THE SOCIAL TRANSACTION COSTS OF CONFIDENTIALITY IN COMMERCIAL AND CORPORATE ARBITRATION: INSIGHTS FROM BRAZIL

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INTRODUCTION

Arbitration is the preferred method for large commercial and corporate dispute resolution in many jurisdictions. Arbitrations’ advantages over courts are well known and established in legal literature. The shorter duration of the process, arbitrators’ expertise and impartiality, choice of law and of a neutral forum, confidentiality, quality of institutional rules and secretariat expediency are some of the relevant reasons why parties opt for arbitration.

In Brazil, after almost two decades of the enactment of Law No. 9,307, of 1996, arbitration’s benefits seem to have been very well accepted. An example is the position occupied by Brazilian parties as users of the International Court of Arbitration of the International Chamber of Commerce (“ICC”). In 2013, Brazil ranked in the 4th place in the users’ nationality sitting in ICC arbitrations, followed by the United Sates, Germany and France2.

Currently, there is a widespread perception that sophisticated Brazilian players have a definitive preference to arbitrate disputes arising out of complex or high value contracts3.

Arbitration proceedings involving Brazilian parties are normally both private and confidential4. There is no disclosure of the existence of the

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3 There is a limited amount of empirical data on arbitration in Brazil, but assertions about the increasing use of arbitration seem an ubiquitous perception of academics, arbitrators and arbitration practitioners. See e.g. MONTEIRO GABBAY, Daniela et al. 2010. Survey Project “Arbitration and the Judiciary”. The Relation between Arbitration and the Judiciary in Brazil. Comité Brasileiro de Arbitragem CBAr & IOB: 7 (“among teachers, researchers and attorneys which study and work in the field of arbitration prevails the opinion that arbitration has experienced a revolution in Brazil ... being incorporated evermore to the Brazilian juridical culture, particularly in corporate law practice”); LEMES, Selma. 2014. Números mostram maior aceitação da arbitragem no Brasil (“Numbers show a higher acceptance of arbitration in Brazil”). Available at http://www.conjur.com.br/2014-abr-10/selma-lemes-numeros-mostram-maior-aceitacao-arbitragem-brasil (“arbitrations increase in number of cases and of amounts involved”); WALD, Arnoldo. 2012. Arbitration in Brazil: Recent Developments, 2006-2012. Available at http://www.iccdr.com; NEHRING NETTO, Carlos. 2011. National Report for Brazil in Jan Paulsson and Lise Bosman (eds), ICCA International Handbook on Commercial Arbitration, Kluwer Law International 66: 1-36 (“The relevant fact we wish to stress is the undeniable continuous growth of domestic and international arbitration now taking place before arbitral institutions or at Brazilian venues, be it under the rules of foreign or local arbitral institutions”); SEREÇ, Fernando E.; BARBUTO NETO, Antonio M.; FARIÀ, Pedro Bento. 2014. Use of arbitration and recent trends. Available at http://www.internationallawoffice.com/newsletters (“Arbitration has advanced considerably in Brazil in recent years. The number of cases, both domestic and international, has increased dramatically over the past decade.”)
arbitration\(^5\), neither of the documents and evidence produced during the arbitration process nor of the arbitration award\(^6\). Confidentiality is usually imposed on the parties, arbitrators, witnesses and the staff of the administering institution.

In fact, confidentiality is praised as one of the most important attributes of arbitration\(^7\). Parties welcome the discretion provided during the dispute for their arguments and their status\(^8\), the protection of their image\(^9\), their business secrets\(^10\) and level of litigiousness.

In spite of its relevance to arbitration, confidentiality has become a controversial topic. Some argue, for instance, that confidentiality in its overarching, comprehensive form, covering the arbitral process as a whole is "opaque"\(^11\), is eroding the key concepts of international commercial law\(^12\) and,

