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Arbitrating Outsourcing and Technology Disputes

Setting out the process when drafting clauses allows parties to take control.

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THIS ARTICLE addresses key issues that arise in the arbitration of outsourcing and technology agreement disputes. These issues include (i) the key role played by party-appointed arbitrators early in the arbitration process, and its impact on the course of the arbitration proceeding; (ii) what the litigators engaged by a party to arbitration should know about the arbitration panel, and how they should learn it; (iii) how briefs should be modified when one of the arbitrators is not a lawyer; (iv) the ways in which a party and its counsel can exercise influence over the arbitration proceedings; (v) how an outsourcing arbitration clause should be drafted to make an arbitration enforceable against an Indian offshore outsource provider; (vi) what an arbitration clause can include to address the most common scenario for a dispute, namely, that a dispute will arise under the Statements of Work, Project Plans or other technical schedules and not the master agreement itself; and (vii) that key witnesses may be former employees and subcontractors and not direct employees, especially in the case of offshore companies.

Early in the Proceeding

Many arbitration clauses require that each party appoint an arbitrator and that the two party-appointed arbitrators then jointly select the third-party arbitrator, who will serve as the chair of the arbitration panel. Thus, from a party's point of view, one of the most important responsibilities of the party-appointed arbitrator occurs at the very beginning of the process: the selection of the proper person to serve as the third-party arbitrator. The third-party arbitrator should have the right mix of technical, legal and administrative skills to chair the panel, work with the party-appointed arbitrators, organize the arbitration proceedings (and thus have the skills a judge needs to effectively manage a case) and work effectively with the American Arbitration Association, JAMS or other arbitration association.

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To play a constructive role in selecting the right third-party arbitrator, the party-appointed arbitrator must have—even before the case begins—an in-depth understanding of the nature of the dispute and what role business, technical and legal abilities will play in resolving it.

A key role served by the party-appointed arbitrator is illustrated by the following hypothetical example: Let us assume that the dispute arises under an information technology outsourcing agreement. One of the party arbitrators may believe that understanding computer technology involved in the dispute is the key issue. He or she thus may initially favor selecting a professor of computer science as the third-party arbitrator. The other party arbitrator may believe that the legal and contractual issues are critical, and will instead favor the appointment of an attorney with outsourcing experience as a way to combine business and legal judgment. As a result, to be effective at the critical juncture, the second-party arbitrator will need to convince the first-party arbitrator to change his or her criteria for the third-party arbitrator. This may include, for example, convincing the first-party arbitrator that the technical issues, while important, can be effectively addressed through the use of expert testimony. In this scenario, the party to the arbitration will have benefited from selecting an arbitrator who was able to persuade the other side's arbitrator to agree to different selection criteria for the third-party arbitrator, and then having the third-party arbitrator selected on that basis.

Non-Lawyer Arbitrators

Litigators should consider substituting or supplementing other documents for traditional legal briefs when one of the arbitrators is not a lawyer. Arbitrators who are business executives, technologists or academicians may not know how to properly read a legal brief. To compensate, a party may consider submitting the types of documents that such arbitrators typically use in conducting their own business. For example, if the third-party arbitrator is a businessperson, it may be advisable to supplement a brief with a list of summary bullet points and to use charts and other technical documents to communicate key points in the case.

Learning About Arbitrators

To be effective, the party's litigators need to understand what factors are important to the arbitrators and what type of reasoning will be persuasive in briefs and oral arguments. Because arbitration awards are not public, litigators cannot review prior written opinions as is the case in traditional litigation. One step the parties' litigators can take to learn about the arbitrators is to seek a series of "pretrial" conferences on preliminary matters as soon as the arbitration panel is selected. This will allow the litigators to meet the arbitrators, listen to their questions, see how the arbitrators work together, and learn what type of evidence and reasoning is persuasive to the individual arbitrators.

While these conferences are often held by telephone as a matter of expediency, there are advantages to holding them in person, even if it requires a party to pay travel costs. One or two conferences held at the beginning of the case will allow the litigators to meet the arbitrators in person and get a more finely tuned read of their judicial dispositions. Video conferences can provide a good middle ground between telephone conferences and in-person conferences.

