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## What Entrepreneurs and Their Lawyers Should Know About Each Other

RICHARD J. GOOSSEN\*

Entrepreneurs will have disputes, misunderstandings, and miscommunications with suppliers, customers, and employees at various stages in the growth of their enterprise. The skill of entrepreneurs in resolving differences will affect the heart of the enterprise – the net income – the bottom line.

One way to settle differences is to adopt a law-focused approach, relying on the legal process as the primary means to resolve disputes. An alternative is to employ a business-focused approach, which addresses a dispute in line with the strategic objectives of a company. The legal process in this approach is one of several factors – not the only one – for the entrepreneur to consider in seeking a comprehensive solution. I believe that entrepreneurs will improve the profitability of their business by using a business-focused approach to resolve differences.

To use a business-focused approach, an entrepreneur must understand and manage four components of the legal process – the law, the legal subculture, lawyers, and litigation. Managing the legal process is of greater concern to entrepreneurs than to other business operators. They have scarcer resources and a fragile administrative infrastructure that is less able to withstand a significant drain on human or financial resources.

### *I. THE LAW: THEORY V. APPLICATION*

It helps entrepreneurs to balance an understanding of the philosophical bases of a law with an appreciation of the application of a law. The law is a set of rules of conduct between individuals and groups created with the help of government and enforceable by government. The law binds the citizens of Western societies for the collective good – everyone submits to the legitimacy of the legal system.

There are several reasons for having a legal system. The law provides a means to protect persons and property without brute power. The law empowers government to act for the benefit of society in general. It enables individuals to make legally binding agreements

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among themselves which courts can enforce. The law is a complement of democratic rights, which lay at the core of Western societies. Everyone is subject to the law, including the government. Rules of law underscore the various rights of individuals, whether enshrined in a constitution or in judicial decisions. This legal infrastructure in which rights are clearly defined and properly enforced provides a stable framework for an entrepreneur's activities.

Apart from the core philosophical concepts of law, any individual or organization doing business in the U.S will encounter mechanical aspects of law as well. For example, the first step for an individual starting a business is to decide on the form of the organization for the pursuit of economic activities. It can be an unincorporated entity, a partnership, or a corporation. Next, the entrepreneur will experience the legal regulations of closing a property transaction or complying with tax laws. He will enter contracts with suppliers and customers and employees, while pursuing his economic objectives. The contract typically will provide a set of obligations. A court can interpret these obligations and award damages if something goes wrong.

Besides contract law, there is the ever-widening scope of tort law. A tort is a wrongful act done to the person or property of another. The most commonly known tort is negligence. The role of tort law is to compensate victims for harm suffered from the activities of others. Tort law identifies those actions that create a right to compensation. If an entrepreneur is negligent – carelessly injures to the person or property of another – there can be liability. One important element of establishing liability under tort law is determining what constitutes “reasonable” behavior by a defendant in a particular set of circumstances. This is not always easy to determine.

An entrepreneur may believe his conduct was reasonable – a judge may not. It will help if the entrepreneur is familiar with current judicial and jury notions of what reasonable conduct is and how aggrieved parties are compensated. Acts of the elusive “reasonable person” are always subject to interpretation. Legislation, private contract law, and tort law all require interpretation. The entrepreneur cannot view the law in a simple black-and-white manner or assume that regulations need only be read to be understood.

There also is the gap between the “law on the books” and the “law in action.” The “law on the books” is the law as is written. The “law in action” is the way in which these apparent straightforward laws are applied. One example is jaywalking, crossing a street outside the bounds of a crosswalk, illegal in many states. People rarely are charged with this offense, although they could be. This is very relevant yet difficult to comprehend.

An entrepreneur must understand the complexities and practical dynamics of the legal system. On the one hand, the law consists of a system of rules and procedures governing the minutiae of establishing and running a business. Many of these, such as the legal requirements for incorporating a company, may be applied predicatively. At the same time, there are many aspects of the law that are not always applied strictly according to the published laws. The entrepreneur must adopt an understanding that the rules in practice are more realistic than the rules in theory.

Comparing business to a game such as ice hockey, the laws are the “rules” of the game, providing the framework within which the game is played. Some elements of the game are clear and not challenged — the length of periods, the number of referees and the types of penalties. Apply the rules and clarity diminishes. Some infractions, while in the rulebook, are rarely or infrequently enforced by the referees.

Learning how the rules are enforced in practice takes place by watching or playing the game, not by studying the rulebook. Likewise, for entrepreneurs to manage the legal process, they must understand the law in practice.

## *II. THE LEGAL SUBCULTURE: A CLASH WITH THE ENTREPRENEURIAL MIND*

The second component of the legal process to manage is the subculture of the legal profession. To manage it is to recognize, understand, and proactively respond to the subculture of the legal profession, which clashes with that of the entrepreneur.

Culture is the system of shared values and norms in a group of people that constitute a design for living. Values are ideas the group believes are good, right, and desirable. Norms are the social rules and guidelines based on values that prescribe appropriate behavior in particular situations.

Students of entrepreneurship accept the notion that there is an entrepreneurial mind or personality, and its values and norms constitute an entrepreneurial subculture. Similarly, there is a legal subculture. This is reflected in the objective of law schools to have their graduates “think like lawyers.” Because of the different subculture from which their perspectives emerge, lawyers and entrepreneurs have different ways of resolving issues.

## *The Differences Between Lawyers and Entrepreneurs*

### *How They Think*

The first difference relates to the nature of the thinking process. Legal training focuses on what can go wrong rather than what will go right. This leads lawyers to see the negatives in a business transaction.

I once sought the advice of a lawyer about the purchase of a business. I wanted help on a couple of issues. This lawyer, intending to be helpful, compiled a list of issues that took two hours over lunch to disclose. He divided his time equally among each one of the issues. Although he highlighted some additional points of concern, the likelihood of those issues arising was so remote that they were not worth considering.

The lawyer believed he was providing a useful service. For me, most of the efforts were misguided. This stark contrast between services expected and services rendered reflects one difference between the subcultures of the entrepreneur and the lawyer.

Lawyers can see what can go wrong, while entrepreneurs think of all that can go right. This is a variation of the glass-is-half-empty, glass-is-half-full adage. The entrepreneurial mindset includes a positive attitude, perseverance, and emotional management necessary to succeed against the odds. And most entrepreneurial education comes from the school of hard knocks. Entrepreneurial publications and general print and electronic media lionize the success stories, reinforcing the values and norms of the entrepreneurial subculture. This is true even when they do not reflect the entrepreneurial experience.

Entrepreneurial successes rarely occur in a methodical, linear fashion. While successful entrepreneurs will analyze and plan their business strategy carefully, there is always an underlying attitude of action-before-analysis. Few negative thoughts pervade the entrepreneurial project. At its heart, the entrepreneurial venture is a dream or a vision. As a result, the emotional lure of entrepreneurship will overshadow rational concerns — emotion and an adrenalin rush are part of the entrepreneur's stock in trade. Entrepreneurs gain sustenance from this psychological disposition, while lawyers are rooted in the technical aspects of their skills.

### *How They Communicate*

The form of communication is a second source of the differences between lawyers and entrepreneurs. Lawyers communicate in a detailed, technical matter, most often in writing – they are professional wordsmiths. They analyze and interpret statutes and case law and write briefs for court – this is their lifeblood. Their battle cry is, “Get it in writing!” The starting point in the mind of the lawyer when advising a client is usually “How do we put the provisions in place which, in the event of a dispute, will assist in its resolution?” The lawyer then focuses on making sure the written agreement records the exact agreement between the parties.

Lawyers are comfortable communicating in writing and prefer a paper trail, as required in a court action. When a client appears on the doorstep of a lawyer, the lawyer typically fires off a letter to the opposing party or opposing counsel stating his client’s position.

Many businesspeople view this approach as counterproductive. Drawing a line in the sand, rather than causing cowering into surrender, more typically creates resolve to stand one’s ground.

Entrepreneurs prefer communicating in person. Most business people I have known over twenty years rarely write a professional letter. They prefer to meet in person and hash things out. The entrepreneur is often most comfortable in a coffee shop, on a job sites, and the factory floor – not in a reclusive corner for quiet reflection.

