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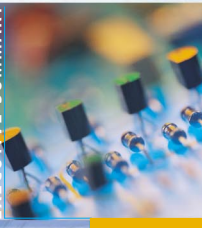
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EXECUTIVE SUMMARY



Dispute Avoidance and Resolution Best Practices for the Application Service Provider Industry

Prepared By:

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EXECUTIVE SUMMARY

The growth of the Application Service Provider (ASP) industry is predicated on a number of interrelated factors, technical and non-technical. Among the technical factors are sufficient bandwidth, connectivity and other factors affecting reliability, availability and security. Paramount among the non-technical factors (and very much dependent on the technical success of the ASP model) is end-user confidence.

The challenge of how to increase consumer or end-user confidence in the on-line world is by no means exclusive to the ASP industry. It is one that also confronts retail businesses and other service providers seeking to exploit the economic potential of the Internet, consumer groups, trade associations and public sector regulators. Particularly in cross-border settings, where the contracting parties are unlikely to share commonalities of geography, culture and/or legal regimes, the challenges regarding raising on-line confidence are considerably greater than those faced within a single country.

Balanced, impartial, expeditious and cost-effective problem and dispute resolution procedures are fundamental to creating a more confident consumer/end-user environment. Notwithstanding

the many "front-end" measures that businesses can try to implement, in large part, customer confidence is based on the belief that disputes will be settled quickly and fairly either by the business or service provider directly or through some other means. In both the traditional and on-line worlds, when disputes cannot be resolved directly between the consumer and the business, the merchant or service provider and consumer must resort to other means. These often include appeals to consumer protection agencies, recourse to the courts, or use of alternative dispute resolution systems.

The main objectives of the whitepaper prepared by the ASP Industry Consortium (ASPIC)¹ and the WIPO Arbitration and Mediation Center (WIPO Center)² are to provide:

- All of the stakeholders in the ASP industry with an insight into the use and possible benefits of conflict management procedures.
- ASPs and their partners with practical and applicable information that will enable them to introduce conflict management procedures within their organizations and into their contracts, and to take advantage of conflict management processes when disputes arise.

- Lawyers, judges, arbitrators and other "alternative dispute resolution" experts not familiar with the ASP industry with an insight into the structure, relationships and likely areas of dispute in the ASP supply chain.

I. Background and Context

As yet, there have not been a significant number of reported disputes in the ASP space. The main reasons for this situation include the following:

- The ASP business model is still relatively new and the market for ASP services is still in an embryonic stage.
- Small and medium enterprises that may have faced difficulties with their ASP services may not have had the resources (financial or otherwise) to pursue a dispute.
- Larger enterprises have a higher threshold of tolerance for technology underperformance. Also, they currently are less dependent on ASP services for mission-critical functions.
- The financial loss suffered by customers/end users that have had problems with their ASPs has not been sufficient to justify pursuing formal dispute resolution, regardless of the forum.

- ASPs and their customers have sought to avoid dispute resolution processes because of the cloud this may cast on the prospects of future funding, and because of the general adverse effects on business and marketing activities.

- Many ASPs are taking additional precautions and measures in service delivery and customer care, which at a later stage may become cost-prohibitive.

However, as the ASP market grows, the number of disputes is expected to rise as a result of the failure of providers to meet service-level commitments to end-user satisfaction. In addition, if analysts' predictions that the ASP industry will experience significant short-term consolidation are correct, disputes over issues such as data ownership, data transfer or software ownership could well materialize.

ASP supply chain disputes are likely to display some or all of the following characteristics:³

- **One-to-Many.** The critical distinguishing characteristic of ASP supply chain disputes is a consequence of the "one-to-many" delivery model. Thus, a single technical problem affecting an ASP serv-

ice delivery, regardless of the source of that problem, could have widespread ramifications. This gives rise to the possibility of multiple claims (potentially by all the ASP's customers/end users) in a chain reaction as a result of claims that may then be made against the ASP's customers.

