SHERBY & CO., ADVS.

ANALYSIS OF SURVEY 2013

Top Story:
The *Failure* Of The 2008 Amendments

Israel's arbitration law is 45 years old, and for the first forty years, it remained untouched.

The first (and so far only) substantive amendments to that law were made in 2008. The results of our survey indicate that such amendments have (to date) *failed* to achieve their desired goal.

The Arbitration Law (1968-5728, the "**Law**") was amended (the "**2008 Amendments**")[1] to provide for an *appeal* (not to be confused with a motion to vacate[2]) of an arbitral award.

Those who lobbied for the 2008 Amendments predicted that, if the Law were to be changed to include the opportunity to appeal an arbitral award, Israelis would be *significantly more inclined to opt for arbitration* – including at the time of contracting, by putting an arbitration clause in their contracts.

The answers to Question 5 of our survey appear to constitute clear evidence that the 2008 Amendments have *failed* to have the desired effect upon the most likely potential consumers of arbitration services.

Question 5 of the survey asked respondents to estimate the extent by which their views concerning the inclusion of an arbitration clause in a contract have *changed* over the past five years. The decision to compare five years ago to the present was not accidental, as five years ago (2008) was when the Law was amended.

Question 5 gave a respondent six answers from which to choose:

> (a) s/he is today significantly more likely than s/he was five years ago to recommend to his/her company to include an arbitration clause;
> (b) s/he is slightly more likely to recommend including an arbitration clause;
> (c) s/he is no more or less likely to recommend the inclusion of an arbitration clause;
> (d) s/he is slightly more likely to recommend against an arbitration clause;
> (e) s/he is significantly more likely to recommend against an arbitration clause; and
> (f) the question is not applicable because s/he was not in-house 5 years ago.

The plurality of respondents (39%) stated that they are ***no more likely or less likely*** to recommend to their companies to include an arbitration clause than they were five years ago (when the 2008 Amendments were enacted). When that group is added to the 11% who responded that they are slightly more likely to recommend ***against*** the inclusion of an arbitration clause, **50%** of the respondents have stated, in substance, that the 2008 Amendments did ***not*** cause them to be more inclined to recommend the inclusion of an arbitration clause (and, as can be inferred from the 11% who are slightly more likely to recommend *against* arbitration, it is possible that the 2008 Amendments had a *negative* effect on their views concerning arbitration).

Over 8% of the respondents to Question 5 answered that the question is not applicable to them because they were not in-house five years ago. Therefore, if we wish to examine only those respondents whose experience affords a meaningful comparison, that 8% should be filtered-out, enabling us to focus only on the respondents who were working in-house in 2008. When we recalculate (after such filtering out), ***the percentage of respondents as to whom the 2008 Amendments did not cause any increase in their preference for arbitration rises from 50% to 54.5%.***

To the best of our knowledge, prior to our survey, no empirical data had been collected post-2008 to gauge the views of *any* segment of the Israeli population concerning arbitration. Undoubtedly those who predicted that the 2008 Amendments would improve perceptions concerning arbitration expected that such improvement would be seen and felt in the Israeli business community. Presumably most would agree that, among the decision-makers in Israeli companies, in-house lawyers have a role second to none in deciding, at the contracting stage, whether to include an arbitration clause.

The answers to Question 5 show that those representatives of the Israeli business community who are likely to be the decision-makers as to arbitration have stated, by a noticeable majority, that the 2008 Amendments have had ***no*** positive effect on their views of arbitration.

Even as to those respondents to Question 5 who said that they are either slightly more likely or significantly more likely to recommend the inclusion of an arbitration clause (collectively, the "**More Likely To Recom-**

mend Group"), it is far from clear that their change is attributable to the 2008 Amendments. (There are other reasons why a respondent might be more inclined today than s/he was five years ago to recommend arbitration. Some obvious reasons include: (a) recent, positive experience with arbitration, (b) recent, negative experience with litigation; (c) a desire to minimize the risk of having to litigate in more than one judicial forum; or (d) a desire to minimize the risk of disclosure of confidential or other sensitive information.)