\(^4\) Privacy and confidentiality, although often used interchangeably, have different meanings. Privacy means the right of the parties "to exclude non-involved persons from the arbitral proceeding", whereas "confidentiality allows parties to contractually bind themselves and others, such as arbitrators and arbitral institutions, from disclosing information revealed during the arbitration, including the ability to prevent the disclosure of the award". RAYMOND, Anjanette H. 2005. Confidentiality in a forum of last resort: Is the use of confidential arbitration a good idea for business and society? *American Review of International Arbitration* 16: 481-482. A very similar definition can be found in AZZALI, Stefano. 2013. Introduction: Balancing Confidentiality and Transparency In *The Rise of Transparency in International Commercial Arbitration*. New York: JurisNet, xxiii.  
\(^5\) [Cite excerpts of institutional rules of ICC plus the top 6 Brazilian arbitration courts]  
\(^6\) In Brazil, although there is a similar provision of disclosure of an anonymous version of the award in the internal rules of the Market Arbitration Chamber of the BM&FBOVESPA S.A. – Securities, Commodities and Futures Exchange ("CAM"), so far the CAM has not made public any award ("6.3. In the publication of arbitration award, the thesis and the legal grounds established in the award may be disclosed, regardless of consent from the parties, provided that their identities are not disclosed").  
\(^7\) Confidentiality seems to be rarely ranked as the top reason why parties opt for arbitration. For example, in Brazil, a recent research indicated that, out of 158 interviews, confidentiality was ranked as the primary reason only for 4% of the respondents’ pool; it occupied the 5th place, below considerations of "time", "technical character and quality of the decision", "proceeding flexibility and informality" and the "possibility to appoint or be part in the appointment of an arbitrator". See Comitê Brasileiro de Arbitragem – CBAr, "Arbitration in Brazil – Pesquisa CBAr-Ipsos". Abdul, André A. C. (Repportheur). Available at [http://www.cbar.org](http://www.cbar.org) 2012, p. 11-13. The results of this research are in line with those of international commercial arbitration, in which "fair and just result" was the primary reason and confidentiality was mentioned as one of the most important reasons by only 10% of the respondents. See NAIRN, Richard W.; KEER, Stephanie E. 2002. What Do Parties Really Want From International Commercial Arbitration?, *Dispute Resolution Journal* 78:84.  
\(^8\) AZZALI, Stefano. 2013. Introduction: Balancing Confidentiality and Transparency In *The Rise of Transparency in International Commercial Arbitration*. New York: JurisNet, xxiii ("In other circumstances, parties may not wish to make public allegations of bad faith, incompetence or lack of financial resources"). BUYSS, Cindy G. 2003. The Tensions between Confidentiality and Transparency in International Arbitration. *The American Review of International Arbitration* 14:123 ("[p]arties to the arbitration may not wish to expose certain allegations to the public, e.g., allegations of bad faith, misrepresentation, incompetence, lack of adequate financial resources, etc. ... may not want a "loss" publicized, especially if the party is involved in other cases with similar claims and defenses ... may want to take positions privately that would be difficult to take publicly or, conversely, may be forced to take positions they would not otherwise take to satisfy certain constituencies if the arbitration is made more public").  
\(^9\) "Parties desire confidentiality because it allows them to control the flow of information, avoid the damage of publicity from an adverse award, and mitigate the potential for a flood of "copycat" litigation." RAYMOND, Anjanette H. 2005. Confidentiality in a forum of last resort: Is the use of confidential arbitration a good idea for business and society? *American Review of International Arbitration* 16:footnote 6.  
\(^11\) See e.g. MENON, Sundaresh. 2013. Keynote Address in Albert Jan van den Berg (ed), *International Arbitration: The Coming of a New Age?*, ICCA Congress Series, 17: 17-18. ("In the days when commercial
disputes were less complicated, parties were willing to accept the rough and ready dispensation of justice. This is not so today when commercial transactions are far more detailed and technical, with modern parties demanding more transparency and assurance that their contractual rights are enforced with legal precision and accuracy. Reference has also been made to the increasingly public law character of the international arbitration process. With it comes a greater call for visibility and public accountability in decision-making.\(^\text{12}\) “Parties desire confidentiality because it allows them to control the flow of information, avoid the damage of publicity from an adverse award, and mitigate the potential for a flood of "copycat" litigation.” RAYMOND, Anjanette H. 2005. Confidentiality in a forum of last resort: Is the use of confidential arbitration a good idea for business and society? American Review of International Arbitration 16: 507.