- **Multi-jurisdictional.** The ASP delivery model may involve multiple partners, some or all of whom may be located in different places. An ASP's customers may also be located in different geographic areas. Thus ASP supply-chain disputes may implicate the laws of multiple jurisdictions, as well as different business and legal cultures. In addition, an ASP may be subject to suit in multiple jurisdictions, possibly at the same time.

- **Problem-Sourcing Complexities.** Because of the multi-layered partnering relationships and technical complexities involved in the ASP delivery model, it will be very difficult to identify, isolate and understand the source or multiple sources of a technical problem – whether software, hardware or connectivity-related. It could take considerable time and resources to determine legal liability. In addition, although the commercial and legal issues to be decided in a dispute

may be relatively simple, the related technology and technical issues may involve significant complexity.

- **Cutting-Edge Legal and Business Issues.** With the ASP delivery model still in its infancy, the pricing, contracting and business models are still evolving. ASP supply-chain disputes are likely to raise novel legal (procedural and substantive) and liability issues, which the existing legal framework may not adequately address. The delivery of software over the Internet also raises a plethora of complex intellectual property issues that are still being debated in national and international forums.

- **Symbiotic Relationships.** As noted, the ASP delivery model can involve multiple partnering relationships where each of the partners is mutually interdependent. A dispute that arises could therefore involve parties who have a very important vested interest in a continued and harmonious relationship with the other. The time and financial resources required to establish a new partnering relationship to fulfill the role of a ruptured relationship may be prohibitively high.

- **Unique Characteristics of the Parties.** Many ASPs, their partners and

customers are young companies or newly formed divisions of established firms seeking scale in the ASP space. They will have a particularly strong interest in the expeditious resolution of any disputes so that important and possibly scarce resources are not diverted away from other areas of activity. There will also be great interest in preserving the confidentiality of the dispute, in order to minimize bad publicity about their emerging businesses.

- **Wide Value Range.** While little data is currently available, it is likely that the value of ASP supply chain disputes will range widely. For example, the losses suffered by a small e-tailer as result of a two-hour downtime of its web site may amount to only a few thousand dollars, whereas the same downtime may result in a loss of several hundreds of thousands of dollars for a large enterprise involved in business-to-business e-commerce. Similarly, there will be a higher level of responsibility regarding a human resource application than for a rudimentary word processing program. Accidental disclosure of the HR application could result in damage amounts that far exceed the damage associated with accidental disclosure of the word processing application.

The various stakeholders in the ASP supply chain know and accept that there will be many difficult challenges as the ASP business model continues to evolve. At the same time, they acknowledge that for the ASP model to succeed, those companies that pioneer the ASP model must not let these challenges stand in their way. Instead, they must address these challenges quickly, efficiently and in a manner that maximizes the likelihood of preserving the underlying business relationship while minimizing business disruption.

II. Dispute Avoidance Best Practices

It would be optimal to avoid disputes from materializing in the first place. Although directed primarily at ASPs, the following "dispute avoidance" best practices are also relevant for other stakeholders in the ASP supply chain.

Dispute Avoidance Best Practices

- Adopt and promote operational best practices in the following general areas:⁴ infrastructure planning and management; connectivity planning and management; security planning and management; applications planning and management; implementation planning and

management; and support planning and management.

- Be proactive in determining service-level compliance problems by deploying systems that can isolate the cause of a problem and the associated vendor that owns the problem component, and through comprehensive and meaningful reporting of service level compliance issues to customers.

- Provide timely and responsive problem resolution, proactive support services, and efficient information management by establishing customer-care policies and comprehensive help desk facilities.

- Negotiate and implement fair, balanced, comprehensive and clearly drafted service level agreements, which set out the respective rights and obligations of the parties and ensure that each party fully comprehends, at an operational level, the legal and technical implications of the contractual commitments.⁵

- Implement technical, administrative and operational mechanisms that enable proactive relationship management.

- Acquire proper insurance coverage as part of an overall risk reduction plan

and work with experienced professionals to obtain the best, most efficient insurance protection available.