The entrepreneur is content to delegate details to a professional adviser, whether lawyer or accountant, and focus on the objective of how to make money and grow his business. The entrepreneur’s lifestyle is fluid, driven by the deal he is working on. His daily routine is not orderly and well structured. He focuses on macro-solutions to business issues. He is at the eye of the storm, dealing directly with various parties. The entrepreneur sees the big picture, which is tied to his vision for the company.

### *How They Focus*

Lawyers are process oriented – they focus on getting their job done and get paid whether the deal comes off or not. They perform tasks or specific jobs for a client who is running a business. The commercial lawyer is compensating for completing a task rather than being paid if an agreement is consummated. If an entrepreneur enters a contract with another party, a lawyer may review the contract for

\$5,000. He is committed to the task of reviewing the agreement and ensuring that his client is fully protected from potential issues.

Whether the deal closes or not, the lawyer still gets his fees. To the chagrin of clients, when a deal does not close, the lawyer gets his fees from the entrepreneur who receives nothing in exchange for his time and effort. Lawyers are often derisively referred to as deal-killers because of they focus on the process and raise an endless number of what-ifs that the other side interprets as an unwillingness to conclude a transaction.

The entrepreneur is results-oriented — a deal-doer. Entrepreneurs are big-picture- and deal-oriented, looking to get something done rather than hearing how it cannot be done. But all the effort and expense is for naught if the deal is not consummated. The objective and the mindset of the entrepreneur focus on the business mechanics — whether the transaction will work. In other words, the concern of the entrepreneur is whether he will make money from the deal and whether it will lead to an ongoing relationship. The entrepreneur is a “deal junkie” working at putting together people, resources and prospects, those things at the heart of seizing opportunities.

Entrepreneurs often make the mistake of expecting others to buy into their dream. I once advised an entrepreneur who needed to refinance his operations in computer and parts distribution. His long-standing banking relationship was in jeopardy, but he had a restructuring plan. The margins were razor thin and his market segment was subject to fierce competition. He wanted to sell his bank on the business plan and get refinancing. Of course, the bank was not interested in buying into a plan but in seeing sufficient assets to secure the loan. The entrepreneurs did not have the assets and the bank did not extend the financing. The entrepreneur thought he could convince the bank to get excited about the deal — he could not. The bank was unemotionally following its lending procedures. There was a culture clash.

### *How They Find Solutions*

By dint of their training, lawyers provide law-centric solutions to problems between their clients and other parties. When an entrepreneur seeks out a lawyer for advice, the proposed solution centers upon legal avenues of recourse. For example, if an entrepreneur goes to a lawyer about a dispute with his landlord, the lawyer will review the lease, consult applicable laws, consider the specter of litigation, and then possibly decide upon sending a letter. The letter

will set out the legal position of his client, possibly suggest next steps, and even hint at the necessity of future litigation. This approach does not consider all the dynamics of the issue. Exceptions I have observed in the practice of law are lawyers with many years of experience, who absorb the lessons of business from their clients along the way. Too often, the lawyer does not consider the best way to solve the problem but how to employ legal techniques to solve the problem.

By contrast, the entrepreneur wants a solution, and for him, the law provides only part of the problem-solving equation. The entrepreneur often has only herself to blame if he goes to a lawyer before exhausting all avenues of resolving an issue.

How, then, can a multidimensional approach solve an issue that an entrepreneur might take to a lawyer? In the landlord example, the best approach to solving the issue might be for the entrepreneur to arrange a meeting with the landlord. When two parties meet, they often can go a long way to understanding each other's perspectives and work toward a solution. A lawyer's approach often will lead to less communication between the parties and more communications between the lawyers.

For the entrepreneur, there are a host of factors to consider in a business solution — the importance of the relationship, extenuating circumstances of the other side, the possibility of miscommunication and the possibility of a genuine misunderstanding. There may be a situation where the other party is in a genuine cash crunch — perhaps some short-term flexibility could lead to long-term payments and an ongoing relationship.

Lawyers are risk averse in their legal practices and their investment endeavors. They have little interest in rolling the dice and they are not skilled at assessing risks. In fact, the nature of the profession fosters individuals who are risk averse. As one lawyer friend of mine puts it to his entrepreneurial clients — “I don't get paid to take risks — you do. I am not here to buy into your dream. You just pay me for what I do.” The lawyer does not make money from invested capital but rather from an investment in himself.

Lawyers bill for their time and are under considerable time pressure. They provide value by selling their services. A lawyer's bills his daily jobs according to the time he spends. As a result, lawyers value time, orderliness, and a predictable return on their investment. A byproduct of this subculture is a lack of respect, even disdain, for those who do not conform to these norms. Entrepreneurial clients embody the antithesis of this approach.

Entrepreneurs embrace risk as a byproduct of their existence. They are in the game to make a considerable sum of money. With the chance of gain comes the ever-present specter of colossal failure, and there may be a fine line separating success from failure. From the outside, the entrepreneurial life may appear turbulent. To the lawyer, for whom organization and structure are important, the entrepreneur often is "flying by the seat of his pants."

Entrepreneurs live in a world replete with risk. They may not be cognizant that others, particularly their professional advisers, view their methods of conducting business as high risk. For entrepreneurs, they're in an arena where they're going for the big score and trying to keep all the plates spinning in the air while their deal comes together. Entrepreneurs see themselves as risk assessors rather than risk takers. From the confines of a cozy, well-ordered office of a professional adviser, this may be a reckless proposition.

Legal and entrepreneurial subcultures differ in several ways and their approaches to resolving issues vary considerably. At a large law firm where I worked, the greatest insult one lawyer could hurl at another was, "He is more of a businessperson than a lawyer." An entrepreneur must be able to distinguish between the legal expertise offered and the bias that accompanies it.

### *III. LAWYERS: MANAGING OR MANAGED*

The third aspect of managing the legal process is the relationship between the entrepreneur and his legal counsel. Despite the differences in the entrepreneurial and legal subcultures, the entrepreneur will need the services of a lawyer at some time. But the entrepreneur will undermine the profitability of his business if he does not manage his legal counsel.

#### *Know What You Need*

Entrepreneurs can manage their legal counsel by understanding the differences among the types of legal advice they need. Preventive? Ongoing? Remedial? Preventive advice assists the entrepreneur to avoid issues. An area where this makes the most sense is tax advice, which will assist an entrepreneur before entering a transaction. One lawyer friend of mine is a tax specialist who is worth every penny of his \$400 an hour. With fifteen years of specialized training, he can save his clients hundreds of thousands of dollars.

But lawyers *always* recommend that a client see them before they enter *any* transaction. This may be a worthwhile approach in theory. In reality, most entrepreneurs cannot afford to do so, and a lawyer's involvement at an early stage can increase the entrepreneur's cost of doing business.

Lawyers also can provide advice as part of the corporation's steady activities — maintain corporate records, review contracts, or handle property transactions. But most lawyers can do this legal work. No specialized expertise is required, so the hourly fees can be less.

Another form of advice is remedial — fixing something that has gone wrong. The lawyer may think that his entrepreneur-client is constantly getting himself into a pickle. But for the assistance by their legal counsel, untold misfortune would rain upon him. And this is true.

The only time the lawyer sees the entrepreneur client is when he needs assistance. The lawyer might think "I told you so" and "Why didn't he talk to me before he entered this transaction?" No matter how much preventive and ongoing advice lawyers may recommend, they render far more remedial advice.

Entrepreneurs are better able to manage their legal counsel and assess the value and need of the advice when they can determine whether it is preventive, ongoing, or remedial. Like insurance or preventive medicine, preventive advice needs to be judiciously used. Ongoing advice is needed — one needs to maintain corporate records. Remedial advice is needed to devise comprehensive solutions.

### *Know Your Lawyer*

Entrepreneurs must assess the advice they receive. The competence, personality, and motivation of their lawyer will always affect their legal matters. Often a client will blissfully state, "My lawyer said . . . ," as if the pronouncement came from the Oracle of Delphi.

Clients often think that since they paid for the advice, it must be infallible. This misses understanding that the lawyer will provide his interpretation of the issue. The lawyer may not even be competent. And, if he is not, how will the client, who is relying on the lawyer, know? The reality is that a lawyer may not be good at his chosen specialty. State bar membership does not equate with experience in the type of law where you require expertise.

Further, the personality of your lawyer will affect your case. Is he a dignified bully or a skillful conciliator? A bullyboy approach can bring out the worst in all the parties. An unskillful conciliator may not extract the best settlement.