\(^{13}\) See e.g. SMIT, Hans. Report: Confidentiality: Articles 73 to 76. American Review of International Arbitration 9:235-236 (“A more modulated concept must be found that properly accommodates the public need for transparency of proceedings that may affect others than the persons that participate in the arbitration and the interests of the participants to preserve the privacy of, or to disclose, their proceedings. When that balancing is performed, it becomes readily apparent that there must be significant limitations on a notion of confidentiality that shrouds the arbitral process in secrecy”); RAYMOND, Anjanette H. 2005. Confidentiality in a forum of last resort: Is the use of confidential arbitration a good idea for business and society? American Review of International Arbitration 16: 501. (“The continued confidentiality of arbitration decisions is shortsighted in that it removes the availability of relevant precedent that can benefit both the judiciary and the business community. ... by removing the common body of public decisional authority we are hindering policy-making bodies, commercial enterprises and individuals by denying them one of their most valuable commodities- information.”); DESSEMONTET, François. 1996. Arbitration and Confidentiality. The American Review of International Arbitration 7: 304 (“On the other hand, it is reasonable to reaffirm the paramount importance of any law requiring a party or both to disclose information to the public or to a state agency. It is reasonable to ask whether public policy would be best served in a given case by an all-encompassing confidentiality. It is reasonable to provide that the legitimate private interests of one party to disclose certain facts may outweigh the interests of the other party to keep them secret. Confidentiality is never absolute.”).


\(^{15}\) See e.g. BOUTILIER, Francis. 1996. Arbitration and Confidentiality. The American Review of International Arbitration 7: 304 (“On the other hand, it is reasonable to reaffirm the paramount importance of any law requiring a party or both to disclose information to the public or to a state agency. It is reasonable to ask whether public policy would be best served in a given case by an all-encompassing confidentiality. It is reasonable to provide that the legitimate private interests of one party to disclose certain facts may outweigh the interests of the other party to keep them secret. Confidentiality is never absolute.”).


\(^{17}\) See e.g. SALAMA, Bruno M.; PUGLIESE, Antonio C. F. 2008. A economia da arbitragem: escolha racional e geração de valor. Revista Direito GV 4(1): 20 ("[...] as partes contratantes, ao preverem a arbitragem como forma de solução de controvérsias, anticipam que a expectativa de decisões mais ágeis e acertadas no futuro diminui o risco de comportamento oportunista no presente. [F]aremos, assim, incentivos para cumprir as obrigações assumidas no contrato, pois eventuais inadimplementos serão punidos com rapidez e precisão. A maior confiabilidade dos contratos reduz os custos de transação ... e desonera a produção de riqueza social. [...]"). It is an efficient way to solve disputes and creates international rules of conduct. See e.g. CREMDES, Bernardo M. 1983. The Impact of International Arbitration on the Development of Business Law. The American Journal of Comparative Law 31: 526 (“Arbitration plays this essential role in the development of the modern international merchant law. When businessmen resort to arbitration in order to settle their disputes they sow important seeds for the future growth of the merchant law. Besides developing a new means for efficiently anticipating and resolving disputes, arbitration is creating a body of arbitral decision making that is defining the standards of conduct of international business.”)
state-administered system is astronomically high\textsuperscript{18} and litigiousness level is significant\textsuperscript{19}, arbitration is more than a remarkable alternative dispute resolution mechanism: it has become a key piece of the legal system.

The increasing use of arbitration in Brazil and the prevailing confidentiality in large commercial and corporate disputes raises one important question: what are the social transaction costs of confidentiality in arbitration to a legal system like the Brazilian?

Answering such question is by no means simple and depends on empirical data that is not available to date. The assertions made here have a speculative and tentative nature and draw on general features of the Brazilian legal system. Thus, they are not supposed to be conclusive, but may help to frame the discussion on the proper extent of confidentiality.

Building on a theoretical model, this article argues that the preference for arbitration to solve highly complex commercial and corporate disputes coped with other characteristics of the legal system (here, as a proxy, the Brazilian system) – structure and organization of the players, dissemination of information intra and inter-players, evolution of legal doctrine etc. – might potentially increase the overall social costs of contracting.

This article proceeds as follows. Part I briefly explains the concept of “social transaction costs” proposed by Richard Posner. Part II examines the effects of confidentiality in arbitration in each term of the social transaction costs formula. It also exteriorizes and examines the interplay of a new formula variable: pre-litigation costs. Part IV concludes with suggestions of future research.

I. Posner’s Social Costs of Contracting

In this paper, I rely on Richard Posner’s concept and formula of “social transaction costs”. He conceptualized them to include both the costs to the contracting parties and the costs to third parties, “such as courts and future transacting parties”\textsuperscript{20}.

