be,” he says. Over the next five years, as these questions are answered, there is likely to be greater conflict and agitation concerning IP in the US, and consequently overseas, according to Mr Fertik.

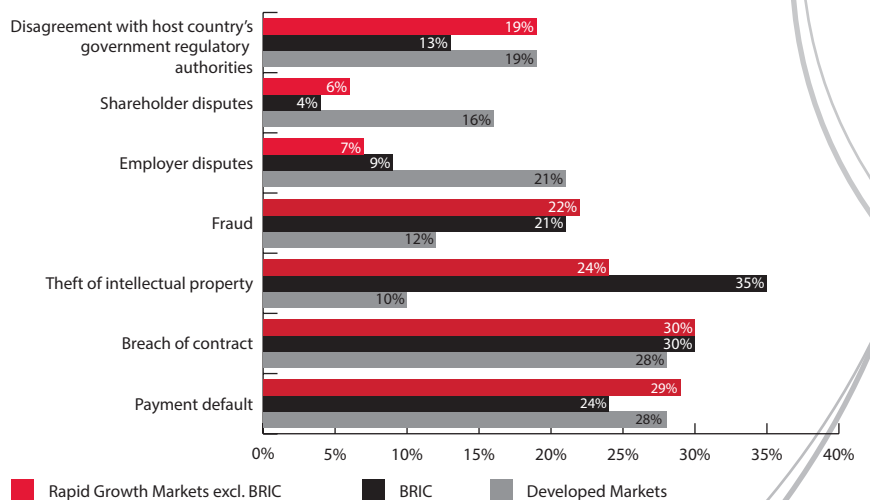
Executives in the EIU survey believe that theft of IP is set to become a greater challenge in BRIC and other rapid-growth markets. Out of the respondents who have not been involved in an international commercial dispute recently, 35% think that theft of IP will be the most likely cause of a commercial dispute involving their organisation in BRIC markets over the next two years, compared with only 30% for breach of contract.

The threat to IP appears to be of greater concern among executives from the media and technology, and healthcare and life sciences sectors, according to the EIU survey. “Every time we look at the opportunities from a business development point of view, IP rights are always high on the agenda,” says Jacob Tolstrup, vice-president for corporate business development and strategy at Lundbeck, a Danish life sciences company that has products registered in more than 100 countries.

Chart 2:

What do you think will be the most likely nature of your organisation's international commercial dispute over the next two years?

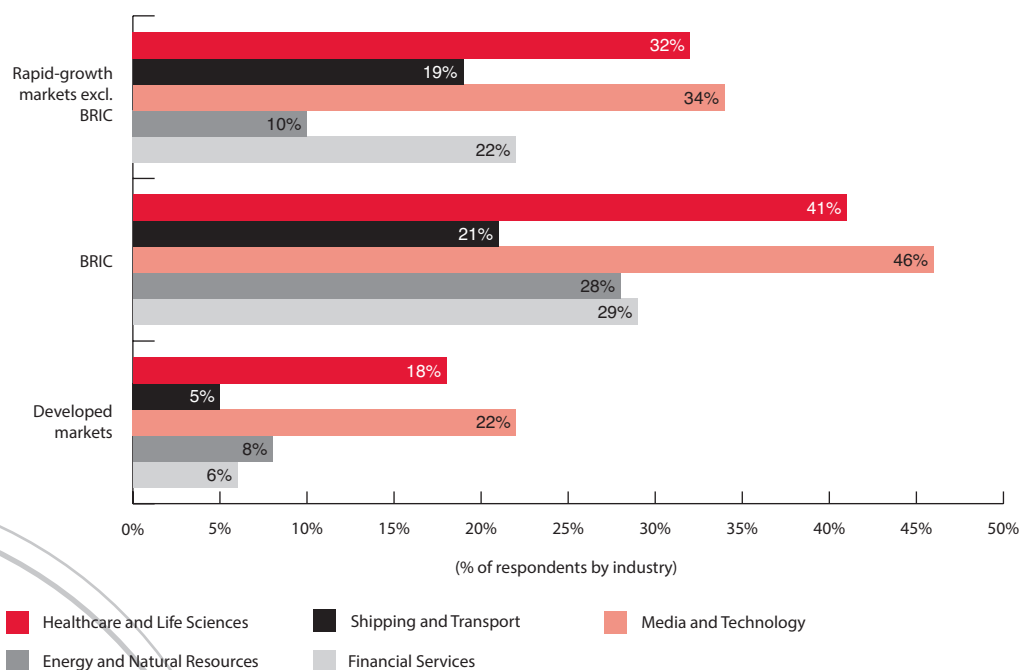
(% of respondents who have not been involved in an international commercial dispute)



Source: The Economist Intelligence Unit

Chart 3:

Of those who have not been involved in a dispute recently, what percentage think they are likely to be involved in an intellectual property dispute? And in which markets?



Source: The Economist Intelligence Unit

Prudent investors will draw up agreements that include clauses determining how disputes will be resolved.

It is difficult to say exactly where IP laws will be in five years' time globally. What is apparent, however, is that more and more countries are tuning their IP laws to US standards, and will continue to do so. This could eventually lead to internationally accepted rules for IP protection. Mr Fertik stresses the importance for any company to be able to develop technology with an engineering team overseas in a way that is safe for shareholders back at home. If a country wants to attract "knowledge economy" jobs, then it must be able to protect intellectual property in a way that is "comparable and fair".

A matter of enforcement

The means of resolving a commercial dispute depend on the nature of the parties involved. When it comes to disputes between companies and governments, there are three likely routes to resolution. First, the issue might be arbitrated either through a contract or through a free-trade agreement. Second, in the absence of a treaty or contractual provision compelling arbitration, the investor may need to ask its home country to bring a claim on its behalf before an international tribunal, such as the International Court of Justice or the World Trade Organization. This does not always deliver satisfactory results for the injured party, says Eric Richards, chair of East Asian Initiatives and professor of business law at Indiana University's Kelly School of Business. "When you're dealing at a national level, the problem is that it takes your home nation to represent you," he explains. "Frequently your home nation won't be willing to bat for you, and, even if it does, any dispute-resolution remedy might result in damages being awarded not to you but to the nation as a whole."

Third, disputes might be litigated in the courts of the host country. Prudent investors will draw up agreements that include clauses determining how disputes will be resolved. “It’s important for companies to see if a country has the underlying judicial infrastructure,” says Mr Richards, “But then they should also negotiate a very solid contract with the investing nation.”

In emerging markets, which may have weaker judicial infrastructure, global dispute-resolution bodies can offer protection for companies facing disputes with either the host government or other companies. “In countries that do not have the same type of rule of law, companies are much more interested in potential systems outside that territory,” says Fredrik Erixon, director of the European Centre for International Political Economy, a world-economy think tank.

In fact, international business contracts are regularly signed under English law and New York law since they are widely regarded as the market standard for global business contracts. “You have a lot of ‘legal tourism’ in the US and the UK simply because they have a longer and better tradition of dealing with commercial disputes,” says Mr Erixon. Building on this strength, the US and the UK have recently been promoting their courts as forums to settle commercial disputes.

In recent decades bilateral investment treaties (BITs) – a popular means of dispute resolution – have proliferated. “With the growth of BITs and dispute settlement in the huge number of foreign free-trade areas, it is getting complex,” says Theodore Moran, non-resident senior fellow at the Peterson Institute for International Economics and professor of international business and finance at Georgetown University.

Companies can also turn to arbitration or mediation as alternatives to court proceedings. In arbitration, a panel of arbitrators listens to the arguments of the parties involved before issuing a decision on how the dispute should be resolved. With mediation, an independent third party works with the companies in dispute to reach a settlement.

However, settlements can be harder to reach in emerging markets, since mechanisms allowing for arbitration may not exist. “Countries in Africa and Latin America, which are now attracting foreign capital, do not have arbitration processes in place,” says Mr Amble. “In such markets, it is important to have relationships with local and global dispute-resolution parties.”

What matters then is for organisations to be aware of the kind of risks that they are likely to encounter abroad, be they the possibility of a payment default or threats to IP. Companies also need to understand and plan for how potential disputes might be resolved, and carefully consider the routes available in different jurisdictions. They need to ensure from the start of an overseas venture that any dispute can be resolved in a fair, transparent and satisfactory manner.

It is of course difficult to entirely eliminate risks, and even the most carefully drafted contracts lose their shine if they cannot be enforced in a particular jurisdiction. But deciding against overseas expansion just to avoid international commercial disputes is not a viable option for companies that are eyeing international growth. The risk of becoming involved in legal entanglements comes with the territory. The question then is whether the rewards will be worth the risk.

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About the research

In January 2013 The Economist Intelligence Unit conducted a global survey of 451 executives on behalf of Reed Smith. All respondents represented companies that conduct business internationally. Over one-half of respondents (56%) are C-level executives and 53% are from companies with annual revenues in excess of US\$500m. Just under one-third of respondents are from Asia-Pacific (30%) and from North America (30%), and nearly one-third (32%) are from Europe. The remainder of respondents are from the rest of the world, including the Middle East, Africa and Latin America. Respondents represent a range of industries, including: 15% from financial services, 14% from energy and natural resources, 14% from media and technology, 13% from shipping and transport, and 13% from healthcare and life sciences.

In parallel to the survey, The Economist Intelligence Unit also carried out several interviews with senior business leaders and experts.

We would like to thank all survey respondents and interviewees for their time and insight.

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