Arbitration and start-ups: can they go together?

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Introduction

In this article, we aim to explain the possible rapports and interrelations between arbitration and the world of the starts-ups.

Before embarking in this analysis, it is worthy to analyse to which companies we are referring when using the term “start-up”.

In this regard, we may indicate a situation where a person, named the founder, has an entrepreneurial idea focused on a product or on a service to be launched on the market. The initial phase related to this “venture” is usually commenced directly by the founder availing of her/his own fundings. Once realized that the business needs more financial injections to grow, the founder may involve in support venture capitalist partners and investors for contributing to the conduction of the company.

In the “world” related to the start-ups many legal disputes may arise.

Hereinbelow, we will give some examples of such disputes and we will demonstrate that arbitration could be considered as a suitable dispute resolution mechanism in such an environment.

The disputes related to the funding of the start-ups: the arbitration may offer a fast way to solve them

The speediness in the solution of legal disputes is certainly a key asset for the start-ups.

This can for example be seen taking into consideration disputes involving the mechanisms related to the fundings.

As mentioned, the start-ups are created on a model grounded on the injection of money from third parties. To this end, capitalist partners or investors enter contractual relationships with the founder/s committing to pay a certain

amount of money for contributing to the development of the start-up under certain conditions (for example the possibility to carry out a due diligence on the company). These agreements are usually named as “term sheets”.

Issues may arise whether there is a refusal for any reason from the capitalist partners or investors to pay the amounts agreed under the relevant “term sheets”[1].

In such circumstances, it is of essence to resolve such kind of disputes swiftly. Otherwise, the start-up may indeed “sink” for lack of fundings.

Under this angle of view, it can be underlined that it is better to provide for arbitration agreements when preparing the relevant “term sheets”.

As a matter of fact, arbitration may bring to a quick outcome of the dispute[2]. This even more if the parties have inserted in their contractual relationship the possibility to resort to expedited proceedings.

On the other hand, it is well known that litigation before national courts may require in certain jurisdictions years for a legal proceeding to be defined[3].

Disputes related to the conduction of the start-ups by the founders: arbitration may offer for confidential proceedings

Another aspect to be considered (and to be valued in a “start-up” environment”) refers to the confidentiality of the legal proceeding.

In this regard, it is telling the situation in which the “lead” in the start-up is entrusted, in the relevant “term sheet”, to the founder (for example because she/he is the person considered able to move forward the “business”). At a certain point, the investors or the venture capitalists who are funding the start-up may have claims against the founder’s way of conducting the business activities. They could then request the removal of the founder or point out to her/his misconducts (especially if there are suspicions of fraudulent accounts, breach of fiduciary duties and/or breach of contract)[4].

Also in this case, it is crucial that it is not disclosed that legal proceeding has been started. The publicity related to the commencement of lawsuits against the founder could affect the credibility of the start-up and ultimately impact on the start-up capacity to make profits. There is then the interest to keep such kind of matters (and the existence of any legal dispute) “under cover”.

Also in this case, arbitration has clear advantages if compared to court litigation.

The parties who have agreed to arbitrate their matters in their contractual relationships are indeed bound by confidentiality obligations. Instead, if it is contractually envisaged litigation before a national court, the legal proceeding is public and the information related to it could thus immediately be spread on the media[5].

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[1] Ryan Abbot and Shirish Gupta, ‘How Arbitration Can Be a Lifeline for Tech Startups Feeling the Impact of the Pandemic’ (*ACCDocket.com*) <https://www.jamsadr.com/publications/2020/abbott-gupta-accdocket-how-adr-can-be-a-lifeline-for-tech-startups-feeling-the-impact-of-the-pandemic-2020-09-30>.
[2] Sanna Kaistinen, Adriana Aravena-Jokelainen and Miisa Happonen, ‘Start-Ups and Arbitration: A Report From Helsinki International Arbitration Day (HIAD) 2021’ (*Kluwer Arbitration Blog*) <http://arbitrationblog.kluwerarbitration.com/2021/12/24/start-ups-and-arbitration-a-report-from-helsinki-international-arbitration-day-hiad-2021/>.
[3] ‘Six Key Differences Between Litigation and Arbitration’ (*Lexis Nexis*, 22 February 2021) <https://www.lexisnexis.com/community/insights/legal/b/thought-leadership/posts/six-key-differences-between-litigation-and-arbitration>.
[4] Daniel Chia, ‘Technology Disputes Involving Founders and Startup Companies in Asia’ (*Morgan Lewis*) <https://www.morganlewis.com/-/media/files/publication/presentation/webinar/2022/technology-disputes-involving-founders-and-startup-companies-in-asia-06sept22.pdf>.
[5] Thais Dourado Amaral, ‘Startup B2B Conflicts: Arbitration of Technology Sector Disputes in Latin America’ *Inter-American Law Review* (22 April 2021).

Disputes related to the complex environment where the innovative start-ups operate: the possibility offered by arbitration to select arbitrators knowledgeable of what the disputes are about

In the previous two sections we have referred to possible disputes related to the funding or to the structure of the start-ups. These kinds of litigations refer then to issues internal to the company.