Following Posner, a simple version of the equation is:

\[ C = x + p(x)[y + z + e(x, y, z)] \]

\textsuperscript{18} Commercial contracts and corporate cases are submitted to state judges. If appealed, cases are subject to review by State Courts of Appeal and, at a third and final level, by the Superior Court of Justice. In 2014, in the 5 bigger Brazilian states, the congestion levels is as follows: São Paulo (82%), Rio de Janeiro (79%), Minas Gerais (71%), Paraná (68%) and Rio Grande do Sul (62%). The congestion level at the Superior Court of Justice in 2014 is of 51.9%. Conselho Nacional de Justiça. Justiça em números 2014: ano-base 2013. Brasília: CNJ, 2014, p. 60 and 385.


In the formula, “x” represents the parties’ negotiation and drafting cost and “p” is the probability of litigation. The litigation costs incurred by the parties are indicated by “y”, whereas “z” stands for the cost of litigation to the judiciary, and “e” for the error costs.

Posner’s “social” aspect of transaction costs applied to contracts is ingenious. It captures the dynamism of contractual interpretation and adjudication. It brings into the formula the impact and interaction of the investments made by the parties in the drafting and negotiation stages and in the litigation stage, combined with those investments made by the adjudicating entity (the judiciary or a private arbitral court). Additionally, it calculates the effects of an adjudication error to the contracting costs of future parties while drafting or litigating their contracts, as well as to the adjudicating entity. Posner’s formula thus seems a suitable methodological tool to examine confidentiality in arbitration and the related private and social costs of contracting.

II. SOCIAL TRANSACTION COSTS OF CONFIDENTIALITY IN COMMERCIAL AND CORPORATE ARBITRATION

Inspired by the general features of the Brazilian legal system, let us imagine a model whereby the overwhelming majority of complex and large commercial and corporate contracts contain a clause that future disputes shall be resolved by an arbitral proceeding. Arbitration is private and confidential. The level of litigiousness is moderate-to-high. For simplicity, let us assume that the pool of potential arbitrators with expertise in the disputed fields is limited and the number of law firms and lawyers hired to assist the parties is also restricted and, thus, overloaded. Trade associations have virtually no significant role in adjudicating disputes among their members. The local legal market is closed to foreign players. Academia is similarly small in size and output.

Considering such model and variables, what would be the impact on social transaction costs?

A. Confidentiality and Its effect on Negotiation and Drafting Costs

Posner’s formula is divided in two terms. The first term, “x”, represents the ex ante costs, the negotiating and drafting costs. Any contracting party incurs these costs, with certainty. They are the only contractual costs borne if the parties smoothly perform the contract. The second term of the formula contains the costs of litigation to the parties and to the judiciary/arbitral tribunal and the error costs, multiplied by the probability of the litigation. The ex post costs in the second term arise only if a dispute between the parties occurs. Each term influences the other and there is a mutual dependence of the variables. Some of the variables work as substitutes (sometimes imperfectly).
The more the parties invest *ex ante* in making the contract clearer and less incomplete – that is, by filling gaps, disambiguating, imagining and writing potential contingencies and their respective courses of actions if such contingencies occurs – the more they contribute to lower the probability of a dispute and the likelihood of an error in the interpretation of the contract and adjudication of the dispute21 22.

Before examining the second term, the litigation term of the equation, let us first consider the impact of confidentiality for the first term.

What is behind “x”? When one thinks of drafting and negotiating costs, we have in mind the resulting action of certain people applying their business and technical knowledge to a certain purpose.

In fact, we are considering the knowledge and expertise of the contracting parties and of their legal counsels (in-house and external). We also have in mind their work material: the business, commercial knowledge, expertise, usage and customs of the contracting parties, and the technical knowledge of their legal counsels about both the substantive law and the legal system. Thus, parties and their counsels negotiate and decide what to draft based on the terms and conditions of the deal and the knowledge they have on how the applicable mandatory, default rules, usage and customs would play out in their business, commercial and legal agreed matters. For that purpose, they take into account procedural decisions and the interpretation of law given by the courts, arbitration tribunals (when available) and the opinion of academia.

If, after a couple of years, virtually all decisions on commercial and corporate disputes are solved by arbitration on a strictly confidentiality basis, how would “x” be affected? How much would the parties invest in drafting and negotiating an agreement? How much would the parties and their counsels know about the matter under dispute?

The impact on the negotiation and drafting costs can be better grasped by examining the body of knowledge on the matter and upon its effects on the relevant players.

*a. The body of knowledge and uncertainty*

We should admit, for reality’s sake, that there is an initial stock, an initial body of knowledge in respect to each and every contract. For large and complex contracts, the same holds true, with a certain amount of knowledge pre-existing the moment in time when knowledge about such contracts became screened by confidentiality.