III. Formal Dispute Resolution Mechanisms

Dispute Resolution Best Practice

- ASPs should promote and rely upon alternatives to court litigation for resolving disputes that may arise with their vendors, partners and customers. Alternative dispute resolution procedures provide a confidential, neutral, quick and cost-effective means to resolve disputes, give the parties significant control over the process and allow for the involvement of specialist neutrals with relevant experience. The earlier on such procedures are invoked, the greater the likelihood of a prompt disposition of the dispute.

Even with the most comprehensive and well-conceived risk management and dispute avoidance measures, there will be always unforeseen circumstances where the parties genuinely will not be able to agree and internal problem resolution procedures will prove to be inadequate. In such instances, the parties will need to resort to a formal dispute resolution mechanism. Accordingly, summarized below are various dispute resolu-

tion options that ASPs and their partners should consider using.

A. Litigation

Litigation is the formal, public process for resolving disputes before national courts. While litigation may be the most appropriate, or only available, method of dispute resolution in certain circumstances, it is generally accepted to be a slow, disruptive, resource-draining, expensive and time-consuming way of resolving conflicts. Litigation also involves considerable uncertainty as to the final outcome of the process, can jeopardize crucial business and investment plans, place valuable corporate assets at risk and result in the breakdown of long-standing business relationships.

In addition, in the context of disputes arising out of an international relationship, the non-local party required to prosecute its claims before a foreign court may find itself in a position of considerable disadvantage when faced with foreign laws, unfamiliar procedural and evidentiary rules and language differences. Even if a party is ultimately successful, because the network of treaties for the recognition of national court judgments is not extensive, a judgment obtained before the national courts of one

country may be difficult to enforce in another country.

B. Alternatives to Litigation

Because of the limitations of litigation as a dispute resolution technique, contracting parties in the ASP supply chain should rely upon dispute resolution alternatives to litigation or “alternative dispute resolution” (ADR). ADR encompasses a range of techniques for resolving disputes between two or more parties outside of formal court processes. These techniques, sometimes referred to as “dispute management” techniques, are not necessarily mutually exclusive in any particular conflict, but can be and often are used sequentially or in a customized combination. They may also be used as an adjunct to litigation.

The main advantages of ADR procedures, which make them particularly suitable for resolving ASP supply chain disputes, include:

- **Speed.** Parties to a contract will disagree at some point. It is the length and level of that disagreement that drives a wedge in the relationship. Disputes distract from core business operations and the costs of a protracted dispute are typically high, both in terms of human and

financial resources. Important business plans and objectives, as well as financing, can be jeopardized by the cloud of an outstanding claim. For young companies, in particular, a speedy resolution of a dispute may be critical as they may not survive the time it takes for a dispute to be resolved through litigation. Even in jurisdictions with expedited dockets, ADR is almost always quicker than court litigation. The possibility of an expeditious outcome is due not only to the general informality of the ADR procedures but, also to the fact that the neutral or panels of neutrals are focused on managing a continuous dispute resolution process and reaching a prompt disposition. The fact that they may have substantive expertise in the subject matter of the dispute is also a contributing factor. In addition, certain ADR procedures are based on the premise of party cooperation and implemented to facilitate such cooperation.

- **Substantial Cost Savings.** An early settlement or disposition of the parties' dispute, normally, will result in substantial cost-savings. Even where non-consensual procedures, such as arbitration, are used, the costs associated with resolving the dispute will be less in the majority of cases than if the dispute had been litigated in court.

- **Privacy and Confidentiality.** For many companies, especially small and medium enterprises, it may be of vital importance that the dispute between the company and a vendor or customer does not become public. A public dispute may have severe consequences for future funding and other business and marketing activities. Moreover, the lower the profile of the dispute, the greater the likelihood that the parties involved will be able to resume normal business operations and work together towards a win/win outcome. ADR is, in its essence, a private procedure. As such, ADR allows for privacy to resolve a dispute, avoid a public record and judgment, and minimize the potential impact on other future disputes. The appropriate ADR procedure can also allow for confidential and proprietary business information to be disclosed. These features of ADR can often be the critical impetus for settlement.

- **Expert Decision Makers.** The issues surrounding an ASP supply chain dispute may involve technology and technical issues that are difficult for a layperson to visualize and comprehend. Moreover, because the ASP industry is still developing, the commercial models tend not to follow standard formats. They, too, are still evolving. ADR procedures allow for the possibility of party participation in

the nomination and appointment of the neutral(s). The parties consequently have the option of having an expert neutral who is knowledgeable about the business, technical and legal issues that may be involved in the dispute, which can lead to valuable savings of time and money.

- **Preservation of Business Relationships.** As described above, certain ASP delivery models are predicated on sound partner relationships that are fundamental to enabling the delivery of services. Accordingly, the parties to an ASP dispute will have a very important vested interest in a continued and harmonious relationship with the other. Where ADR procedures such as mediation are used, the lines of communication between the parties can remain open, and the parties assisted to balance their interests in pursuing the dispute against the value of preserving their commercial relationship.

- **Predictability of Outcome.** The outcome of litigation is often characterized as an “all-or-nothing” result. Arbitration has sometimes been criticized for the “solomonic” nature of arbitral awards. In ADR procedures, such as mediation, the outcome is based on the extent of the parties' willingness to compromise, rather

than being imposed on them. The final settlement, as a reflection of each party's respective business interests, thus has a much more predictable quality.

• **Creative Business-driven Solutions.**

In non-adjudicative ADR, such as mediation, the parties have the ability to fashion win-win resolutions reflecting business objectives and priorities, which might not be available from a court or arbitral tribunal where the decision will typically be based on more technical or narrow issues. Once ADR has opened up the lines of communication, parties can, and often do, go beyond the particular dispute at issue to resolve broader concerns. Moreover, ADR allows for greater involvement of the principals, which can be a big benefit in encouraging business-based rather than legalistic resolutions.

• **Procedural Flexibility and Party Control.**

The parties and their lawyers are free to choose an ADR procedure that they agree is most suitable for the circumstances underlying their dispute, their respective business objectives, time-frame and corporate mindset. Moreover, the parties and their counsel then have the ability to tailor and refine the chosen procedure to fit their needs and preferences. This includes not only the mechanical and evidentiary aspects of the process

but substantive aspects as well, including narrowing the factual and legal issues at hand.

• **Business Disruption.**

While ADR does require management resources upfront, the amount of time expended typically pales in comparison to the disruption litigation causes, including significant burdens on business and operational personnel, as well as in-house counsel. Moreover, a longstanding contingent liability or pending challenge to valuable assets can have a major adverse impact on financing, marketing activities and business expansion plans.

• **Reservation of Rights.**

When parties decide to deal with their problems through a binding adjudicatory process such as arbitration, they do so on the basis of waiving their right to have these issues determined by a court by way of litigation. They may still go to court for the purposes of obtaining interim relief or in aid of the arbitral process. However, where the parties use a non-binding, consensual form of ADR such as mediation, there is an implicit (and sometimes contractually explicit) reservation of their rights to have the matter resolved by adjudication, whether litigation or arbitration, in the event that no agreement is reached in the non-binding process.

Pursuing non-adjudicatory ADR is thus largely without risk.

• **Jurisdictional Issues.**

Because ADR is a private process, based on party agreement, it eliminates one of the most significant problems likely to emerge in ASP supply chain disputes – that of jurisdiction. Issues relating to the law to be applied to the substance of the dispute may still have to be resolved. But the parties' agreement to use an ADR procedure, such as arbitration, eliminates the need for a claiming party to prosecute its claims in potentially multiple jurisdictions that may be implicated by the underlying commercial relationship giving rise to the dispute. It also eliminates the possibility that the party against whom the claim is brought will have to defend its interests in several potentially inconvenient and unfavorable forums.

The main disadvantage of ADR for resolving ASP supply chain disputes is that the dispute may involve more than two parties, who most likely will not have a contractual relationship. This poses a significant, although not insurmountable, challenge for private dispute resolution mechanisms, such as arbitration and mediation, as it generally is not possible to force a third party -- by definition not a party to the contract out of which the

dispute arises -- to participate in the proceedings without its agreement. The above complications are minimized in proceedings before national courts, which generally have the power to order parties subject to their jurisdiction to be joined in court proceedings when it is thought to be necessary or even convenient.

The table on the next page identifies some of the most commonly used ADR techniques, each of which differs in terms of the level of formality and, hence, the level of party control, expense and finality of outcome.

Commonly used ADR Techniques

Negotiation	Least Formal	An informal, typically unstructured, process, where the parties attempt to resolve their differences through direct interaction. A third party may be appointed by the parties to facilitate the negotiations.
Settlement Counsel	Least Formal	A relatively new ADR technique where the disputing parties retain counsel who are given the specific mandate of settling the dispute. The settlement counsel normally are not permitted to participate in any subsequent proceedings, in any capacity, if the attempts at settlement fail.
Mediation	Least Formal	A private, voluntary, non-binding, confidential and flexible procedure in which a neutral intermediary endeavors, at the request of the parties to a dispute, to assist them in reaching a mutually satisfactory settlement of their dispute. Or, if requested, provide a neutral evaluation of the parties' respective positions and the final outcome.
Mini-Trial	Least Formal	A private, voluntary, non-binding, and confidential procedure that takes the form of a "mock trial" in which the parties make submissions to a panel comprised of senior executives of the disputing parties and a third-party neutral.
Early Neutral Evaluation	Least Formal	A private, voluntary, non-binding and confidential procedure involving the referral of a dispute by the parties to a third party for non-binding evaluation, in which the evaluator applies all of the principles that would be used in the event of formal adjudication.
Neutral Fact-Finding Expert	Least Formal	A private, voluntary, non-binding and confidential procedure in which the parties submit specialized issues (e.g., technical, scientific, accounting, economic) to an expert for a neutral evaluation of the facts, typically invoked in aid of a parallel dispute resolution process.
Ombudsperson	Least Formal	A particular kind of fact finder used by many corporations, educational institutions, government agencies, trade groups and consumer agencies to investigate and assist in resolving grievances and complaints. Generally ombudspersons make non-binding advisory reports and recommendations to the responsible manager about how to resolve a dispute, but can also issue decisions that are binding.
Dispute Review Board	Least Formal	A private, voluntary and confidential procedure commonly used in the context of an ongoing long-term relationship, which consists of an informed standing group of experts who can quickly deal with disputes as they arise. This is commonly used in the construction industry and in high-value outsourcing contracts. Determinations may be binding or advisory.
Arbitration	Most Formal	A private, voluntary and confidential procedure involving the adjudication of rights, in accordance with the applicable law, by a tribunal of one or more arbitrators that has the power to render a decision that is final and binding on the parties. Arbitration can also be non-binding.
Litigation	Most Formal	Formal, public process for resolving disputes before national courts.

IV. Model Dispute Resolution Clauses and Drafting Guidelines

Generally speaking, it is advisable to include a dispute resolution clause (i.e., a clause dealing with the process or procedures by which disputes arising out of, or relating to, the parties' contractual relationship can be resolved) at the time of negotiating the other terms and conditions of the agreement. Once a dispute has arisen, it may be impossible for the parties to agree about anything, let alone the procedures about which to resolve their dispute. Moreover, a pre-dispute clause provides both parties with a degree of certainty regarding how problems will be resolved and can expedite the dispute resolution process. It is, however, possible to decide on a dispute resolution process after a dispute has arisen, particularly if the parties' relationship is such that an agreement on the process could be achieved without significant delay, expense or acrimony.

Once the parties have decided on a dispute resolution process, that process needs to be memorialized in the form of a written agreement. Accordingly, the white paper provides examples of dispute resolution clauses developed by the WIPO Center that contracting parties in

the ASP supply chain should consider including in their contracts, as well as commentary on the clauses and possible variants.