In fact, there is evidence that the 2008 Amendments are ***not*** the reason for the change in the More Likely To Recommend Group. That evidence comes from the responses to Question 3.[3]

Question 3 asked:

> **In those cases over the past five years in which your company has been involved in a business-to-business international negotiation, and the issue of including an arbitration clause in the contract was raised but ultimately rejected, the PRIMARY REASON that it was rejected was...**

Five reasons were provided, and one of them was the *lack of appealability* (in the international context) of an arbitral award. If we were to assume that the More Likely To Recommend Group (from Question 5) owes its existence (in whole or in part) to the 2008 Amendments, then we would expect that the reasons given by that specific group to Question 3 (arbitration clause raised but rejected) would be noticeably different from the reasons given by respondents overall.

But that was not the case -- at all. In response to Question 3 (why the option of arbitrating was rejected), overall the reason "lack of appealability" was given by 21.88% of the respondents. When focusing on the More Likely To Recommend Group, we see that their response rate to Question 3 is statistically the same as the overall response rate. The More Likely To Recommend Group cited the lack of appealability only 21.43%.

Thus, even though we *might* have expected the More Likely To Recommend Group to cite in great numbers (in response to Question 3) the lack of appealability as the reason for failing to reach agreement to arbitrate, that group cited the lack of appealability at the same rate as those respondents who are ***no*** more likely to recommend arbitration (than they were five years ago).

Even though Question 3 had an international focus (whereas Question 5 did not), the answers to Question 3 indicate that, even among those who are more likely today to recommend the inclusion of an arbitration clause than they were five years ago, the reason is ***not*** the 2008 Amendment.

Such conclusion only further bolsters the conclusion that the 2008 Amendments have failed to have the desired (predicted) effect.

It's All (or almost all) About Costs

It is not surprising that the issue of costs is a significant theme in the answers to the survey.

As noted above, Question 3 asked:

> **In those cases over the past five years in which your company has been involved in a business-to-business international negotiation, and the issue of including an arbitration clause in the contract was raised but ultimately rejected, the PRIMARY REASON that it was rejected was...**

Question 3 gave five possible reasons. More than 37% of the respondents said that the primary reason was the expected ***costs*** of arbitration.

That percentage – 37.5% -- was approximately 16 percentage points higher than the second most popular reason, and it was double the third leading reason.

The fact that over a third of respondents stated that the expected costs of arbitration was the primary reason for deciding against an arbitration clause is not surprising. Empirical data from studies outside of Israel have long indicated that the cost of arbitration is a major consideration in the decision whether to include an arbitration clause.

Yet there is a paradox in the answers to Question 3 and certain other questions in the survey. Specifically, Question 8 asked:

> **In connection with an agreement involving a NON-UK company, if your company would have to choose a non-Israeli seat for arbitration," [how likely would you be to recommend London?]**

Over 73% of the respondents were at least somewhat likely to recommend London, and over a third would be ***very*** inclined to recommend London – even though it is well-known that London is an ***expensive*** forum for conducting an international arbitration (and, for that matter, litigation).

It appears that respondents gave London a high "grade" *despite* knowing that London is expensive. Possible reasons for that high grade include: (a) London's reputation as a leading center for international arbitration; (b) similarities between UK contract law and Israeli contract law; (c) familiarity with the language; and (d) the perception that, in *other* European cities, an Israeli party to an arbitration might encounter more anti-Israeli sentiment than in London.[4]

Arbitral Institutions – Winners and Losers

The survey asked in-house lawyers both about (a) the *experience* that their companies have had (over the past five years) with the major arbitral institutions, and (b) the individual lawyer's willingness to *recommend* those institutions.

Some of the responses were very surprising.