Another factor to consider is the motivation of your lawyer. Your lawyer may be juggling 10-20 cases – is yours a priority? An entrepreneur has to bear in mind that no lawyer is as interested in his file as the entrepreneur himself. A lawyer may even lose interest, depending upon how the case is proceeding and how he is being remunerated. I once had lawyers represent me where partial payment was shares of a publicly traded company. As we proceeded toward trial, the value of the shares of the company dropped dramatically and so did the lawyer's interest in pursuing the matter.

Because of these foibles, a lawyer can mismanage a case. The likelihood of this increases when the entrepreneur does not do what he can to manage the file. An entrepreneur who keeps the lawyer accountable serves his own legal matter well.

#### *Don't Give Away the Process*

An entrepreneur must manage the role of his lawyer in communications with an opposing party. Having lawyers communicate with one another is dangerous for several reasons. It can be an expensive process – the client will be pay for all phone calls, correspondence, and meetings. There will be little opportunity to assess the value of the communications. The client will not know whether time is being well spent and will get the lawyer's spin on the value of this communication. The cost of the communication process can be dramatically heightened through posturing or personality conflicts. Some lawyers have a need to demonstrate their expertise at the expense of their clients.

The communications may focus on all imaginable issues, not just on the relevant ones. Lawyers will anticipate issues and consider all the ways those issues might be dealt with if they occur. Lawyers will keep asking questions, coming up with every last contingency. This is when the clients may begin to question the value of their relationship to each other. Reviewing all the details is important in one-off transactions where you are not likely to run across the party again. By contrast, where you are likely to have an ongoing relationship, the nature and extent of the questioning may be too much for the relationship to bear.

The entrepreneur must be clear on what advice he wants from legal counsel. Interestingly enough, many law firms present themselves as “business lawyers,” to convey that they are hybrids between lawyers and businesspersons. In certain industries, law firms may present themselves as kindred spirits, such as some law firms in Silicon Valley that mimic their high-tech clients.

More experienced lawyers can add value in creative problem solving, having gained business knowledge throughout their legal careers. These firms are the exception, because underlying any superficial attempts to identify with clients is the underlying legal culture. What do lawyers know about business? In my experience, very little. And why would they? In a similar vein, do business people profess to advise others about legal matters, simply because they have observed lawyers in action? The legal profession would not allow this, of course.

When I was an articling student (intern), I heard a senior real estate lawyer ask a client whether he was sure he wanted to buy a property, as the market was in the dumps. The client did a double take – this comment was coming from a respected professional. He went ahead with the purchase, despite this veiled advice, and the market turned upwards in a four-year cycle.

Entrepreneurs need to be vigilant that they are getting what they are paying for and not show the lawyer undeserved deference. Lawyers tend to render business advice, deliberately or inadvertently, in a context of intellectual leverage.

#### *IV. LITIGATION: AN UNPREDICTABLE & COSTLY PROCESS*

Entrepreneurs must approach litigation strategically, going beyond legal considerations. Entrepreneurs, often small business operators, may be tempted to use the legal system to enforce their rights. But the role of the law in dispute resolution, compared to its role in ordering one’s business or personal affairs, can be an unpredictable and expensive process.

There are the obvious financial costs, including the lawyer’s billable hours and disbursements such as filing fees. As the path to litigation proceeds, there is the cost of discovery. There are non-monetary considerations as well – time, effort, energy, and foregone opportunities.

First, the entrepreneur must view the specter of litigation with pragmatism and not principles. A decision to litigate involves strategic review. As one of litigator friends put it, you “should prepare for war but hope for peace.”

A good litigation lawyer borders on being a master psychologist. They have no illusions about the frailties of human nature. They realize that individuals do not honor agreements. They find clients who think otherwise to be painfully naive.

Litigators realize that true character emerges when money is involved. The potential for litigation increases in proportion to the amounts of money involved. Key to resolving a matter are understanding human nature and settling based on pragmatics, not principles. A strategic-thinking lawyer will settle to your best advantage rather than fight to your long-term disadvantage. The entrepreneur may think he wants the aggressive litigation glorified on TV, but is not a practical way to function in commercial litigation.

The entrepreneur is offended when he believes he has gotten the short end of the stick. But doing what is best often means moving on to future opportunities, putting the past behind him. Being chained to the past will limit his upside potential.

The best litigators are like pacifists, trained to fight but preferring to settle. Their best approach is to demonstrate problem-solving skills privately and not engage in an adversarial process through the courts. Only in rare instances is a resort to the courts needed.

There are unreasonable and stubborn people in the business world, and occasionally we run into them. One consolation is that the other parties will later reap what they have sown. To those with principle, pragmatism in commercial litigation may seem like a Faustian bargain. But the entrepreneur's own best interests are almost always served by a fair settlement. By focusing on the overall picture of the effect on his business, the entrepreneur will decide wisely.

Second, if the entrepreneur decides to litigate, he must realize that courts make mistakes. Unlike on television, the just party does not always win. The legal system does not always find the truth through evidence, witnesses, and legal arguments. In our adversarial system, the mutual exaggeration of arguments does not always lead to the truth, just as bargaining for a blanket on the beaches of Acapulco will not always establish a fair market value for an item.

Individuals can be wrongly convicted. One high profile case was that of the boxer, Rubin "Hurricane" Carter. He was acquitted after the reversal of several bad decisions. But the same dynamics apply to every level of the court system, including commercial litigation. The lower the court, the greater possibility for a wrong decision. Your case could be one of the cases that are not properly decided.

The resources of the parties also affect justice. As Napoleon well understood, sufficient resources are required to successfully wage war. In litigation, if you do not have the resources, you may lose the battle. There may be delays in getting a date in court. There are the practicalities of enforcing a judgment – there is no point winning the legal battle unless the other party has the means to pay.

Related to the issue of insufficient resources is the risk that the legal system may become your adversary rather than your ally. The system may be used as an instrument of legal extortion – the threat of litigation to coerce a party into a settlement. Looming financial and time costs of litigation can cause a party to settle, regardless of the merits of their own case.

I have worked with biotech companies that have been subject to legal extortion. A smaller company with an innovative product tried to wedge into a market with one of the larger players. The larger player may either sue the company based on a bogus infringement of their own patent or copy the patent of the small company and allow themselves to be sued. In either case, the larger company knows they will win the economic battle regardless of which party is right or wrong. Their strategy? Either bankrupt the other company or drive it into its arms.

This strategy is routinely deployed by the largest players in the marketplace. It shows that litigation is an imperfect mechanism to resolve disputes and will not always achieve justice.

Third, entrepreneurs must carefully review the value equation of litigation. Entrepreneurs cannot afford a Pyrrhic victory. I once rented a small commercial property to a company that trained security agents. Over a couple of years they caused some damage to the walls of the space, beyond reasonable wear and tear. They denied their liability self-righteously! I took them to small claims court and after 18 months received a judgment in my favor and the money required to repair the damages. But the time and effort involved in the process negated the value of the judgment. An entrepreneur will not enhance his business efficacy with hollow victories.

A practical analysis of whether to pursue litigation is always helpful. Your litigation counsel may advise you that no matter how good your case, it is better to settle for 50% now than to fight for two years to get 100%. Analyze the risks, the costs, the time, the aggravation, and the opportunity costs.

Bill owes John \$100,000. Bill refuses to pay even though he should. Bill offers \$25,000 and a mutual release agreement. John is irate. When he learns the cost of litigation and is advised to take what

he can get, John agrees to take \$50,000. John lost \$50,000. Bill won since he saved himself \$50,000 (and can afford to pay his lawyer). The logic of the litigation lawyer is to have you think about what is likely, not what you think you should get.

One aspect of the value equation of litigation is the opportunity cost of your time. An unfortunate irony is that the more your time is worth, the less the value in pursuing litigation. The less valuable your time, the more willing you may be to fight for a victory through the courts. For example, a dentist or doctor making \$300 an hour will lose money defending himself in court. As a result, some parties will settle a case because of nuisance rather than merit. Business people know that many individuals live by the life-is-too-short principle – better to resolve a dispute promptly rather than waste money and cause aggravation by fighting. One entrepreneur's approach to another party's unwarranted demand for shares from a high-tech company was simply, "Can't you throw some shares at her?" In short, give her something to make him go away. The bottom line – experienced business people and lawyers recommend to settle and move on.