So we start from that initial body of knowledge. Arbitration carried out with confidentiality limits the access of the public to one decision and then to the sequence of the decisions about that specific type of large, complex contract.

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21 [Not in a linear fashion. Discuss ?].
What is the end result? After several years, the initial body of knowledge becomes aged, outdated, stalled. It may no longer capture the innovations the parties have made to the contract, nor changes to the contracting environment. It may no longer represent the relevant issues regarding such contract or the interplay between the agreed contractual terms and the contractual environment. Parties may become uncertain about the legal effects of the contract or may have doubts as to how to interpret it.

An outdated body of knowledge means a lack of predictability. It means uncertainty. Parties, especially business parties, dislike uncertainty. Uncertainty has at least three significant consequences: it may increase negotiation and drafting costs, it may diminish the incentives for performance and it may increase the probability of litigation.

When uncertainty prevails, parties tend to be more cautious. Especially if the contract is complex or involves a high amount or relevant interest, parties tend to invest more in making the contract more complete for fear of how it would be construed in a future litigation. They tend to dedicate more time and resources to gap filling and to avoid ambiguity, to avoid a wrongful interpretation of the contract in case of litigation.

With the passage of time, if the feeling of inadequacy of available knowledge and uncertainty concretely increases (and/or a not so good arbitration experience reaffirms such perceptions), parties would tend to negotiate and write more even more, until it is no longer efficient to do so. Thus, a first negative externality of uncertainty created by confidentiality in arbitration is an increase in negotiation and drafting costs.

As will be discussed below, if confidentiality remains prevalent in arbitration (with only few institutions publishing its awards), few players will have an updated body of knowledge on certain matters. In any case, unless there is a significant trend in administering institutions publishing their awards, it is likely that even those players will be only having a partially updated knowledge. The knowledge of such players may, however, push “x” into the other direction, mitigating it. This point will be examined in the interplay of “x” and litigation costs.

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26 [Cite]
How could interested players update their knowledge? The answer varies according to the industry, administering arbitration institution and country.

In the United States, securities arbitration awards issued by the Financial Industry Regulatory Authority are available since mid-2007, and by each individual stock exchange back to 1989, at no charge. In Brazil, securities arbitration is administered by the Market Arbitration Chamber of the BM&FBOVESPA S.A. – Securities, Commodities and Futures Exchange. Under CAM’s rules, arbitration is confidential. In spite of the statutory authorization to publicize anonymous version of the awards, CAM has not published a single one to date.

Institutions such as the ICC have been publishing their awards for several decades, through paid access. ICC publishes a “sanitized” version of the award, erasing the name of the parties and any potential identification data. Arbitration awards from other institutions, such as the International Centre for Dispute Resolution can be found in paid databases, like Lexis and Westlaw.

The Society of Maritime Arbitration, Inc., in New York, publishes the facts and reasoning behind its awards. Since 1963, it has published more than 4,200 awards and is proud to state that lifting the veil of confidentiality in arbitration increases the predictability of decisions.

With confidentiality in arbitration, other than in a few areas, the overall costs for all actors rise. Compared to court decisions, where costs are basically opportunity costs, arbitration awards add an informational cost to all interested players. Although it may not be significant on an individual basis, on the aggregate this cost may be meaningful.

b. Relevant actors

Let us now think about the relevant actors. Who is interested in an updated knowledge? It is fair to say that each of the parties, parties’ internal and external lawyers, adjudicators (courts and arbitral tribunals) and the government (for instance, regulatory authorities) has a stake in updating their knowledge, for different purposes and in different extents.

b.1. Arbitrators

- Repeat player
- Part of several cases, but limited capacity
- No access to awards of other cases
- Reputation: interest in transparency and in confidentiality
- [Data about Brazil]

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27 Securities arbitration administered by CAM is confidential (article 9.1 of the Rules of the Market Arbitration Chamber).
b.2. Arbitral administering institutions

For large commercial and corporate arbitrations, Brazilian parties’ normally resort to the International Court of Arbitration of the International Chamber of Commerce (“ICC”). In the country, among the most relevant entities are the Business Arbitration Chamber (“Camarb”), the Market Arbitration Chamber of the BM&FBOVESPA S.A. – Securities, Commodities and Futures Exchange (“CAM”)28, the Conciliation and Arbitration Chamber of Fundação Getulio Vargas (“CAC-FGV”), the São Paulo Chamber for Mediation and Arbitration (“FIESP-CIESP”), the Centre for Arbitration and Mediation of the Chamber of Commerce Brazil-Canada (“CCBC”) and the Arbitration Centre of the American Chamber of Commerce (“AC-Amcham”).