Although neither of Israel's main arbitral institutions – the Israeli Institute of Commercial Arbitration and the Israeli Bar Association's Arbitration Institution – received high grades for recent experience, both of those institutions received respectable grades in the *recommendation* question:

Name of Israeli Institution	Percentage With Experience within 5 yrs.)	Percentage Recommending
Israeli Institute of Commercial Arbitration	17%	20%
Israeli Bar Association's Arbitration Institution	35%	32%

At the very least, the numbers concerning the Israeli Institute of Commercial Arbitration indicate that even respondents who have not had experience with the IICA are nonetheless willing to recommend it. Similarly, even though the Israeli Bar Association's Arbitration Institution saw a drop from the "experience" column to the "recommendation" column, that delta is minor.

Although the two Israeli institutions saw only minor differentials between the experience column and the recommendation column, that was not the case with respect to three major international arbitral institutions. The chart below shows the responses concerning the International Chamber of Commerce, the "**ICC**"), the London Court of International Arbitration (the "**LCIA**"), and the International Centre for Dispute Resolution (the "**ICDR**," of the American Arbitration Association):

Name of Int'l Institution	Percentage With Experience within 5 yrs.)	Percentage Recommending
ICC	57%	40%
LCIA	13%	44%
ICDR (AAA)	26%	36%

Even though the companies of 57% of respondents have had recent experience with the ICC, ***only 40%*** of respondents are willing to ***recommend*** the ICC.

That differential is significant.

The LCIA and the ICRD scored the opposite of the ICC:

> (a) even though the companies of only 13% of respondents have had recent experience with the LCIA, 44% of respondents are prepared to ***recommend*** the LCIA, and
>
> (b) even though the companies of only 26% of respondents have had recent experience with the ICDR, 36% of respondents are prepared to ***recommend*** that institution.

The LCIA scored ***lower*** in the experience column than did *four* other arbitral institutions (two Israeli, two non-Israeli) – yet the LCIA received the ***highest recommendation grade of any institution*** in the survey.

That result is surprising for an institution as to which only 13% of the respondents' companies had experience over the past five years. Moreover (and because we were surprised by that response level), our law firm contacted the LCIA in October 2013 to inquire as to the number of cases involving Israeli parties in 2012 (the last year for which such statistics are available): the LCIA informed us that, ***in all of 2012, there were no LCIA cases involving Israeli parties.***

Therefore, it is clear that the high grade that in-house lawyers gave to the LCIA is not based primarily on experience.

As for the relatively low "recommendation" rate of the ICC, the most obvious reason is the ICC's reputation for being ***costly***. The ICC amended (effective January 1, 2012) its arbitration rules (among other things) to streamline certain procedures, in the hope that doing so would reduce the costs of arbitrating before the ICC. Yet most observers believe that the ICC still has a way to go in convincing the arbitration marketplace that ICC arbitration can be cost-efficient. The results of our survey confirm that belief.

At the very least, the responses to Questions 3, 6, and 7 indicate that the willingness of an in-house Israeli attorney to recommend a particular arbitral institution turns not only on his/her company's experience with that institution but – perhaps primarily – on the reputation of that institution.[5]

How Do Forum Selection Issues Play Out At The Contracting Stage?

It appears that issues concerning forum selection (including arbitration) matter considerably to in-house lawyers, but it also appears that the arbitral institutions and the arbitration "community" still have their work cut out to convince in-house counsel at Israeli companies that the "product" that they are selling can solve any of the problems faced at the negotiating table.

Question 2 asked respondents to estimate the relative time and effort devoted to the negotiation of choice-of-law clauses and forum selection (including arbitration) clauses in the types of international, business-to-business contracts to which the respondent's company is most frequently a party.

Twenty-nine percent of the respondents stated that their companies devote ***more time and effort in negotiating forum selection clauses*** than in negotiating choice-of-law clauses.[6] That percentage was almost ***three times*** the number of respondents (11%) who stated that their companies devote more time and effort in negotiating choice-of-law clauses.[7]

From the perspective of a country whose larger trading partners are *not* among its neighbors, a failure to reach agreement as to forum selection can often pose an obstacle for an Israeli company in reaching an overall agreement.

If it is true that, in many cases, more time and effort are devoted to forum selection (including arbitration) clauses than to choice-of-law clauses, then it would seem that, during the course of an international negotiation, multiple options as to the forum for dispute resolution would be proposed.

