



## "ARBITRATION AND STATE COURT JUSTICE: COMPARATIVE COST-EFFECTIVENESS"

### RESEARCH ABSTRACT

The study entitled "**Arbitration and State Court Justice: Comparative Cost-Effectiveness**", carried out by SDA Bocconi School of Management, in collaboration with the Milan Chamber of Arbitration (CAM) and concluded in 2024, consists of a comparative analysis of the arbitration procedure versus the State Court judicial procedure.

The research is divided into three stages:

- 1) **analysis** of the values, duration and costs of **345** CAM arbitration proceedings, either closed or still ongoing, administered by CAM in the three-year period 2019–2021;
- 2) sending of **questionnaires**: in order to obtain more detailed information, in particular on the costs and duration of arbitration proceedings and State Court proceedings and for the purposes of a comparison, questionnaires were sent to three types of recipients: more than 250 people responded, including defence lawyers who had taken part in CAM proceedings, expert witnesses (court-appointed technical consultants involved in CAM proceedings) and corporate lawyers (lawyers working within companies);
- 3) **comparison with an economic-financial approach**: information on the values, costs and duration of the disputes in both procedures (arbitration and judicial procedure) was analysed using an economic-financial evaluation model, which allowed for assessing the cost-effectiveness of each procedure.

### METHODOLOGY AND RESULTS

#### STAGE 1. ANALYSIS: DURATION AND VALUE OF DISPUTES IN CAM PROCEEDINGS.

**345** arbitration proceedings filed with CAM in the three-year period 2019–2021 were analysed, classified as either closed or still ongoing at the time of extraction, which took place at the end of 2022.

Objective: to analyse the relationship between the duration of the proceedings and other characteristics, such as the subject matter, sector, nature and value of the disputes.

Analyses on the duration of proceedings were conducted on proceedings closed at the time of extraction, i.e. at the end of 2022. Therefore out of a total of **232** proceedings.

#### Results:

1. **Mean duration** of the proceedings: proceedings at the Chamber of Arbitration have a **mean duration of under one year (307 days)**. In the most complex cases (international or high-value disputes), the mean duration is less than two years.
2. **Value** of the disputes: in most cases, the value of the disputes tends to be between **€52,000 and €260,000**. The mean value of the disputes amounts to €2,174,196.

3. **Costs:** in terms of onerousness, proceedings before the Chamber of Arbitration have a mean cost of €38,000, and €61,000 in the case of a final award. The mean fees for the Chamber of Arbitration is approx. €8,000, which increases to €10,500 in the event of a final award being filed.
4. Over **74%** (152 out of 206 proceedings, which are those with the highest frequency and hence the highest incidence) are characterised by a mean cost of between **€4,000 and €16,000** and a mean duration of **5 months to 1 year**. With reference to the proceedings concluded with a final award, we can see that the mean duration and cost values of the proceedings are substantially proportional to the mean values of the dispute.

A cross-analysis between the variables of time and value of the dispute with a number of other characteristics of the proceedings showed that:

- The proceedings with the longest mean duration are attributable to disputes concerning **leasing** (476 days), **property** (433 days) and **industrial issues** (400 days). The shortest are those attributable to **agency** contracts (201 days).
- When looking at the sector of the parties involved, the longest duration is found in **fashion** (372 days) and **information technology** (373 days), while the shortest proceedings are related to the **commercial** (265 days) and **chemical-pharmaceutical + healthcare** sectors (265 days).
- If we analyse the **nature** of the parties, i.e., private individuals (P) or businesses (B), we note that the longest proceedings are **PTP** (346 days), while the shortest are **PTB** (238 days).
- With regard to the **outcome**: the longest proceedings are those with a final award (445 days on average).
- With regard to the composition of the Arbitral Tribunal, in the case of a Panel of Arbitrators, the duration is longer (341 days).
- If the dispute is **international**, the duration is longer (367 days).
- If we look at the **values** of the disputes, the longest proceedings are those with a dispute value of between €1 million and €2 million (lasting on average 585 days). In general, lower dispute values correspond to shorter durations.

**Costs of arbitration proceedings:** the analysis covered **206 proceedings** (where it was possible to retrieve the figure, because in the other 26 cases the parties waived the proceedings, resulting in a null value of costs settled by CAM).

The mean value of the costs of the proceedings was just over **€38,000**.

The costs related to the CAM fees amount to an average of €8,000 while those related to the Arbitral Tribunal fees amount to €44,000.

If we analyse the class with the highest incidence in relation to the value of the dispute (between €52,000 and €260,000), the mean total cost of the proceedings is just over **€3,000** if there is no final award, and just under €13,000 in the case of proceedings resulting in an award.

**Typology:** proceedings concluded with a final award characterised by a higher cost can be attributed to the cases of **insurance + banking contracts** (over €93,000) and **corporate contracts** (over €88,000). Proceedings relating to **construction contracts and sale and purchase agreements** are on average **less costly** (approx. €16,000).