- Repeat player
- Reputation: interest in reinforcing its reputation as an impartial and reliable institution
- Challenges to awards
- [Data about Brazilian arbitral administering institutions]
- [Data about other main arbitral administering institutions used by Brazilian parties]

b.3. Law firms and lawyers

- Arbitration law firms and lawyers as a repeat player
  - One-shot players (Marc Galanter)
  - Within the same law firm, can arbitration lawyers inform their learning and exchange information re arbitration with their colleagues, contract lawyers?
- Reputation
- [Data about Brazil]

b.4. Government

- Public interest, public policies, regulatory importance
- [Data about Brazil]

b.5. Academia

- Public interest29

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28 Unlike the other arbitration chambers or centres mentioned, CAM is a default, mandatory arbitration venue. All participants in the markets managed by BM&FBOVESPA S.A. – Securities, Commodities and Futures Exchange are obliged to settle their disputes “in connection with shareholder and partnership issues or contractual matters disciplined by corporate law (Lei das S.A.), company bylaws, or the rules and regulations applicable to the capital markets in general” in the CAM.

29 See e.g. SMIT, Hans. Report: Confidentiality: Articles 73 to 76. 1998. *American Review of International Arbitration* 9:236 (“After all, publication of awards serves a variety of public interests: It provides an insight into how society resolves disputes; (...) it contributes to the development of the law by disclosing to the world at large the rules arbitrators apply to international disputes and by exposing their decisions to critical analysis; and it enables arbitrators in subsequent cases to draw guidance and inspiration from decisions others made in comparable cases. Indeed, the increasing frequency with which the ICC International Court of Arbitration publishes its awards, and the great measure of attention these awards receive from the
B. Confidentiality and Its Effect on Monitoring and Pre-Litigation costs

Posner’s formula contains two terms: “x”, drafting and negotiation costs, and “y”, litigation costs. The definition of drafting and negotiation costs varies but it comes normally defined as all the costs incurred by the parties until the contract is executed and the transaction consummated\(^{30}\). Litigation costs are the sum of the litigation costs of the parties, of the judiciary/arbitration tribunal and the error costs.

On the last paragraph of his article “The Law and Economics of Contract Interpretation”, Posner acknowledged the existence of another term, a pre-litigation stage, which however was not made explicit in his transaction costs formula\(^{31}\).

The impact of confidentiality in arbitration to the social contractual costs is better perceived if this intermediary term is made evident in the formula, as such:

[to be included]

- Uncertainty, again: arbitration awards are not valued as precedents, but have a paramount importance for consistency and predictability\(^{32,33}\).

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\(\text{POSNER, Richard A. 2005. The law and economics of contract interpretation. Texas Law Review 83: 1614 ("Actually there is an intermediate stage. When a dispute over the contract’s meaning arises, the parties will first try to resolve it themselves. They will do this not only because of the costs of litigation, but also because of the reputation factor that I discussed earlier: the party demonstrably in the wrong on the interpretive issue will hesitate to force the issue to litigation; he is likely to lose and in any event may acquire a reputation as someone who does not honor his commitments. The more carefully drafted the contract is, the easier it will be for the parties to resolve a dispute over its meaning when the dispute first arises, in other words at the prelitigation stage").}\)

\(\text{CREMADES, Bernardo M. 1983. The Impact of International Arbitration on the Development of Business Law. The American Journal of Comparative Law 31: 527 ("As a result it is very difficult to discern clear patterns among the numerous arbitration awards which would indicate a particular trend - a trend that one might call a new ethic in international business. Moreover, any attempt to discern such patterns is hindered by the much espoused confidentiality of arbitration awards, as well as by the pure and simple fact that arbitrators are not necessarily bound by precedent. Nonetheless, after long and careful scrutiny of numerous arbitration awards certain decisional trends begin to appear. These trends, though generally followed by arbitrators, are not without an occasional and isolated contradictory decision.").}\)