Fourth, there are risks associated with the litigation process. Justice is usually equated with getting what you think you deserve. This may be different than what the courts think you deserve. There are always two sides to a story, the issue is never black and white, and there is a chance the court will find against you. What may be a clear issue to you, which has become even more clear in your recounting the facts to your friends, becomes muddy when exposed by the arguments of the other side. The opposing party typically will deny everything frivolous, vexatious, and without merit. As the case proceeds to trial, your litigation adversary will attempt to obfuscate matters as much as possible proposing competing explanations and theories.

For example, you may simply not be able to prove your case. It doesn't matter if it happened – it matters whether you can prove it happened. Your judge may not have sufficient experience in your subject matter. He may not be able to discern the credibility of witnesses. Studies have shown that judges are no better than anyone else at determining the truthfulness of witnesses.<sup>1</sup> Some people are good liars and will successfully lie in court. In short, you may lose your case for reasons apart from whether you are "right." If too much money, time, and energy are required to achieve justice, the process may not justify your involvement.

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<sup>1</sup> Smyth, J.E. et al. *The Law and Business Administration in Canada* (10th Edition). Toronto: Pearson Prentice Hall, 2003, p. 204-5.

To succeed, entrepreneurs must manage carefully the decision to pursue a remedy through the courts. Even an apparently convincing case may not yield a just result. For the entrepreneur, litigation is a costly and unpredictable process, and the costs are even greater for smaller businesses with fewer resources.

Litigation and other legal costs reduce the net income of the business — they come directly from the bottom line. Legal expenses are best invested in corporate housekeeping. An entrepreneur can increase profitability by managing the legal process through a business-focused approach to resolving differences.

A business-focused approach, managed by the entrepreneur, can incorporate legal considerations into a broader strategy by integrating several business considerations:

- Available human and financial resources
- Opportunity cost
- Corporate morale
- Reputation in the marketplace
- Impact on profitability
- Impact on future business development

A business-focused approach to resolving disputes that incorporates managing the legal process will allow entrepreneurs to achieve the true win of increasing profitability and operating a thriving business. Without it, they may have no more than the hollow victory of a successful legal battle.



## A Survival Guide for Small Businesses: Avoiding the Pitfalls in International Dispute Resolution

SUSAN D. FRANCK\*

During the last two decades, international trade has expanded by leaps and bounds. With this growth, opportunities for small businesses to jump into the international business environment have increased. To facilitate the entrepreneur's transition from Main Street to the global village, entities such as the U.S. Department of Commerce and the Small Business Administration have initiated programs and provided resources to promote the entry of small businesses into international trade.<sup>2</sup> As a result of these programs and resources, entrepreneurs have made massive strides into the global marketplace. According to the Small Business Administration's *America's Small Businesses and International Trade: A Report*, the number of small businesses exporting outside the United States has tripled and the dollar amount of these exports has soared.<sup>3</sup>

Small businesses are learning the same hard lesson that multinationals learned about the global marketplace. Even in a successful international transaction, there is a risk that the honeymoon will end and commercial partners will find themselves at odds. These disagreements have dynamics different from purely domestic disputes. In a challenging economic climate, every dollar, pound, yen, and euro counts. Small businesses need a fair, flexible, and reliable dispute resolution process to ensure that their international commercial disagreements are resolved effectively. When dealing with their international counterparties, small businesses should contract for an effective dispute resolution mechanism.

This article shows small businesses how to avoid pitfalls in international dispute resolution in order to minimize commercial risks and maximize commercial gains. Focusing on dispute resolution options at the beginning of a transaction maximizes the chances of securing the

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<sup>2</sup> [http://www.commerce.gov/trade\\_opportunities.html](http://www.commerce.gov/trade_opportunities.html) [last visited Sept. 17, 2004].

<sup>3</sup> <http://www.sba.gov/library/oitreport/archive/oitnov99report.pdf> [last visited Sept. 20, 2004].

most beneficial terms, which will pay off in the event of a commercial dispute.

A fundamental question small businesses should ask is which mechanism will be the most effective mechanism to resolve a dispute. Options range from informal procedures such as negotiation to binding and enforceable mechanisms such as litigation. While negotiation or mediation might be initially appealing, these methods typically are done informally, before a dispute escalates. The major downside of these options is that they do not result in a final, binding, and enforceable result. There are options that *can* result in an enforceable decision.

Expert determination is a contractual mechanism for the resolution of disputes without recourse to litigation or arbitration where a single “expert” resolves a technical dispute based upon the facts before her and often without reference to the applicable law. This mechanism has been used in the grain, IT and construction industries. Expert determination has the benefit of being relatively fast and cheap.

The downside to this choice for general commercial disputes is that there is often a sense that expert determination is “rough and ready justice.” Expert determinations must be enforced through separate litigation on the award wherever enforcement is sought. This process can consume as many resources as traditional litigation.

As these options – negotiation, mediation, and expert determination – are typically unsatisfying, small businesses are left to answer the question of whether arbitration or litigation is the best method for resolving their dispute.

Litigation may be appealing as a familiar option in the unfamiliar world of international trade, particularly as it creates precedent for future cases that businesses can use to guide their future commercial conduct. When all is said and done, however, commercial parties from one country will rarely agree to submit their disputes to the courts of their foreign commercial partners.

A basic rule for selecting an effective dispute resolution mechanism: Contractually agree to a single, exclusive forum for the final resolution of all disputes arising out of or related to the transaction.

### *Choose Arbitration*

International commercial arbitration is superior to traditional court litigation and serves modern businesses by satisfying four core needs.

1. *A Neutral Independent Forum.* Arbitration provides a neutral forum for resolving the substance of a dispute. The forum is largely independent of the influence of local courts. In countries where there may be concerns about the impartiality of the judiciary or local protectionism, the need for a neutral forum is critical. It offers both parties the chance to feel like they are on equal ground, without one party receiving an unfair “home field advantage.” This can actually facilitate the negotiation of commercial transactions.

2. *Autonomy and Flexibility.* Arbitration gives small businesses both the autonomy and flexibility to resolve their disputes in a manner that suits them. In arbitration, parties can create their own rules about how disputes will be resolved and even pick the person who will resolve the dispute. This control is attractive and may even permit small businesses to select arbitrators who are sensitive to their unique business activities.

3. *Confidentiality and No Publicity.* Arbitration typically provides parties with confidentiality and avoids the publicity, which accompanies court proceedings. Where there is an ongoing commercial relationship or sensitive intellectual property, this benefit could be critical.

4. *Enforceability.* Enforcing a court judgment in a foreign country requires separate litigation on the award, which often enquires afresh into the merits of the dispute and is typically more time consuming and costly than enforcing an arbitration award. There is no treaty on the enforcement of civil judgments, but there is the New York Convention, which requires its signatory states to enforce arbitration agreements and decline to litigate disputes subject to an arbitration agreement. This makes arbitration awards easily enforceable in most countries throughout the world.<sup>4</sup> Particularly for small businesses anxious to conserve litigation costs and focus on their core business, having a single award that can be easily enforced creates a streamlined procedure for enforcing their rights in many different countries, which results in significant savings of time and money.

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<sup>4</sup> <http://www.uncitral.org/english/texts/arbitration/NY-conv.htm> [last visited Sept. 24, 2004.]

### *Don't Mix Dispute Resolution Mechanisms*

This is the easiest and most important pitfall to avoid in choosing a forum. Make a clear choice of a single, exclusive forum to resolve disputes finally and stick with it. Large businesses sometimes pay dispute resolution specialists to draft highly complex clauses that combine multiple forms of dispute resolution. These provisions are often unnecessarily sophisticated, costly, and untested. Most businesses are best served by the more conservative commercial approach of having a single standard dispute resolution mechanism that minimizes litigation risk and maximizes the predictability of the dispute resolution process.

In countless international transactions, businesses often overlook simplicity and include clauses that require both arbitration and litigation without a clear indication about *where* disputes must be resolved. Whether this lack of clarity is due to negligent drafting or inadvertent error caused by improper cutting and pasting of boiler-plate provisions, it has important ramifications.

First, a small business could end up fighting a war on two fronts — fighting the substance of the dispute and fighting about where and how to resolve the dispute. Second, this failure may mean both parties end up with an invalid and unenforceable clause. Third, a small business can find itself in the worst of all possible worlds — litigating all over the globe rather than deciding disputes in one pre-selected forum.