Discovery matters are often the subject of the early arbitration conferences. By making motions and seeking rulings from the panel on discovery matters, the parties' litigators can create a situation where they can learn the information about the arbitrators identified above. Moreover, if the parties agree to require reasoned awards, rather than unexplained rulings, the preliminary rulings can provide insights into the panel and its decision-making process which the litigators can use to their advantage later in the case.

Exerting Control

The parties' litigators also have an opportunity to introduce flexibility into arbitration proceedings that may not be available in judicial proceedings. For example, the parties may request that the arbitration panel give a preliminary rather than final ruling on some issues, and give the party to be adversely affected by the ruling an opportunity to bring facts (or law) to the attention of the panel that may change the decision before it is made final. (The other party should, of course, be able to be heard on the issue as well.)

Another example is as follows: It is common in arbitration to limit the number of depositions, as a result of either an agreement by the parties or a ruling of the panel. A party should seek the right to take additional depositions later in the proceedings upon a showing of good cause.

One of the advantages of arbitration is speed,

but one of the practical impediments is the fact that good arbitrators are often busy lawyers, and it is often difficult for a panel of three lawyers to find common open days in their calendar to schedule arbitration hearings on short notice. A solution is to set up a briefing, hearing and decision schedule at the beginning of the case. In this way, the arbitrators have the hearing dates built into their schedules, and thus delays can be avoided that would otherwise be incurred if the schedule for each hearing would need to be arranged separately.

What to Include in Clauses

The parties should work backwards in deciding what to include in the arbitration clause. For example, the parties should consider including the qualifications to be met by arbitrators. Should they be lawyers? Should they also have active experience in the industry or intellectual property? Is a technical background required, or is industry experience sufficient?

A potential danger is specifying an unrealistically short period in an arbitration clause in which the third-party arbitrator will be selected. Too short a period may result in undue pressure to select an arbitrator before a qualified candidate who is able to satisfy scheduling needs, geographic requirements and other criteria can be identified. While a contractual time period can be extended by agreement, an individual party should consider whether it will be adversely affected if the other party does not agree to extensions, conditions or other limitations.

The parties should also consider whether to include discovery provisions in the arbitration clause. In many technology development and outsourcing agreements, the disputes are more likely to arise under the Statements of Work and Project Plans than under the Master Services Agreement, and the disputes themselves may be fact-intensive.

A party should consider, at the time the arbitration clause is drafted, how the other party is likely to breach the agreement and what evidence will be required to prove the breach. For example, if the breach involves failure to meet technology development specifications, the parties should be aware that these specifications are often modified during the course of performance. How will these changes be proven? In addition, in today's technology agreements, "documents" are often electronic files. Thus, the same issues addressed by the recent e-discovery amendments to the Federal Rules of Civil Procedure need to be considered in arbitration, including which party will bear the expense of restoring archived data and whether a conference will be required at the beginning of the proceedings to address and agree on e-discovery issues.

In addition to considering a limitation on the number of depositions, the parties need to carefully consider whether depositions are limited to a party's then-current employees. Disputes arising out of the development phase of a technology agreement may require the testimony of former employees—and this applies to both sides of the dispute. Moreover, in today's world of offshore outsourcing, key witnesses may reside in a foreign country and may be subcontractors or independent contractors rather than true employees. While such issues arise in outsourcing transactions, they also arise in technology development agreements where the development work has been outsourced or subcontracted.

Where the vendor or other party is a company from an offshore country, it is advisable from the point of view of an American company to specify as part of the arbitration clause that all arbitration proceedings will be conducted in English. This includes requiring that all awards and rulings from the panel be written in English. The language requirement should not be taken for granted.

On a related point, when one of the parties is located in an offshore outsourcing country or other foreign country, the other party especially should be certain that the arbitration provisions (including the requirements for the award) in the contract and the conduct of the arbitration proceedings satisfy the requirements in the applicable foreign country (or countries) necessary to enforce a foreign arbitration award in that country (or those countries).