**Sector:** the highest cost values are found in the **food service sector** (over €170,000) and the **fashion sector** (over €118,000). The least costly are **property** (€28,000) and **information technology** (approx. €33,000). The most costly proceedings are among the PTPs (€84,000); the least costly are PTBs (just over €22,000).

If there is a **Panel of Arbitrators**, the mean cost is **higher** than for a Sole Arbitrator (approx. €120,000 vs. €23,000), in the former case including the remuneration of 3 arbitrators.

The proceedings concluded with a final award that have a higher total cost are those with a dispute value of between €8 million and €16 million (over €260,000). By contrast, proceedings with a dispute value in the €52,000 – €260,000 bracket have a lower cost (approx. €13,000).

**Total costs: costs of proceedings plus legal costs.**

In this case, an analysis was made of the proceedings that concluded with a final award (**99 cases**), in which it was possible to retrieve the information on the legal costs awarded by the Arbitral Tribunal (TA). The TA awards legal costs in cases where one party is ordered to pay all or part of the costs of the other party.

The analysis shows that the mean total costs of the proceedings are €48,000, those for the CAM fees are set at €9,000. While the TA's fees amount to €37,000.

## **STAGE 2 – QUESTIONNAIRES**

Three questionnaires were administered to obtain information on the duration and costs of arbitration in relation to the duration and costs of State Court proceedings, in the absence of public data containing the degree of detail required for the study.

Comparisons were made between the arbitration procedure and the two levels of judgement in the state justice system, since the arbitral award has a finality comparable to that of a second-instance judgement, in that an appeal is not provided as a means of challenging the award.

The questionnaires made it possible to collect data on the duration and costs of both State Court and arbitration proceedings, necessary to carry out a comparative analysis on the cost-effectiveness of the two types of proceedings. On 26 September 2023, three questionnaires were sent out to three types of recipients: lawyers, legal expert witnesses and corporate lawyers.

This survey-based analysis was conducted with reference to disputes valued at €150,000, the rounded median value of the most populated class in terms of dispute value (from €52,000 to €260,000). The questionnaires were collected between 26 September and 15 November 2023.

### **Results.**

Arbitration is perceived by the lawyers who responded to the questionnaires as a significantly more rapid solution compared to the State Court procedure. In fact, since arbitration is not appealable (unlike a first-instance judgement before the Court) but can only be challenged on limited and specific grounds provided by law, an arbitral award can be considered – in terms of finality – equivalent to a second-instance judgement. The majority of the lawyers surveyed (over **87%**) and **91%** of the corporate lawyers believe that arbitration is concluded in a shorter (or significantly shorter) duration than civil litigation. This result is crucial when comparing the values of the two procedures in order to determine which of the two options is more cost- and time-efficient.

In the perception of the respondents to the questionnaire survey, civil litigation in fact tends to last an average of almost **four years**, considering the two levels of judgement, while the duration of arbitration is **one year and two months** for arbitrations concluded with a final award (the data correspond with the findings of the analysis of CAM proceedings data: arbitration lasts on average 445 days).

The fees charged by lawyers for technical defence in arbitration tend to be higher than those charged in the State Court procedure, when, however, only one level of judgement is considered. In fact, the proportion of lawyers who reported fees exceeding €10,000 is higher in arbitration cases than in each of the two State Court levels of judgement. Where, on the other hand, the comparison has to take into account both levels of the State Court procedure, in deference to the need to compare procedures that reach the same degree of finality, the latter is perceived as more burdensome in its overall course.

## **STAGE 3: COMPARISON WITH ECONOMIC-FINANCIAL APPROACH**

For a company, the comparative evaluation of the two proceedings, carried out only by taking into account the parameters of duration, costs and values of the disputes, may be incomplete. A company's decisions are

based on criteria of economic rationality; therefore, the **financial value of time** becomes central in the company's evaluations of investment alternatives.

**Sample.** In order to compare the proceedings with an economic-financial approach, CAM proceedings filed between 2019–2021 closed with a final award (99 cases), having a mean duration of 445 days and a total cost of €61,274 were taken into consideration. In particular, the focus was on the most frequent proceedings, i.e. those with a dispute value of between €52,000 and €260,000: **38 cases out of 99**, with a mean duration of proceedings of **385** days and a mean total cost of proceedings of **€12,853**.

In order to analyse legal costs, in addition to the values listed in Italian Decree No. 55 of 10 March 2024 (Regulation establishing the parameters for the determination of fees for the legal profession), a survey was conducted through a questionnaire administered to lawyers, asking them to declare their fees for proceedings with a dispute value of €150,000. For reasons of confidentiality, the values of lawyers' fees were collected in three brackets: less than €10,000, between €10,000 and €25,000, and over €25,000.

In order to be able to make an economic evaluation, using precise data on legal costs, assumptions were made on said costs: a cost value of €5,000 was chosen for fees in the bracket below €10,000; a reference value of €17,500 was chosen for the bracket between €10,000 and €25,000, while a reference value of €35,000 was chosen for the bracket over €25,000.