\(\text{SMIT, Hans. Report: Confidentiality: Articles 73 to 76. 1998. American Review of International Arbitration 9:236 ("[o]nce an award has been rendered, the public interest in disclosing it becomes particularly pressing. After all, publication of awards serves a variety of public interests: (...) it enables arbitrators in subsequent cases to draw guidance and inspiration from decisions others made in comparable cases. Indeed, the increasing frequency with which the ICC International Court of Arbitration publishes its awards, and the great measure of attention these awards receive from the commentators, counsel, and arbitrators in subsequent cases, bear telling testimony to the significant public interest that is served by publication of international awards").}\)

• Increasing factors
  o High cognitive load to parties and lawyers\textsuperscript{34}
  o Costs in the attempt to elucidate interpretive doubts
  o Costs in the attempt to find success rate of claims, in deciding whether to litigate or to settle
    ▪ Research costs to the parties
    ▪ Legal dogmatics and legal doctrine
  o Uncertainty
    ▪ Reduced incentives for performance
      ▪ Then increased probability of litigation
  o Costs are incurred even if the decision is to settle

C. Confidentiality and Its Effect on Litigation Costs

\textit{a. Probability of litigation (“p”)}

If due to confidentiality’s uncertainty, parties have invested more in negotiation and drafting costs, there is a likelihood that more gaps will be filled, that the contract will contain less ambiguity and that parties will have less interpretive doubts. Investment in “x” may then reduce “p”, the probability of litigation\textsuperscript{35}. But there are sources of endogenous and of exogenous nature that might increase “p”, and which are present in arbitration.

There are two noteworthy endogenous factors that may increase the probability of litigation: contractual complexity and the dollar value of the transaction.

Commercial and corporate contracts subject to arbitration are usually complex: they include a myriad of contingencies of medium to high probability of materializing, the related obligations and payoffs vary in case such contingencies materialize and they demand a high cognitive load (i.e. cross-references, references to other agreements etc)\textsuperscript{36}. Contractual complexity increases the likelihood of gaps, of events of low probability that were not dealt with by the contract, or simply of matters being overlooked during the negotiation and

\textsuperscript{34} HAGEDOORN, John; HESSEN, Geerte. 2009. Contractual complexity and the cognitive load of R&D alliance contracts. \textit{Journal of Empirical Legal Studies}, 6 (4): 822 and 826 (“[t]he degree of difficulty that people face when they attempt to understand contracts ...” in relation to “… to the effort and mental activity imposed on a person’s ability to process information”).

\textsuperscript{35} POSNER, Richard A. 2005. The law and economics of contract interpretation. \textit{Texas Law Review} 83: 1584 (“An increase in x is a real cost, and it may outweigh the savings in expected litigation costs from the reduction in the probability, and therefore expected costs, of litigation”).

drafting stage and that would create interpretive doubts. Thus, complexity increases the probability of litigation.

Of course, "x" tends to be higher in complex contracts, and this, as said, would reduce the probability of litigation. In any case, as a general comment, the odds of litigation are high in a scenario of contractual complexity.

Another endogenous contribution to increase the probability of litigation comes from the high amounts or stakes involved in disputes submitted to arbitration. The point is simple: the higher the amounts or stakes, the likelier the litigation. Again, a higher expenditure on "x", especially because of the dollar value of the transaction, could be a counterbalance force, mitigating the probability of litigation.

In a setting of confidentiality in arbitration and in view of specific legal features, "p" may be exogenously high due to certain relevant features of the legal system [to be developed]:

- if only one (ICC) of the top 7 preferred administering arbitration institutions publishes its awards, the virtual absence of a consistent body of awards generates uncertainty, in the form of lack of consistency and predictability.
- few law professors act as arbitrators (and when do so are bound by confidentiality) + no access to awards, the development of legal dogmatics and legal doctrine is stalled; therefore, more uncertainty.

In spite of the investment made by the parties in "x", these exogenous and endogenous factors may increase the probability of litigation.

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37 **Eggleston, Karen; Posner, Eric A.; Zeckhauser, Richard J.** 2000. The design and interpretation of contracts: why complexity matters. *Northwestern University Law Review* 95 (1): 117 ("For a given economic stake in the contract, the highest level of formal complexity will be optimal when duration is long enough for drafting cost to be quite spread out, but not long enough for reputation effects to substitute too much for formal complexity").

38 **Posner, Richard A.** 2005. The law and economics of contract interpretation. *Texas Law Review* 83: 1612 ("A factor that influences several of the variables in the model is the dollar value of the transaction. The greater that value, the likelier litigation is and also the greater are the litigation expenditures that the parties are likely to make").