If small businesses want streamlined and effective dispute resolution options, they should prevent excess litigation costs caused by fighting about procedural issues that are contractually avoidable.

### *Don't Be Too Greedy*

Some businesses, particularly lending institutions and franchisors, have become fond of unilateral dispute resolution agreements that leave the party with the stronger bargaining position the right to pick litigation or arbitration at its sole discretion. While courts in many common law countries have enforced these types of clauses, the courts of some international trading partners may not feel the same way. For example, courts in Eastern Europe and Asia have found this inequality sufficiently noxious to void the dispute resolution agreement for violating public policy.<sup>5</sup> This means that an award rendered pursuant to such a dispute resolution mechanism is probably unenforceable. A business is not well

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<sup>5</sup> <http://www.freshfields.com/practice/disputeresolution/publications/pdfs/8287.pdf> [last visited Sept. 18, 2004].

served by agreeing to a lop-sided dispute resolution agreement that exposes it to the loss of considerable time and money to procure an unenforceable award.

### *Maximize the Benefits of Arbitration*

This is a crucial issue for small businesses, given arbitration's significant advantages. The plethora of options generated by arbitration's flexibility can sometimes leave business people and their lawyers feeling like proverbial "kids in a candy store," without a firm guide as to what options are best for the businesses. When trading with international counterparties, there are answers to five key questions that will help businesses decide which arbitration mechanism will best suit their needs.

#### *1. Ad hoc or institutional arbitration?*

*Ad hoc* arbitration resolves a dispute without the oversight and administrative assistance of an institution. The tribunal and the parties are essentially left to fend for themselves. It may be cheaper than institutional arbitration because the parties do not pay fees to an institution. And there may be marginal utility in not being bound by a particular institution's procedural rules. In practice, parties do not often realize these benefits.

In some countries, like the People's Republic of China, *ad hoc* arbitrations are not advisable because the requirements are so onerous as to make arbitration agreements unenforceable. According to the Article 16 of the Arbitration Law of the People's Republic of China, "The following contents shall be included in an arbitration agreement:

1. the expression of the parties' wish to submit to arbitration;
2. the matters to be arbitrated; and
3. the Arbitration Commission selected by the parties."<sup>6</sup>

In institutional arbitration, parties consent to resolve their dispute before a panel of arbitrators at a particular institution, under the specific rules of that institution and the administrative support of that institution. With institutional arbitration, parties can work within

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<sup>6</sup> <http://english.sohu.com/2004/07/04/78/article220847885.shtml> [last visited Sept. 26, 2004].

the ambit of an institution's rules and vary them to suit their needs. And institutional arbitration has a central benefit – it enlists the assistance of an internationally recognized arbitral institution to provide administrative support to your arbitration. This support can take the form of assisting with, even expediting, the appointment of arbitrators, evaluating a challenge to an arbitrator's impartiality, reviewing awards for errors of content and clerical errors, and providing general administrative coordination. Relatively minor administrative fees are an invaluable investment as they provide an opportunity to monitor and promote the efficient resolution of disputes.

## *2. What institution best serves the business' interests?*

There are several major and internationally recognized arbitration institutions:

- London Court of International Arbitration (LCIA)
- International Chamber of Commerce (ICC)
- American Arbitration Association's International Centre Dispute Resolution (ICDR)
- Stockholm Chamber of Commerce (SCC)
- Hong Kong International Arbitration Centre (HKIAC)
- China International Economic and Trade Arbitration Commission (CIETAC)

As arbitration law throughout the world has harmonized, institutional rules have also become standardized. The rules and administrative capacities of the major institutions have been tried and tested in major international commercial disputes. Awards from these institutions have an established international currency. Some national courts may be more likely to enforce awards from established institutions such as the ICC, LCIA, and SCC. Small businesses may wish to opt for a recognized institution and avoid local ones, which may be susceptible to parochial influences or lack a track record of recognized success.

Even among the major institutions, however, there are important variations. No business should choose an institution without reading its rules. Turning a blind eye to an institution's rules minimizes the chances that the selection will promote a business' commercial objectives.

Some institutional rules might even subject a business to unexpected burdens. For example, while CIETAC has taken great strides to modernize its arbitration procedure, there are still critical restrictions on the parties' freedom to choose arbitrators. Parties are limited to a single list of arbitrators, two-thirds of whom are China, Hong Kong or Macao nationals.<sup>7</sup>

There are other institutional variations that businesses ignore at their peril. While most institutions like the ICDR have confidentiality obligations related to documents during the proceedings or the hearings, the ICC does not.<sup>8</sup> Yet, in contrast to most other institutions, the ICDR has a presumption in favor of publicizing "sanitized" awards, decisions and rulings, which remove certain details including parties' names.<sup>9</sup>

The LCIA has a special provision which permits the joinder of third parties where one party to the arbitration consents. If businesses are not aware of this provision, they might unwittingly find themselves in the middle of a larger dispute, which can delay and increase the cost of resolving their dispute.<sup>10</sup> By the same token, it might also be a useful mechanism to bring in an indispensable third party.

There are also benefits that can be overlooked by ignoring institutional rules. For example, if a transaction involves significant intellectual property issues, a small business may prefer to arbitrate under the auspices of the World Intellectual Property Organization (WIPO). WIPO has specific rules and significant institutional experience to deal with those issues.<sup>11</sup>

Parties arbitrating under the auspices of the ICC Rules have recourse to an internal procedure that permits the ICC Court to review and evaluate draft arbitration awards before they are final.<sup>12</sup> This reduces the risk of a tribunal rendering an unenforceable award as the ICC Court can suggest clarification of issues or correction of errors prior to an ICC tribunal rendering a final award.

Picking the right institution does not involve only analysis of rules and institutional competence — there is also a question of cost. Small businesses should try to avoid the pitfall of having an overly expensive

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<sup>7</sup> <http://www.cietac.org/> [last visited Sept. 18, 2004].

<sup>8</sup> <http://www.iccwbo.org/court/english/arbitration/rules.asp> [last visited Sept. 18, 2004].

<sup>9</sup> [http://www.adr.org/index2.1.jsp?JSPssid=15732&JSPsrc=upload\LIVESITE\focusArea\international\AAA175current.htm#Intl\\_Arbitration](http://www.adr.org/index2.1.jsp?JSPssid=15732&JSPsrc=upload\LIVESITE\focusArea\international\AAA175current.htm#Intl_Arbitration) [last visited Sept. 18, 2004].

<sup>10</sup> <http://www.lcia-arbitration.com/download/rules.pdf> [last visited Sept. 18, 2004].

<sup>11</sup> <http://arbiter.wipo.int/arbitration/rules/index.html> [last visited Sept. 25, 2004].

<sup>12</sup> <http://www.iccwbo.org/court/english/arbitration/rules.asp> [last visited Sept. 18, 2004].

arbitration by evaluating during the contract negotiation phase what disputes are most likely to occur and the potential value of those disputes. Institutions generally have one of two approaches to the issue of cost: (1) fees are charged at an hourly rate and (2) fees are based upon the amount in dispute. LCIA arbitrators, for example, have an hourly basis that must be within a fixed range set by the LCIA; the ICDR, in contrast, allows arbitrators to set their own hourly fees. The ICC, however, fixes its fees on the basis of the amount in controversy. What this means is if a small business is likely to have highly complex, low value commercial disputes, the ICC may provide the best value for money. If there are likely to be high value, straightforward disputes, however, the LCIA may provide a more cost-effective service.

Ultimately, the major institutions resolve international commercial disagreements effectively and the best choice will depend, in part, of the specific facts of your transaction.

### *3. Where should the arbitration be located?*

Choosing the place of the arbitration is a fundamental step toward ensuring that your dispute resolution mechanism is effective. While an international arbitration can generally be held anywhere in the world, including in one of the parties' home country, selecting place is a tactical choice that can either help or hinder small businesses in ways they might not anticipate.

A business should avoid choosing a place of arbitration that is not a signatory to the New York Convention.<sup>13</sup> Choosing to have arbitration in a country that is a signatory to the New York Convention means that the award can be enforced under that treaty. While most countries are signatories, several are not — Bermuda, the Cayman Islands, Taiwan, and the United Arab Emirates, for example.

