

The Benefits of Mediation and Arbitration for Dispute Resolution in Outsourcing Agreements

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Benefits of Mediation in Outsourcing Cases

In outsourcing, a business process or technology process is transferred from one organization (the “customer”) to another organization (the “service provider”) so that the customer can focus on its “core competencies.” For example, a company might contract with a service provider to run its IT functions, its data management or its telephone sales activities.

Outsourcing agreements typically establish long-term relationships between the customer and the service provider. Outsourcing agreements are usually complicated agreements that must be managed by both parties over the long term. Beset by issues that arise from business and technology changes, these long-term agreements are never performed without disagreements over scope, price, adequacy of performance, reasons for delay, and changed requirements. Handling these disputes is an important aspect of the day-to-day governance of outsourcing relationships.

Disputes come in all shapes and sizes in outsourcing relationships. For example, disputes frequently arise during the initial transfer to the provider’s process, often as a result of delay by one or both parties. Disputes over scope and price (“scope creep”) are also typical, with the customer concerned about paying extra for services which it argues should be included in the provider’s services, while the provider argues that such services are extras, and were never intended to be delivered at the initial pricing.

Parties also frequently dispute the cause of performance failures, or indeed whether such failures were correctly measured (*i.e.*, whether there was in fact a failure). Agreements contain various pricing mechanisms which often call for “equitable” price adjustments, “truing up” to revised figures on baseline assets and transaction volumes, and benchmarking to market price, and the parties may not be able to come to mutual agreement about such forward pricing or adjustments. In all of these situations, the parties managing the outsourcing attempt to resolve their differences, and frequently they are able to do so on their own. However, for those occasions when the parties reach an impasse, timely mediation can ensure that disputes over specific issues do not fester and contribute to a broader communication problem, ultimately affecting the viability of the relationship.

Mediation in outsourcing disputes can be used to remind the parties of the positive reasons both chose to enter into the agreement. Because it is usually in the

interest of both the customer and the provider to reach a resolution that allows for the ongoing viability of the relationship, it makes sense that the parties should look to a mutually trusted neutral who understands the history and objectives of the venture. It is often useful to select this person in advance, so that the use of mediation is not itself considered a failure of the relationship.

In addition, a knowledgeable mediator may be able to help the parties identify creative ways to resolve disputes. Mediators are trained to look for value which can be traded in such a way that an item that is valued highly by one party, but not by the other, may be traded for a reciprocal item. Often, the mediator can identify these while the parties themselves cannot. For example, a mediator can act as a bridge, receiving confidential information from both sides, and, without disclosing it to the other side, use it to help the parties reach an accord. And the mediator is trained in techniques that encourage the parties to focus on positive solutions, rather than wasting effort in blame and recrimination. Finally, the mediator can help the parties agree to adopt changes in the governance of the relationship that will reduce the chances of future misunderstanding.

Often outsourcing relationships give rise to disputes that are essentially technical in nature. It therefore may be useful to appoint a technically savvy mediator to resolve these types of issues as they arise. A number of the leading arbitral institutions administer proceedings in which experts can be brought in to mediate or resolve disputes. If an agreement has a technical component, providing for resolution of particular categories of technical disputes by a neutral expert can go a long way to smoothing the relationship.

The parties’ agreement to devote time and energy to the mediation process is itself an important indicator of the likelihood of success of an outsourcing relationship. The mediator can also act as a guardian of the parties’ relationship, resolving disputes as they arise and, if appointed for the long term, even anticipating and smoothing over disputes before they become a problem. For these reasons, particularly in large outsourcing relationships, judicious use of mediation can considerably enhance the customer/provider relationship.

Benefits of Arbitration in Outsourcing Cases

Arbitration is often used as the final dispute resolution process in outsourcing disputes, especially in international outsourcing relationships. Using arbitration in out-

sourcing relationships can benefit both the outsourcing provider and the customer in a variety of ways. Where, as in outsourcing, the goal is a continued relationship of mutual benefit to both sides, a public dispute in court is usually the last thing that either party wants. Court litigation can even have the effect of ending a relationship over a dispute that otherwise could be resolved. On the other hand, because neither party wants to go to court, the threat of litigation in court can cause both parties to avoid dispute resolution until a point when the parties' positions are so far opposed that it is no longer possible to salvage the relationship.

Arbitration is beneficial to outsourcing customers because litigation, an expensive and time-consuming last resort in most commercial relationships, cannot usually address the customer's business risks associated with a failing outsourcing relationship. It becomes a "nuclear option" that, if initiated, ends the relationship at the expense of great business disruption to the customer. Moreover, it is seldom in the interest of the customer to publicize its difficulties with the provider of key services by filing a lawsuit.

The outsourcing provider likewise has reasons to resolve its disputes outside of court. Its business success depends very much on its reputation as a professional, competent supplier of services. Consequently, most service providers prefer to settle disputes without public airing, and will work very hard to retain relationships which were expensive to obtain, and may have required substantial up front investments which cannot be recovered unless the agreement continues for several years.

Finally, many outsourcing relationships involve offshore or nearshore performance. Even after the long and arduous process of obtaining a judgment in court, it is often very difficult to enforce such a judgment in a foreign jurisdiction—and it may be necessary to do just that if the other party resides (or keeps its assets) in that foreign jurisdiction. In the more than 150 jurisdictions that are signatories to the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards ("the New York Convention"), arbitration awards can be routinely enforced with very little opportunity for challenge or re-litigation even if the award was obtained and confirmed overseas.

Arbitration is an important tool when a dispute must be adjudicated (or enforced) in a court system which has problems in rendering timely decisions. For example, under Indian law, a dispute under an agreement between the Indian affiliates of two contracting companies must be litigated in Indian courts, which are notoriously slow, unless the parties agree to arbitration. Thus a global deal which provides for litigation between the parties could

contain an exception providing that disputes between certain local country affiliates will be arbitrated. Similarly, agreements involving parties residing in countries where courts are not reliable or may be unlikely to enforce foreign judgments should include arbitration provisions.

Parties may wish to accept that in these complicated multi-year (and often multi-party) relationships, difficult disputes will be inevitable, and therefore designate arbitration panels which are available on call should an impasse occur. So-called Dispute Resolution Boards are used in the construction industry, where large multi-year projects cannot be put at risk of being side-tracked by disputes between developers, contractors and sub-contractors. The building must go on, just as the process must go on in an outsourcing relationship. A readily available resource to resolve disputes, including arbitration services, mediation services, or both, can go far to make the outsourcing relationship a long and productive one for both parties.

Indeed, it is often useful to try to resolve a given outsourcing dispute through a combination of mediation and arbitration. A mediator can help the parties narrow down a dispute. For example, with the help of a mediator, general displeasure with service performance may be tracked to a root cause. Both parties can settle on an agreed solution, with only the cost of the solution left to be arbitrated. The roles of mediation and arbitration can be pre-arranged in the outsourcing agreement through the use of an appropriate "step-clause" providing for mediation then, if necessary, arbitration or through provisions allocating some types of disputes to mediation and other types of disputes to arbitration. The parties may also decide to use arbitration and/or mediation on an ad hoc basis as disputes arise.

In sum, arbitration protects the outsourcing process by providing an efficient mechanism for resolution of disputes between the outsourcing customer and provider outside of the public eye. Arbitration is also a vital element of outsourcing agreements that cross international borders as it results in awards more easily enforceable internationally. A carefully drafted arbitration clause in the outsourcing agreement can help to ensure a long and profitable partnership between the outsourcing provider and its customer.

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