39 See e.g. **Fouchard, P.; Gaillard, E.; Goldman, B.** 1999. *On International Commercial Arbitration*. The Hague: Kluwer Law International, p. 187 ("On reading the ICC awards and their commentaries, one significant phenomenon becomes clear: the more recent awards are based on earlier decisions, and the decisions reached are generally consistent. The publication of awards thus enhances their homogeneity. In both arbitration law and international commercial law, arbitral awards have now become a private source carrying considerable weight and have undoubtedly helped to create the arbitral component of lex mercatoria"); Society of Maritime Arbitrators, Inc. Why Arbitration in New York Under SMA Rules?. Available at [http://www.smany.org/arbitration/WhySMA.html](http://www.smany.org/arbitration/WhySMA.html) ("Awards rendered by SMA members are always supported by fully reasoned written opinions and, thus, offer instructive insight for future commercial dealings. Although not binding precedent, the body of written awards does provide a degree of predictability regarding the likely outcome of similar disputes"); **Azzali, Stefano.** 2013. Introduction: Balancing Confidentiality and Transparency In *The Rise of Transparency in International Commercial Arbitration*. New York: JurisNet, xxv ("The reasons for transparency – or the downsides of confidentiality – are several ... There are also reasons of predictability and consistency. ... More visible proceedings and transparent awards would guarantee a higher level of consistency and predictability, which in turn, would enhance the legitimacy of the process itself, having the parties a greater understanding of it; if they are more satisfied and, because of transparency, have the perception that the process is fair, they are likely to use arbitration again."
b. Party’s litigation costs (“y”)

- Increasing factors
  - Uncertainty costs
    - Strategizing in view of uncertainty of awards and lack of legal dogmatics and legal doctrine
    - Experts and evidence
  - Cognitive load
  - “Clubbiness” effect: higher fees charged by the relatively small group of law firms and lawyers and arbitrators with expertise
  - Unknown conflict of interests among lawyers and arbitrators
  - Reputation
  - Time

- Decreasing factors (with more transparency)
  - More lawyers will be able to work as arbitration lawyers. Same for arbitrators.
    - Lower fees
    - Higher number of arbitration processes
    - Lower litigation costs?
    - Affects probability of litigation
  - Disclosure of arbitrators names
    - Accountability
    - “Clubiness”, again: reinforce names of arbitrators or alter choices based on track-record

c. Administering institution litigation costs (“z”)

- Lower litigation costs
- [complete]
- Transparency improves arbitrators and administering institutions accountability and quality of decisions

d. Error costs (“e”)

- Are error costs borne only by the parties? Dollar factor magnifies error costs
  - Confidentiality circumscribe error to the parties

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40 New York City Bar. 2014. Report by the Committee on International Commercial Disputes. Publication on International Arbitration Awards and Decisions. Available at http://www2.nycbar.org/pdf/report/uploads/20072645-PublicationofInternationalArbitrationAwardsandDecisions.pdf, p. 2 (“Increased publication of arbitral decisions may tend to level the playing field and open the practice of international arbitration to more lawyers. The extent of leveling may, however, depend on the cost of access to publications and the degree to which published decisions are redacted. Smaller practices may not be able to afford the often high subscription rates of the publications of arbitration institutions, which would tend to counter-balance the greater openness that publication would otherwise bring.”)
• Transparency
  o Reduces uncertainty
  o Perception of the parties of the error in arbitration process fosters “x”
    ▪ However, negative externality of erroneous interpretation
  o Removes inefficient arbitrators, lawyers and arbitration courts from the market
    ▪ Lower litigation costs
  o Reputation

• Social costs of arbitration errors
  o Challenge of awards by the London Court of International Arbitrators and Stockholm Chamber of Commerce

[to be further developed, including interplay of variables]

III.
CONCLUSIONS

• Need for a more modulated concept of confidentiality, one that discloses the award for the benefit of the public at large in order to increase the body of knowledge.
• Confidentiality in arbitration hampers increases in the social welfare of accuracy and reduces both the private and social value of contracts as a method of allocating resources
• Would certain characteristics of the system increase or reduce such costs? Socially optimal system?

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41 See e.g. Azzali, Stefano. 2013. Introduction: Balancing Confidentiality and Transparency In The Rise of Transparency in International Commercial Arbitration. New York: JurisNet, xxiv (“Obviously, the publication of awards would make people learnt of other’s mistakes and misbehaviors, avoiding future disputes”).
IV.
REFERENCES


Articles/Works to be included: