

17 Dec 2022

Arbitration is a financial imperative for Sri Lankan companies engaged in cross-border trade

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By
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As Sri Lanka seeks to attract Foreign Direct Investments (FDIs) amidst its economic crisis and places a greater emphasis on exports to boost its reserves, this is an opportune time for parties entering into transactions with overseas partners to carefully examine whether their rights are protected in their commercial agreements with the inclusion of an arbitration clause that truly captures the worst case scenarios, so as to avoid being wiped out financially in case of a dispute. In the recent past, Sri Lanka has witnessed examples of how not having the suitable arbitration clauses can trap companies in a legal mess, for example, the flight which was detained in Sri Lanka due to a commercial dispute with its overseas partners and the Xpress Pearl Marine disaster, for which Sri Lanka has still to be recompensed.

An arbitration clause is part of the contract that addresses the parties' rights in the event of a legal dispute over the contract and helps facilitate disputes under a legal regime outside the courts. Sharing his decades-long expertise on the topic, Hiran de Alwis, a Chartered Arbitrator and Lawyer, Member of the Board of Governors of the Sri Lanka National Arbitration Centre and Vice-President of the Chartered Institute of Arbitrators Sri Lanka branch says: "The importance of arbitration for cross-border trade should never be underestimated - a properly framed dispute resolution clause can save local parties millions of dollars in case of conflict with a foreign party. In most cross-border transactions, the parties do not want to fight cases in the courts of the other's country for obvious reasons. However, there is an internationally established treaty called the New York Convention, which Sri Lanka and close to 160 countries have



Hiran De Alwis

acceded to, which allows for dispute resolution by arbitration. Enabling legislation incorporating this is available in Sri Lanka's Arbitration Act. Both parties to the contract can select what law will govern them, how any dispute will be determined and how the arbitration is to be conducted."

De Alwis cites many instances in cross-border transactions when, for example, exporters don't get paid and then are faced with the dilemma of how and where they can claim their dues. When they realize they can't file action in Sri Lankan courts or foreign courts they have to refer the matter for arbitration. But first, their basic contract has to have the arbitration clause enshrined in it for the matter to be sorted out favourably.

Arbitration is a private sector dispute resolution process, recognized internationally and locally for resolving disputes. But the resolution of disputes has to be in accordance with due process of law. Once you get a decision, which is equivalent to a judgment of a court, you can go to the High Court in Colombo or anywhere in the world and execute that judgment.

Not only is having the right arbitration clause vital in the present context of the economic recession worldwide, but it's critically important now for Sri Lankan businesses due to currency depreciation issues, as any case filed against them in dollar terms could potentially erode their profits entirely.

Forewarned is forearmed, cautions De Alwis, "because if you get sued by a party overseas in US dollars, the equivalent in Sri Lankan rupees would be untenable. So, there is a huge financial risk now if businesses do not have the arbitration clause that best suits their business. It's important to understand that arbitration can be used both as a shield to protect our business community and a sword to claim dues. It amazes me that even today there are senior business managers do not have a clear understanding of how dangerous it is not to have a properly drafted arbitration clause".



The knowledge of arbitration and how it can protect your assets is vital for multinationals, exporters, importers and even small and medium scale businesses. It is also critical for state sector bodies which are involved in cross border transactions, as after all it is the citizens of Sri Lanka who would be held accountable for these payments as well.

He cites the case of two young software developers who sold their software to an overseas company but the company refused to pay them. At that point they realized they would have to fight the case in US courts because they had not inserted their arbitration clause properly. Without the funds to fly to the US and pursue legal proceedings, they were wiped out and had to forget about claiming their dues. This was all because they had hurriedly cobbled together a contract online without consulting an expert.

In legal parlance Arbitration is also called the 'midnight clause' because it's known as a last minute search for arbitration clauses which people cut and paste disjointedly, putting them at serious risk.

"So, it's a wise investment if you can get a properly drafted clause from arbitration experts or lawyers. With the expected rise in international trade and promotion of exports and trade in services by Sri Lankan authorities, in my opinion the International Dispute Resolution is a vital business necessity for international trade," he adds.

The way that arbitration laws are developed, there is a very good opportunity, even for local business engaged in international trade, to have international arbitrations even in Colombo by utilizing an internationally accepted mechanism for resolution of disputes. For example, some adopt UNCITRAL rules - United Nations Trade related set of rules, which are highly recommended. Under this, parties can say we do not want to adjudicate our dispute in a foreign country, but we can do the same thing in Colombo. And to establish confidence with the other party, they don't have to arbitrate in terms of the local law but under the UNCITRAL rules which are available in Sri Lanka.

There are also other mechanisms known as ICC rules etc, which parties can utilize but what is important is that Sri Lanka has the mechanism to facilitate these international arbitrations right here, without having to travel abroad and incur additional costs.

De Alwis explains, "The local business community should heighten their knowledge of arbitration and how it can protect their business and profits. It is in their financial interest at the end of the day to incorporate the proper kinds of clauses in their agreement - giving them a huge cost saving in case their business deal sours. Most businesses don't realize that it is almost mandatory in international trade to have an Arbitration clause. Even in cases of private contracts or bilateral trade where the state is involved, for example, in free trade treaties, they should ensure dispute resolution is covered by arbitration."

In the current crisis where the economy has been weakened, having any leading exporter being slapped with a legal dispute can snowball into a financial emergency if it gets sued in foreign currency, or conversely, whether it has to make a claim in an overseas jurisdiction and will be rendered helpless.

All joint ventures with other companies, mergers and acquisitions, and shareholder agreements with foreign parties are generally covered by arbitration clauses.

Sri Lanka has a vibrant start-up culture in the IT sector, with lots of young entrepreneurs developing digital technologies for foreign buyers, but they should be warned that a very, imprecisely drafted dispute resolution clause could fail to protect their hard work. There are various arbitration centres in Sri Lanka that facilitate arbitrations and hold hearings under qualified arbitrators who can be appointed by the two parties to a contract.

De Alwis says, "My experience is that although Sri Lanka boasts high literacy levels, financial literacy still remains low. Some leading firms don't think about how they will enforce their rights if there's a breach of contract. Investing in consulting a lawyer or arbitration expert is critical and should be viewed as an investment and not an expense."

The Chartered Institute of Arbitrators (CIArb) is a UK registered charity and an international centre of excellence for the practice and profession of alternative dispute resolution (ADR). The membership of over 17,000 is based across 149 countries and supported by an international network of 42 branches. CIArb provides education and training for arbitrators, mediators and adjudicators. It also acts as a global hub for practitioners, policy makers, academics and those in business, supporting the global promotion, facilitation and development of all ADR methods. CIArb is represented in Sri Lanka by the Chartered Institute of Arbitrators Sri Lanka.