With reference to the values of State Court proceedings, data were collected through questionnaires, asking lawyers to indicate a mean duration for first- and second-instance judicial proceedings and corresponding fees for a dispute valued at €150,000, to align this value with that chosen for CAM.

The comparison between State Court proceedings and arbitration was carried out using the investment economic analysis model, which is based on **discounted cash flows** (a methodology widely used in investment valuation).

The cost of the proceedings is considered to be a kind of “**investment**”, made in order to obtain the recognition of a right. The **compensation** obtained at the end of the proceedings is the **return on the investment** made.

It can be hypothesised that the **sum awarded** to the prevailing party in the arbitral award, once the proceedings are concluded, is **reinvested** for the remainder of the time that would otherwise be required to reach the conclusion of the State Court proceedings. Additionally, the actual economic and financial return for the prevailing party would be greater than what emerged from the study, since most of the costs are borne by the losing party.

Thus, the **return on the compensation awarded in advance in the arbitration is calculated**. Those who are still bound by the State Court procedure continue to bear a cost for a longer period of time, a cost that becomes a **revenue opportunity** for those who resolved the issue earlier through arbitration.

## CONCLUSIONS

The analyses conducted on the sample observed enable us to draw some useful indications in terms of comparison:

1. Assuming that the costs of both parties are equal or only slightly higher in the case of arbitration compared to the State Court procedure, **arbitration becomes more cost-effective as the value of the dispute increases**.
2. The State Court procedure is more cost-effective when the “Procedure Margin” (the difference between the value of the dispute and the total costs of the proceedings) is small and thus unable to generate sufficient financial income to offset the difference in the present values of the costs incurred, which, due to the different durations of the two procedures, penalises the arbitration procedure.

3. Conversely, in cases where **the value of the dispute increases, arbitration may become more cost-effective than the State Court procedure**. This greater cost-effectiveness depends on the increase of two variables: the value of the dispute and the **reinvestment rate**. Arbitration should, therefore, be preferable in cases in which the value of the dispute is sufficiently substantial and when the possibility of “freeing up” in advance the resources awarded by the judgement enables them to be productively used in alternative investments that offer profitability rates not lower than the investment rate in the procedure.

Insights:

- firstly, the consideration of the shorter duration of arbitration, compared to the State Court procedure;
- secondly, it emerges that the fees charged by lawyers for technical defence in arbitration do not appear to be higher than those for the two levels of judgement in the State Court procedure;
- finally, it is important to underline that a mere comparison between the costs sustained in the two procedures appears limiting, since it fails to consider – in addition to other elements, such as the certainty of the outcome, the expertise of the arbitrators and the confidentiality guaranteed – the relevance of the economic-financial profile, deriving from the possibility of using the compensation obtained in the award in profitable alternative investments, according to principles of economic rationality.

The comparative cost-effectiveness analysis between arbitration and State Court procedure is therefore justified and summarised in the evaluation of their economic-financial profile, encapsulated in the concept of the financial value of time.

In conclusion, the study points out that, similarly to other choices made in corporate management, those concerning the most appropriate way of handling a dispute must take into account multiple factors: legal, duration, costs, the values at stake, and the opportunity to gain additional benefits by promptly reinvesting the compensation awarded at the end of the proceedings in alternative profitable projects.

## **RESULTS IN 5 POINTS**

### **FIRST RESULT**

CAM proceedings have a **mean duration** of less than one year. In complex cases, such as **international disputes or those with high dispute values**, the mean duration is, in any case, **less than two years**.

### **SECOND RESULT**

CAM proceedings have a **mean total cost of €38,000**. The mean cost rises to **€61,000** in the event of a final award. **The mean CAM fees are €8,000, or €10,500** if a final award is filed. These data were calculated on a sample of **206 proceedings**, from which cost data could be retrieved. If we analyse the class with the highest incidence in relation to the **value of the dispute (between €52,000 and €260,000)**, the **mean total cost** of the proceedings is just over **€3,000** if there is no final award, and just under **€13,000** in the case of proceedings resulting in an award.

### **THIRD RESULT**

**Over 74% of the proceedings** analysed (i.e. **152 proceedings**, which have a high frequency and therefore a greater impact on the total **206 proceedings** analysed) are characterised by a moderate **mean cost** (between **€4000 and €16,000**) and a fairly short **mean duration (between 5 months and one year)**.

In the case of proceedings concluded with an award, the mean values of duration and cost of the proceedings are **proportional to the mean values** of the dispute.

#### **FOURTH RESULT**

Arbitration is perceived by lawyers as a **more rapid solution**. Moreover, since the arbitral award is not appealable (unlike a first-instance judgement before the Court) but can only be challenged on limited and specific grounds provided by law, it can be considered – in terms of finality – equivalent to a second-instance judgement.

#### **FIFTH RESULT**

The comparison between arbitration and the State Court procedure must take into account the concept of the **financial value of time**.

A mere comparison between the costs of the two procedures and the value of the dispute in constant euros is limiting and does not consider the **possibility of freeing up and deploying funds in advance** – funds that would otherwise not be available for longer periods – **in profitable alternative investments**, according to the principles of economic rationality.