But the responses to Question 9 suggest that, whatever other options might be considered at the contracting stage, the option of arbitrating in Israel is frequently *not* one of them – which is not good news for the arbitral institutions.

Question 9 asked as follows:

> **To what extent do you agree with the following statement: "In those international negotiations in which the issue of forum selection (litigation) versus arbitration arises, our company's experience is that a non-Israeli company is more likely to agree to arbitrate before an Israeli arbitrator than to litigate before an Israeli court."**

Thirty-five percent of the respondents agree,[8] and 21% of the respondents disagree.[9] Yet those responses are ***not*** the most telling ones from Question 9.

The most telling response to Question 9 is that **over 44%** of the respondents stated that the possibility of arbitrating *has not arisen in enough negotiations for the respondent to be able to form a view* as to whether a non-Israeli company is more likely to agree to arbitrate in Israel than to litigate in Israel.

The fact that *almost half* of the respondents state that the possibility of arbitrating in Israel does not arise enough to form a view as to the willingness of non-Israelis to arbitrate in Israel strongly suggests that the major arbitral institutions – the Israeli Institute of Commercial Arbitration, the Israeli Bar Association's Arbitration Institute, and the ICC – have done an inadequate job at making known the availability of their services to the most im-

portant decision-makers (on this issue) at Israeli companies.

Moreover, the fact that 35% of the respondents are of the view that non-Israeli companies ***are*** indeed more likely to agree to arbitrate in Israel than to litigate in Israel suggests that a significant opportunity to ***increase*** the use of arbitration – in Israel – is being missed.

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Endnotes:

[1] Under the 2008 Amendments, an appeal to an *appellate arbitrator* is permitted only if the parties have expressly agreed to it in the arbitration agreement. The 2008 Amendments further provide for an appeal, to a *district court*, of an arbitral award, subject to three conditions: (a) the arbitration agreement expressly provides for such an appeal; (b) the arbitration agreement provides that the arbitrator is to be bound by substantive law; and (c) the court is of the view that, in applying the law, the arbitrator made a fundamental error that would cause a miscarriage of justice.

In addition to the amendments concerning an appeal, the Law was amended in 2008 to require the arbitrator to set forth a "reasoned" decision -- unless the parties have expressly exempted him from doing so.

[2] The grounds under which a court may grant a motion to vacate (cancel) an arbitral award are set forth in section 24 of the Law. Those grounds do *not* include mere "error" on the part of the arbitrator.

[3] Question 3, admittedly, asked about *international* negotiations, whereas Question 5 did not distinguish between the international and domestic contexts. Despite that the difference in scope, the answers to Question 3 shed at least *some* light on the reason for the existence of the More Likely To Recommend Group – or at least help *eliminate* a possible explanation as to why that group exists.

[4] There is yet another possible explanation for why respondents whose companies are cost-conscious might, nonetheless, select London – namely, the costs to the *adverse* party. Question 8 focused on negotiations involving a *non*-UK company. In other words, the hypothetical negotiative situation presented by Question 8 was one in which *both* an Israeli company and a non-UK company would be negotiating over the situs for a possible arbitration and would be considering arbitrating in a forum *other* than their home states. In such a situation, an Israeli company might very well want the high costs of arbitration in London to be a factor that the other (adverse) company would have to take into consideration in deciding whether to initiate an arbitration against the Israeli company.

[5] It is unlikely that the high grade of the LCIA was the result merely of the fact that it is based in London. The ICC conducts arbitrations in dozens of major cities every year, making it unlikely that a respondent would have thought that an arbitration could not take place in London under the auspices of the ICC.

[6] More than 14% stated that their company devotes “somewhat more” time and effort to forum selection clauses, and that same number stated that their company spends “significantly more” time and effort on forum selection clauses.

[7] Only 2.8% stated that their company devotes “significantly more” time and effort to choice-of-law clauses, and 8.5% stated that their company devotes somewhat more time and effort to choice-of-law clauses.

[8] Over 8% strongly agree, and over 26% somewhat agree.

[9] Over 8% somewhat disagree, and almost 12% strongly disagree.