Ignoring the local arbitration law of the place of arbitration is another pitfall to avoid. In most cases, the law applicable to the arbitration will be the governing law of the country where the arbitration takes place. Local law will affect the opportunities for the local court to assist with — or potentially interfere with — the arbitration proceedings.

For example, many laws permit courts to assist with issues such as interim measures, the arbitration's relationship to parallel proceedings, the appointment of arbitrators, challenges to arbitrators, securing the attendance of witnesses or the disclosure of documents, and the local

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<sup>13</sup> <http://www.uncitral.org/english/status/status-e.htm> [last visited Sept. 18, 2004].

grounds upon which an arbitration award can be vacated.<sup>14</sup> Local arbitration law might also affect variables such as the minimum number and qualifications of arbitrators. Obtaining legal advice as to the local arbitration law can sensitize businesses to their risks, so that they can make informed choices as to the best place of arbitration.

A business should also consider practical questions when choosing the place of arbitration.

- How far will potential witnesses have to travel to give evidence?
- Where will the majority of the documentation be?
- Is there faith in the integrity of the local courts?
- Is there sufficient experience with international arbitration issues on the local bench and bar?
- Are there facilities and administrative support for oral hearings?
- Is it a geographical location where the parties and their lawyers will be comfortable spending several weeks?

A small business that is able to answer these questions will pick a strategic location that is advantageous and minimizes potential arbitration costs.

Conventional arbitral seats – New York, London, Paris, and Zürich – are preferable, because their judiciaries have established track records of effectively handling international arbitration issues. Also, there is a variety of skilled local lawyers in a variety of price ranges. Miami and Vancouver are also gaining popularity as venues.

On the other hand, if the jurisdiction where enforcement is likely to be sought finds it significantly more straightforward to enforce a domestic award (e.g. Brazil), small businesses may be better off agreeing to arbitrate in a country where assets are located. Again, this is an issue where local law advice provides crucial insight.

Some businesses negotiating international agreements are more concerned with having the dispute administered by their national arbitration institution than the place of arbitration. Given the uniformity of institutional rules and parties' ability to modify most rules

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<sup>14</sup> <http://www.uncitral.org/english/texts/arbitration/ml-arb.htm> [last visited Sept. 18, 2004].

by agreement, the more important tactical issue is the place of arbitration.

While small businesses should use the issue of an arbitral institution as a bargaining chip, they should bargain away the place of arbitration with due care. Place of arbitration has a more dramatic impact upon the integrity of the arbitration process and is more likely to create a distinct advantage. While a foreign counterparty is likely to be sensitive to this point and request a more neutral venue for resolving commercial disputes, small businesses should not hesitate to use what bargaining leverage they can to secure a venue that is favorable both legally and tactically.

*4. Who will resolve the dispute and what qualifications should they have?*

One of the significant benefits of international commercial arbitration is the parties' ability to control who will be resolving their dispute. There is commercial utility in picking an arbitrator who is likely to understand your business, the context in which the dispute arises, and who will view your arguments favorably while still adhering to her obligation to be independent and impartial.

The major pitfall to avoid in answering this question is defining too narrowly the attributes that an arbitrator must have. During negotiations, it is not certain what commercial disputes, if any, will arise in connection with the transaction. It is prudent not to restrict a business' option to choose an arbitrator in its ultimate best interests.

Classic miscalculations involve parties agreeing to appoint an arbitrator who dies or requiring qualifications that narrow the pool of potential arbitrators but are irrelevant to the dispute. In each of these cases, prescribing attributes for arbitrators at the contractual stage does a disservice to a business' commercial objective to have a flexible and enforceable dispute resolution mechanism.

Another problem arises if the arbitration agreement requires broad, uncertain, or undefined qualifications. Requiring an arbitrator to have qualifications, which are subject to interpretation, opens the door to an argument that the arbitrator lacks the requisite background. This could be a basis for non-enforcement of the award. While there is utility in selecting an arbitrator with a background that may be helpful in resolving the dispute, nothing prevents a small business from doing this after a dispute arises when facts and issues have crystallized. If there is a need to provide some minimal qualifications, a small business should consider the most likely types of disputes and the background strictly necessary to address those issues effectively.

*5. Are there issues unique to the transaction that require modification of a model dispute resolution mechanism?*

This is the final issue that small businesses should consider when drafting an effective dispute resolution provision. If businesses can identify these issues, they can consider whether it is appropriate to modify the default institutional rules or, if possible, the law of the law of the place of arbitration.

If, for example, time is of the essence, parties can implement time limits and other provisions to provide the arbitrators with an incentive to fast-track the dispute resolution process.

If there are special third-party or confidentiality concerns, specific provisions can address these considerations. If a small business is doing business with a government-related entity, it might be useful to include waivers of sovereign immunity for jurisdiction and execution.

Failure to consider whether there are any unique characteristics of the transaction to justify modification of particular rules can decrease the possibility of having procedures that might otherwise provide tactical benefits. While the parties can always try to agree on additional procedures after a dispute arises, as a practical matter, this is difficult to accomplish, as agreement to additional rules will form part of the overall litigation strategy.

Being able to answer the question of what is special about your agreement is critical to the commercial interests of the small business. It may well be that there are no special considerations, but asking the question will provide an opportunity to maximize the effectiveness of each international commercial transaction.

Once a small business answers these five questions, it will have a better idea about the type of arbitration that is best for the business and will be in a better position to maximize the benefits of arbitration.

*Identify the Appropriate Governing Law*

Small businesses may be tempted to pick the law of the state that is their principal place of business. This is commercially palatable for a U.S.-based business that is likely to know the law of its home state, organize its commercial activity around the law of that state, and have locally retained lawyers. The foreign counterparty, however, may have radically different ideas and insist on the application of their own national law. It may suggest use of its own law for various reasons,

including familiarity with the local law, protectionism, nationalism, or the burden of having to hire a foreign lawyer.

A small business should insist upon a law which is well-developed, commercial, and predictable, such as New York or even English law. This not only allows the commercial arrangement to be enforced as written but also minimizes risks related to the dispute resolution process, which might otherwise require a secondary dispute about what law is applicable to the transaction.

Before agreeing to the application of a foreign law, however, small businesses should identify all the differences that might have an impact upon their contract. For example, in contrast to their common law counterparts, civil law systems will not necessarily strictly construe the specific terms of a contract and may import terms such as “good faith.”<sup>15</sup> Moreover, civil law systems may require the incorporation of certain statutory terms and may not necessarily have such familiar terms of art such as “arm’s length” or “best efforts.” Similarly, Islamic legal systems have certain prohibitions against traditional business tools such as interest and, if transactions are not structured properly, they could be void.<sup>16</sup>

While obtaining legal advice or a legal opinion on the subject of the law of another jurisdiction may add to transaction costs, the price of ignoring choice of law all together or being willfully blind to the potential implications are more significant. Prudent businesses engaging in international transactions must protect their carefully negotiated contracts from attacks that might leave them exposed commercially.

### *Avoid Eleventh Hour Negotiations*

Businesses should not wait until the last minute to negotiate dispute resolution issues. If businesses wait until the end of negotiations, important protections may become tactical bargaining chips, even though it is in both parties’ best interest to have an enforceable and effective dispute resolution mechanism. Delaying negotiations can result in inadequately considered compromises. Last-minute negotiations can also lead to drafting mistakes.

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<sup>15</sup> Ole Lando & Hugh Beale (eds.), *Principles of European Contract Law, Parts I and II* xxiii (2000).

<sup>16</sup> John Y. Gotanda, *Awarding Interest In International Arbitration*, 90 *Am. J. Int’l L.* 40, 45 (1996).

Choosing a place of arbitration without adequately reviewing the place's arbitration law may result in unanticipated results. A classic example involves a sophisticated transaction that had an enforceable commercial framework under U.S. law. When the parties opted for "neutral" Swiss law at the last minute, they did not realize that Swiss law would not enforce the framework because there was no Swiss law on point.

In contrast, if the parties address dispute resolution *early*, they can better anticipate what types of disputes are likely to arise and evaluate what mechanisms can resolve those differences. By fleshing out the parties' assumptions about how disputes would best be resolved, they can agree to a procedure that meets the needs of the particular transaction. Early consideration also permits the parties to implement their mutual expectations effectively, avoiding drafting errors and minimizing litigation risks. Early analysis pays off in the end and permits small businesses to get the most "bang for their buck" in the unhappy event of a commercial disagreement.