A dispute resolution process may be conducted ad hoc (i.e., the parties decide, possibly with the help of a neutral, on the procedures according to which the dispute will be decided). It may also be conducted according to set of rules made available by an institutional dispute resolution service provider (e.g., the WIPO Arbitration and Mediation Center, the American Arbitration Association, the London Court of International Arbitration, the International Chamber of Commerce), which are typically incorporated by reference in to the dispute resolution clause. The model clauses refer to the WIPO Arbitration and Mediation Rules, as a particularly appropriate set of rules for resolving ASP supply chain disputes, and the WIPO Rules are annexed to the white paper. Guidelines are also provided to enable parties to decide whether to proceed ad hoc or in accordance with institutional dispute resolution rules.

V. Process and Methodology

From the very outset ASPIC and the WIPO Center considered it vitally important that the recommended best practices and guidelines should be the result of a process involving extensive research, consultations with stakeholders in the ASP supply chain, and independent review and validation by experts. Hence, the recommendations reflected in the white paper are a reflection of the following:

- Interviews of senior personnel representing a cross-section of the ASP supply chain.
- Comments submitted through a web-based comment filing system made available via the WIPO Center's web site.
- Contacts with experts in alternative dispute resolution knowledgeable about the ASP Industry.
- Results of a survey on SLAs conducted under the auspices of ASPIC's Research Committee, in which several questions were included on alternative dispute resolution.

- Information provided by ASPIC members and other interested parties regarding ASP supply chain dispute models.

- Research regarding disputes that have arisen in connection with traditional outsourcing contracts and systems integration projects.

- Other bibliographic research, including legal databases, current press reports and Internet searches.

- Comments submitted by a specially formed international group of experts in law, business and policy, known as the WIPO-ASPIC Dispute Avoidance and Resolution Experts Group.

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1. Founded in May of 1999, the ASP Industry Consortium (<http://www.allaboutasp.com>) is an international advocacy group of more than 1000 companies formed to promote the application service provider industry by sponsoring research, promoting best practices, and articulating the measurable benefits of the ASP delivery model. Its goals include educating the marketplace, developing common definitions for the industry, as well as serving as a forum for discussion and sponsoring research. Among the technology sectors represented among the ASP Industry Consortium membership are Independent Software Vendors (ISVs), Network Service Providers (NSPs), Application Service Providers (ASPs), as well as emerging business models and other sectors supporting the industry.

2. The WIPO Arbitration and Mediation Center (<http://arbitrator.wipo.int>) is a leading dispute resolution service provider offering arbitration and mediation services for the resolution of international commercial disputes between private parties. Developed by leading experts in cross-border dispute settlement, the Center's dispute resolution procedures are considered to be particularly appropriate for technology, entertainment and other disputes involving intellectual property. The Center has focused significant resources on establishing an operational and legal framework for the administration of disputes relating to the Internet and electronic commerce and is frequently con-

sulted on issues relating to intellectual property dispute resolution and the Internet. The Center also provides dispute resolution advisory services and has worked with a variety of organizations to develop dispute resolution schemes tailored to meet their specific requirements. An independent and impartial body, the Center is administratively part of the International Bureau of the World Intellectual Property Organization. It is based in Geneva, Switzerland.

3. An appendix to the white paper provides a list of the types of disputes that persons interviewed by the ASPIC Best Practice Committee's Dispute Avoidance and Resolution Team (DART) or who submitted comments separately, indicated they (a) have faced in the past, (b) are presently trying to resolve, or (c) believe could be flash-points in the future.

4. The white paper provides a checklist of items that should be considered under each of the items listed and cross-references to the ASP Industry Consortium's *A Guide to the ASP Delivery Model*.

5. The white paper provides a checklist of some of the most common service level agreement clauses and cross-references to the ASP Industry Consortium's *A Guide to Service Level Agreements*.