A foreign company may oppose the enforcement of a foreign (e.g., U.S.) arbitration award on the theory that the award contravenes the law of the foreign jurisdiction where it is sought to be enforced. Accordingly, the parties should ensure that the remedies the arbitrators can award are enforceable under the laws of the foreign jurisdiction and that the conduct of the arbitration proceedings will not give rise to a challenge under that jurisdiction's laws. This is illustrated by the following factors regarding the enforcement of arbitration awards in India.

Agreements in India

Arbitration is often used in Indian offshore outsourcing agreements because Indian judicial proceedings are generally very slow. This is the case whether the arbitration is to take place in India or whether it will occur in another country and the award will be enforced against an Indian company under Indian law in an Indian court.

Domestic and international commercial arbitration is governed in India by the Arbitration and Conciliation Act, 1966 (the Act). The Act is based on the UNCITRAL Model Law. (UNCITRAL stands for the United Nations Commission on International Trade Law.) Under the Act, an arbitration award is subject to enforcement in India if the award was issued pursuant to an agreement subject to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the "New York Convention") and is based on a dispute arising out of a legal relationship treated as commercial under the law in force in India. (See Section 44 of the Act.) Arbitration awards issued pursuant to arbitration provisions in contracts between a U.S. and Indian company generally meet these requirements.

Notwithstanding the enforceability of foreign awards under the Act, strong consideration should be given to including a carveout in the arbitration provision so that a party can apply for injunctive relief in an Indian court, particularly with respect to intellectual property matters. Indian courts generally provide injunctive relief reasonably quickly, and have a track record of issuing Anton Piller orders. An Anton Piller order provides for the right to search the premises and seize evidence without prior warning and is used to prevent the destruction of incriminating evidence, particularly with respect to intellectual property infringement.

Under the Act, the enforceability of a foreign award can be challenged on the following grounds: (i) if the party against whom the award is sought to be enforced proves that the parties to the agreement were, under the law applicable to them, under some incapacity; (ii) the agreement between the parties was not valid under applicable law; (iii) there was no due compliance with the rules of a fair hearing (with respect to the arbitration hearing); (iv) the award exceeds the scope of submission to the arbitration; (v) the composition of the arbitration panel or the arbitration proceedings did not comply with the agreement; or (vi) the award is not binding on the parties, or has been set aside by competent authority of the country in which, or under the laws of which, the award was made.

In addition, an Indian court will not enforce an arbitration award if it is satisfied that the dispute is not capable of resolution by arbitration under Indian law or if enforcement is contrary to public policy.

U.S. companies should be aware of provisions of Indian law in drafting arbitration provisions in U.S. contracts. In particular, when an arbitration award will be enforced in India, the parties should include the following in the arbitration provisions: (i) a specification of notice periods with respect to the commencement of the arbitration, and time periods for the conclusion of the arbitration proceedings; (ii) a clear statement of the scope of issues that can be subject to arbitration; (iii) specification of the qualifications and procedures for selecting arbitrators, and a requirement for an odd number of arbitrators on the panel (if there will be more than one arbitrator); (iv) a clear identification of the governing law and venue; (v) a clear statement of the rules that will govern the arbitration proceedings and other "constitutional" issues providing for how arbitration will be conducted; (vi) provisions for the allocation of costs between the parties; (vii) choice of the English language; and (viii) a requirement that a majority of the arbitrators (if more than one) agree on the award.

Thus, parties to an offshore outsourcing agreement, software development agreement or other agreement where an arbitration award may be sought to be enforced against an Indian company should keep the requirements of Indian law in mind when drafting the arbitration provision. Among other things, the contract provisions should be drafted with care so that a technical deficiency does not become the grounds for an Indian court to refuse to enforce an arbitration award.

Conclusion

The nature of technology, intellectual property and outsourcing raise special factual and legal issues that need careful attention when drafting the arbitration provision. The parties should take these issues into account when establishing the qualifications required of the arbitrators and when selecting the arbitrators themselves.