While no dispute resolution mechanism is perfect, small businesses can avoid possible common pitfalls to ensure that the dispute resolution mechanisms in their international transactions maximize their commercial objectives. One of the best ways to do this is by deciding, at the outset of a transaction, to have all disputes resolved by arbitration tailored to meet the business' needs that will result in an internationally enforceable award. In this manner, small businesses can achieve certainty and reduce litigation risk. They can concentrate on their core businesses activities. Then entrepreneurs and small businesses can then increase U.S. business opportunities in the global village and continue to expand international trade.



## Kommerstad Center Speakers Forum

### Six Decades of Business Law

JOHN MOOTY\*

#### *Introduction of Mr. Mooty by Professor E. Thomas Sullivan:*

This afternoon I have the pleasure to introduce a distinguished member of our community. When I was asked to give the introductory remarks, I realized I could speak for an hour about this man. But you didn't come to hear me -- you came to hear John Mooty. I thought about what kind of an introduction I can give a man who has such a distinguished reputation and background.

Three qualities came to mind -- impeccable judgment, integrity, and humility. John Mooty began his professional career at this law school and graduated in 1944. He has practiced law for 58 years with Gray Plant Mooty, Minneapolis's oldest continuous law firm. While John was not present at the creation of that firm in 1866, he certainly has been a foundation of the firm for 58 years.

He is one of the country's leading business transaction lawyers and I know from working with John that he is also a very astute litigator. He has, over those 58 years of practicing law, not just been a practicing lawyer -- he always has been, in addition, a businessperson. For over 30 years John was Chair of the Board of International Dairy Queen -- until Warren Buffet bought it a number of years ago. He has been a director of many corporations and an entrepreneur *par excellence* in real estate development.

We graciously greet him as our fourth lecturer in the Kommerstad Center for Business Law and Entrepreneurship Speakers Forum. It's wonderful to have him back at his *alma mater*. Please join me in a warm welcome home to John Mooty.

*Mr. Mooty:*

A fabulous overstatement.

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\* John Mooty is well-known both in law and business circles. A graduate of the University of Minnesota Law School, he has been a principal at *Gray Plant Mooty Mooty & Bennett*, one of Minnesota's oldest and largest law firms for 58 years. He was responsible for the successful turnarounds of National Car Rental and International Dairy Queen.

It's been a long time since I went to my first class in this Law School. It's more than six decades ago and I still remember very vividly that first class. It was Property, taught by Dean Fraser. It wasn't very far into the first class when he said, "Take a good look at the person on your right, and take a good look at the person on your left, because when we get done there will only be one of the three of you left!"

That was when you were able to get into the school before they did a weeding process. I realize that now you have these profound tests and everybody who comes in is imminently qualified and brilliant students and you don't have to have the weeding-out process anymore.

In my time, that was of particular concern to me, because I came from a small junior college in the southwestern part of the state. You could get into law school with two years of pre-law and then take four years of law school. Or you could have an undergraduate degree and then take three years in law school. Some of the competition already had the four-year degree, so when I looked at odds of one out of three, my two years didn't exactly enhance my prospects.

I have to say that I immensely enjoyed the time in law school. I enjoyed that the faculty challenged you and how they made you think. I enjoyed it from the point of view of a student because students are a wonderful group of people, many of whom are going to be life-long friends. And whether you ever practice law, the fact that you have this training is valuable to you in all sorts of other areas you may decide to go into.

We'll just digress for just one second. We did have a professor whose name is displayed here on the Law School -- Stefan Riesenfeld. One day when I was working on the law review in the library Professor Riesenfeld came up to me and said, "Have you ever had a C in a course? What would you think if you got a C in my course?" Utilizing the maximum diplomacy, I said, "Well, you know, the way that course was taught, I'm not sure anybody could get more than a C." I will only say this -- when I finally did get my grade, I had to conclude that he had taught the course brilliantly.

While I was still in law school, I had the opportunity to do a research project on British law with the firm I'm still with. When I finally finished it, Dean Fraser said, "If you could end up with that firm, it would be a very good choice" As it turned out I spent my whole career there.

I'd like to tell you a couple of things about that experience which have been particularly beneficial and that I really appreciate. When I started, we had a managing partner, Harold Cant, who believed that

everyone had a civic duty to participate in the affairs of the community. He said, "Lawyers have an extra special duty to get involved in the community. They're equipped with tools that make them especially valuable." We were all encouraged to do that.

When I with the junior bar in Hennepin County, There was no bar referral service for people looking for an attorney. We thought that there ought to be one, and the junior bar decided to undertake it. And our firm was perfectly delighted to let us man the phones and run the initial sessions of the bar of reference which of course now is a very stable entity in Hennepin County and other counties. The firm gave me the opportunity to get involved.

I also had the privilege of working with another of the senior partners -- Frank Morley. Frank had an extensive business background and he had served on the board of major corporations. He was an absolutely brilliant lawyer, and it gave me an opportunity to see someone who is extremely skilled in the corporate area. I also got to see that, regardless of his achievements, he had no problem going into the library himself to fortify a brief he didn't think was persuasive enough.

At the time that I started, things were totally different than they are now in terms of specializations. At that time, if you were the last guy into the office, you worked on everything and anything. That might be researching antitrust in the morning, or it might be taking a trust account over to the court to get it approved in the afternoon. That had at least one advantage -- you did get a little bit broader base of looking at things than you have when you have to specialize. But in today's world there really isn't any choice. Look at the magnitude of environmental law or employment law or all sorts of other areas in the law today. The volume of law in one area is probably as great as the total volume of law around at the time I started out. So you really have to have a specialization, but it can cause you to have a little more concern about burn-out.

As I got involved in the practice of law, I had an opportunity to work with a couple of brothers by the names of Walter and Henry Baskerville who founded Upper Mississippi Towing Corporation for transporting petroleum products. Initially I worked with them as a lawyer, but as time went on they wanted me much more involved in business decisions. That gave me the opportunity to see things from the businessperson's point of view. Later, at National Car Rental and International Dairy Queen, I knew that problems look very different from the point of view of the businessperson than they do from the point of view of the lawyer. Sometimes I see that I'm looking as a businessperson at what some other lawyer is doing and I'm saying to

myself, "Wait a minute, why are we going all the way around the horn? There must be a better way to do this than what we're doing." When you're able to look both from the point of view of the business as well as from the point of view of the law, you bring a dimension to a problem that is extremely important.

Let me talk to you for a minute about National Car and International Dairy Queen. There are similarities in how we got involved with each. Both were insolvent when we got into the act, and both were depending largely on franchises. And unfortunately the franchises were developed by the franchisees. My brother-in-law, Ken Glaser, had the Twin Cities franchise for National Car Rental and he was desirous of maintaining a majority interest. I became an investor and got involved in it from the business point of view. We wanted to try to change the basic structure of National, because at that time it was literally a nonprofit association. But someone else was picked to do the job.

Well, they converted it to a for-profit company, but the for-profit company concept rapidly diminished, and the result was that they had a serious financial problem. Citizens State Bank in Atlanta, Georgia, said that if Ken would serve as chairman, they would stick with the project for a while. Ken said, "Fine, but not in New York -- we'll do it in Minnesota." So National came to Minnesota.

At that point we had the benefit of insolvency. General Motors had been forced by the government to divest itself of Hertz and they were the only major automobile manufacturer with no car rental agency connection. One of the initial fun little projects we had when we met in Detroit was to convince GM that helping an insolvent company was not a violation of their divestiture order. General Motors did a lot of wonderful things to launch National. By the time it was sold to Household Finance, it was even with Hertz and Avis.

Before National was sold to Household Finance, we had a call from the people who were running International Dairy Queen. They wanted to know whether they could acquire National. Well, we had some discussions on that, which went nowhere. A few years later we got another call. This time they said that they had some financial problems. Since we were the people who sold National to Household Finance they thought we might have some money we wanted to invest.

I spent an extensive amount of time reviewing the Dairy Queen situation and found that, as a franchisor, they had a lot of financial problems. We also found that the franchisees were very successful. If we could find some ways to straighten things out we had the basis to proceed. It was a good move. A number of years ago International Dairy Queen was merged into Berkshire Hathaway.

When we sold, we had three constituencies -- the shareholders, the employees and the franchisees. As far as the shareholders were concerned, it seemed to make a lot of sense because it was a tax free exchange and they didn't have to take only Dairy Queen holdings.

The point of view of the employees was very important to us. We knew that whatever had been achieved was because of what the employees had done. Having been involved in a lot of mergers and acquisitions, I know full well that employees are always told that nothing will change. And what that really means though if you want to translate it into plain English is, nothing will happen until the cock crows, and then things do change. But one of the things that are very true about Warren Buffet is that that is not his strategy. He makes a definite point that he will not make any investment unless the management of the company is good, and if the management of the company is good, why would he change it? And he proves that point. In spite of the fact that Berkshire Hathaway is one of the largest capitalized companies in the world, Buffet has 13 people in his office in Omaha.

We also had a problem as far as the franchisees were concerned. We wanted to be sure that this was something that would work from their point of view. We communicated with them openly, things were worked around, and it ended up well. If the world's greatest investor thought this was something he ought to be investing in, maybe it was worth it.

All of this fit as far as our law firm is concerned. My law firm clearly is the premiere franchise law firm in the upper Midwest. Working with franchise situations gives you a good mixture of business and law.

Not everybody wants to be involved in this sort of practice, and that's one of the wonderful things about law. You have all sorts of options.

I'd like to comment a little about some of the problems facing the corporate world today. We read about Enron and others. The Enron situation doesn't give you much guidance as to what really should be and what shouldn't be the case. I think there are some basic things that are really very important that need to be examined.

First of all, the days when Henry Ford owned Ford or when the Dayton family owned Dayton's are gone. Almost without exception, most major companies have a widespread shareholder body that really is not that effective at anything, and they are particularly not effective in terms of protecting their own interests. What tends to happen many

times is that boards of directors are self-perpetuating. True, the shareholders vote on them, but they vote on whoever is presented to them, so that it really becomes kind of a self-perpetuating situation.

Boards of directors have a greater tendency to be responsible to management than to the shareholders. The result of this is manifest in some of the extreme things that you read about that get the approval of a board of directors. What can the shareholders do about it? If the shares are in funds, it's hard for the funds to be effective because they have the same basic problem in their funds that they have trying to correct the corporation. The result is that nothing works out all that productively.

And what about independent auditors? Obviously the Arthur Anderson situation was extreme. But, again, it's extremely difficult to see how the auditing function can be performed when they're also doing countless other things for the company and have such a tremendous amount of income coming from the company. How can they be in a totally independent position? Fortunately, we now are making some progress within the SEC, but we still have a question of how we get a greater role for shareholders.

If you have any questions that you want me to muddle with, I will be happy to do so.

*Student Question: What did you do with Dairy Queen to turn it around so that the franchisor was in a more beneficial position with the franchisee?*

Mr. Mooty: Well, a lot of things and a lot of hard work. But the basic thing is you start with a franchise agreement that applies to any new franchise. That prevents a continuation of the problem. Second, by acquiring territories, we were often able to improve things as far as the agreements were concerned. For example, when we first became involved, the Texas territory was paying nothing to the central system and they had about 20% of the business. I got the job of talking to the fellow who owned the Texas system. He said, "Well, you guys know something about car rental, but I haven't seen that you know how to put the curl on the cone yet. When you do, come back and we'll talk about it."

*Student Question: From a law firm perspective, what do you think is the value of an MBA?*

Mr. Mooty: I will give you a prejudiced answer because of my past. In some areas this may not be true, but in the areas that I'm involved in, the more that you know about how to conduct a business the better off you are. A majority of lawyers don't really know how to totally analyze a financial statement.

If you are going to end up practicing corporate law, it would definitely be an advantage to have that degree. The big question is whether it is worth the time to get it? I think it all depends on the individual. Some people have not had a lot of exposure to the things taught in a business school. So it makes more sense than for those people. I do think that anything that will enhance your knowledge of business affairs is beneficial if you are going to end up going into corporate law.

*Student Question: We've heard that if we're going to have careers as lawyers, we best take some sort of introductory accounting. Is it worthwhile to study accounting at this point?*

Mr. Mooty: Frankly, I think understanding accounting is important for any lawyer. Even if you are in litigation and settling a matter, you need to understand what the tax consequences are. That doesn't mean that you can't have other people you work with provide that for you. But, in my experience, accounting is critical in negotiations.

When I handled the sale of the Vikings, they had twelve owners who basically said, "You go ahead and handle the sale." We looked at over thirty different prospects. We set up two due diligence rooms. We brought in the lawyers and the accountants and guaranteed them confidentiality.

This is not a real case, but it is parallel. Let's say you owned the Chicago Blackhawks. You've wanted to get even with the Halis family for years, so you really want to beat the Bears and you want to get the Vikings in order to do it. You want confidentiality because the minute that it is known that you are trying to buy the Vikings, it's also known that you have to sell the Blackhawks. You can't own the Blackhawks and the Vikings at the same time.

Anyway, when you're trying to work on a transaction like that there are many accounting aspects to it. And sure, you can always get assistance from accounting people. But I think that if you are trying to negotiate something you better understand it yourself and not depend on somebody else to do it.

*Student Question: As an attorney, do you find that your clients are interested in having you come up with ways to grow their businesses and protect their businesses, or do they come to you more with ideas? Does it work better if the client the attorney is generating new avenues to develop business?*

Mr. Mooty: That is a two-way street. It is important to get the full input from the client, because the client invariably has information that you don't have. By the same token, it is important for a lawyer to be creative.

The client is not coming to you to have you confirm his ideas most of the time. He would prefer to have a better idea. You want to listen to what they have to say because often they have a lot of insight that you don't have. Nevertheless, if you are going to really perform for a client you have to be in a position, after you understand his business, to be creative and come up with solutions. The difference between being a skilled professional and not being a skilled professional is the ability to add something.

*Student Question: Do you think lawyers can sit on boards of directors for corporations and have their law firms also represent those corporations?*

Mr. Mooty: Some malpractice insurance carriers are very reticent as it relates to coverage. At this time, they're not as concerned with service on a board, but they may limit coverage if you are an officer of a company.

My own feeling is that it is fraught with some of the same problems that the accounting people have and I think that it has to be very carefully watched. It may depend on the nature of the corporate structure in terms of ownership. It probably is going to be increasingly difficult for lawyers to be on the board of directors of companies that they provide legal services to.

*Student Question: I noticed in Twin Cities Business Monthly that you have been active in Minnesota politics. Has that been beneficial to your law practice or business interests, or is it just a passing interest of yours?*

Mr. Mooty: I was really very involved at one point. I served as acting chair of the Minnesota Republican Party. And my firm was gracious enough to let me do it, but it wasn't for very long. Did it have any great impact on generating business? I don't think so. But I did meet a lot of people, and once in a while lightning strikes. And while I don't think that it is more beneficial than other civic involvement, I have enjoyed it.

*Student Question: What do you think are the keys to the successful management of a corporation or a law firm for that matter?*

Mr. Mooty: Well, this is really trite, but I think that the main thing in both places is people -- how you deal with people. As you probably already know, my firm has had a couple of awards for being one of the best places to work.

You have to start with the people whether you're in a business or a law firm. And that means you have to start with all the people. In a law firm, that's not just the senior partners -- it means everybody. The same is true in any business. If you don't treat your people well and they are not a happy group of campers, it is very hard to be successful. And it's not easy to accomplish -- you have to work hard.

*Professor John Matheson: John, I'll take the prerogative of asking the final question. Some of our students may not realize that business development has become a big part of becoming a partner in many law firms -- law firms expect the people who want to become partners to bring business into the firm. What suggestions would you have for the young lawyer or even the law student for starting the process of developing clients and business development?*

Mr. Mooty: It is certainly true that the development of your own practice is a very important thing in almost any law firm whether small or large. What can you do about it? My experience says that the single best way that you have of developing a client base is to do a good job with whatever you do in the practice of the law.

If you have done a good job and the client tells somebody else that you have done a good job -- that is the single best way. Even with one client -- you do a good job and it may be that they have five other things that they could bring to you that they're bringing to somebody else. So, superb performance is the single most important thing.

The second most important thing is to be involved in activities where you have a chance to meet people who might be clients. The question earlier was whether getting into politics is an answer. It may be to some people. But, whatever you're doing and involved in, you're meeting people who are potential clients.

I am glad that you asked that question because it is a very important part of the law and you will not be as successful if you don't develop a client base that has some kind of loyalty to you.