On the other hand, it shall also be noted that most of the start-ups are involved in very innovative industries and are operative in developing technologies such as data analytics, artificial intelligence systems, blockchain and smart contracts. There may then be the need for the start-ups, in their day-by-day activities, to interact and avail of the services of different players such as for example e-retailers, large technology companies and social media/internet platforms. For these purposes, the start-ups may thus enter very sophisticated contractual relationship such as software development agreements, software maintenance agreements, etc.[6]. Obviously, it may happen that disagreements may arise between the parties with reference to such rapports. In this case, it is very likely that the relevant disputes may be complex and focused on quite sophisticated matters.

The advantage of inserting arbitration clauses in the said contractual relationships are clear.

The parties (and thus also the representatives of the start-up) have the possibility, if a dispute arises, to select arbitrators who are knowledgeable of the specific disputed matter.

The same does not hold true in case of national litigation where the parties do not have the power to select the Judge for their case. They could then be assigned to someone not having a specific expertise and thus ultimately not "fit" to decide the dispute.

The cross-border nature of the disputes related to the digital dimension and of the metaverse: the "added value" to get an arbitral award enforceable in all the countries in which the New York Convention has been signed

It is finally worthy to make a last point "bringing on the scenes" another very interesting market for the start-ups: the metaverse.

As well known, by this expression, we refer to the evolution of the internet (as today known) in a digital environment made of a three-dimensional virtual world and focused on the social connections[7].

A consistent part of the solutions (*e.g.* hardware and software) related to the "construction" of such new virtual reality are being developed by start-ups[8].

Also in this case, there is certainly a huge array of disputes in which the start-ups (active in such market) could be involved. We may refer for example to IP disputes related to the infringement of a trademark developed by a start-up in the metaverse. Likewise, there may be disputes arising from a blockchain system to be implemented in the metaverse commissioned to a start-up. Such kind of disputes have all the common characteristic of being borderless (given that they take place in the "digital world")[9].

As such, for the parties involved, there is the full interest to get decisions which could be recognized in multiple jurisdictions.

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[6] Leandro Toscano and Oscar Suàrez, 'WIPO Mediation and Arbitration for FinTech Disputes' (*Wipo Arbitration and Mediation Centre*) <https://www.wipo.int/export/sites/www/amc/en/docs/2020fintechdisputes.pdf>.
[7] 'Metaverse' (*Wikipedia*) <https://en.wikipedia.org/wiki/Metaverse>.
[8] 'Metaverse Startups; 10 Compelling Metaverse Startup Companies in 2022' (*Metandrill Metaverse Information*) <https://metamandrill.com/metaverse-startups/>.
[9] Simon Chapman and Charlie Morgan, 'DIGITAL DISPUTES - ANTICIPATING AND RESOLVING DISPUTES IN THE DIGITAL SPHERE' (*Herbert Smith Freehills*) <herbertsmithfreehills.com/insight/inside-arbitration-digital-disputes-anticipating-and-resolving-disputes-in-the-digital>.

In this regard, if the relevant contractual framework provides for arbitration, once the dispute is decided by arbitrators, there could be a free circulation of the award in the countries which have adopted the New York Convention[10].

This may not be the case for national litigation where in some instances there may be more difficulties in recognizing abroad decisions taken before a State Court[11].

If arbitration works for start-ups, how can we get closer the two "words"

Considering the above, we can conclude that arbitration may have a great potential in the "market" related to disputes involving start-ups.

On the other hand, the "arbitration community" shall be ready to take this opportunity.

In this regard, spaces of "dialogue" have already been put in place for example organizing "*ad hoc*" conferences aimed at explaining why arbitration would be a perfect dispute resolution mechanism for the start-ups[12].

Nevertheless, there is the necessity to build a rapport of mutual trust between the stakeholders also considering that the start-ups environment is very particular. As such, it is important for the arbitration practitioners to develop new expertise in areas (such as the digital world and the blockchain) where the start-ups are very much active. This would allow the arbitration lawyers to: *(i)* present themselves as reliable and trustworthy "partners" having a real understanding of the relevant industry; *(ii)* demonstrate to be in a position to bring an effective added value in dealing with the disputes in which the start-ups may be involved.

[10] 'Convention on the Recognition and Enforcement of Foreign Arbitral Awards' <https://www.newyorkconvention.org/11165/web/files/original/1/5/15432.pdf>.
[11] Chapman and Morgan (n 9).
[12] In this regard, reference can be made for example to the "*Helsinki International Arbitration Day (HIAD) 2021*" which took place in Helsinki on 3 December 2021 covering the topic "*Start-ups and Arbitration*" (Kaistinen, Aravena-Jokelainen and Happonen (n 2)). Further, in the frame of the "*AIJA International Arbitration Annual Conference & Public Procurement Law/Healthcare and Life Sciences Seminar*" organized in Berlin on 6-8 October, the Author has had the occasion to speak at a workshop named "*How can we make arbitration a true option for start-ups?"* ("**Workshop**") also featuring Dirk Wiegandt (as moderator) and Alexander Steinbrecher and Chun-Kyung Paulus Suh (as further speakers) (https://www.aija.org/print/fullprog.php?id=678). The views and the opinions expressed in this article are only those of the Author and do not necessarily reflect the position and ideas of the moderator or of the other speakers of the Workshop.

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