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Managing Legal Risk: A Case Study in the New Middle East

Israeli tech innovation and the Emirati business platform create enticing opportunities; international arbitration and third-party funding can help navigate the risks.

By Eli Schulman

The historic Abraham Accords have launched a dramatic new era of commercial opportunity in the Middle East. While prospects are brimming across a range of countries in the MENA region—including in Bahrain and Morocco, which have joined the regional normalization initiative—the match between Israel and the UAE, the two most advanced economies in the region, is particularly promising.

World-Class Tech Meets a World-Class Business Environment

In recent studies, Israel—the so-called "Startup Nation"—ranks first globally in per-capita venture-capital investment, second globally in per-capital R&D investment, and second globally in the number of startups. Many of the startups nurtured in this ecosystem have grown into cutting edge companies. Between 2010 and 2019, Israeli startups enjoyed exits worth over $100 billion. The NASDAQ exchange now lists more companies from Israel than from any country outside North America other than China. Israel is an elite hub of technological innovation with similarities to Silicon Valley; its technology involving water, agriculture, renewable energy, health care, life sciences, fintech, and cybersecurity, are expected to be of special interest in the UAE. Collaborations between Israeli and Emirati entities in more established industries such as construction, infrastructure, defense, and finance also hold promise.

The UAE, for its part, is a finance powerhouse and gateway to the broader Arab world and beyond, and it has strategically laid the infrastructure for foreign direct investment. The UAE's inviting business climate includes a diversified economy, strong banking system, first-rate logistics, free-trade zones that allow 100% foreign ownership of companies and (with limited exceptions) provide 100% tax exemptions, and other investor-friendly regulations. In 2020, the UAE placed 16th in the World Bank's "ease of doing business" rankings, ahead of leading economies like Japan, Germany, and Canada.

Israeli and Emirati businesses have wasted no time seizing the moment. Within a month of the UAE and Israel consummating their normalization agreement, OurCrowd—Israel's most active venture investor, managing over $1.5 billion of startup funding—agreed to a $100 million collaboration with Dubai's Phoenix Capital. Israeli VC fund Maniv Mobility made the first reported investment of an Israeli venture-capital fund in an UAE-based startup. Israeli and Emirati energy companies agreed to a deal creating the shortest route to transport oil and related products from the Arabian Gulf to consumption centers in the West. (The deal raises environmental concerns that could be mitigated if, as many expect, the Saudis join the region's normalization project, thereby allowing the creation of a pipeline from the UAE to Israeli via Saudi Arabia and obviating the need for oil tankers to sail near the coral reefs of Eilat at Israel's southern tip.)

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In addition to the numerous Israeli business delegations arriving in Dubai to explore opportunities, tens of thousands of Israeli tourists have already visited the UAE. Virtually overnight, the countries jumped from zero direct flights to 112 per week. Relationship building is expected to pick up even more dramatically when business travel surges post-pandemic, *Inshallah*. All of this precedes the launch of a promised $3 billion trilateral "Abraham Fund" by the US, UAE, and Israel to invest in projects that "promote regional economic cooperation and prosperity in the Middle East and beyond." Putting these dynamics together, initial predictions of $10 billion in economic activity between Israel and the UAE now appear overly modest; some are projecting as much as $100 billion.

Opportunities—and Risks

Doing business in such unfamiliar cultures and jurisdictions is replete with opportunities, but also risks. Any deal team venturing into foreign territory with no personal or company-wide frame of reference must expect challenges, including misunderstandings and, inevitably, disputes. Misaligned cultural expectations may lead to breaches of contract—from agreements involving joint ventures to those for licensing, distribution, fundraising, M&A, and other collaborations. Founders of joint enterprises may also have uneven expectations concerning the exercise of fiduciary duties, which can lead to disputes involving shareholders or among founders themselves. First-time dealings with unknown state-owned entities, or with local and national bureaucracies, may create their own surprises and perils. In the worst cases, interactions with unknown counterparties can result in misappropriation of valuable intellectual property or outright fraud.

Disputes are a normal part of any business environment—but a risk that warrants forethought and preparation. Fortunately, two critical developments in international dispute resolution offer encouragement to those exploring business opportunities in uncharted territory: the spread of international arbitration and the rise of third-party funding.

Managing Risk: International Arbitration

International arbitration has become the method of choice for resolving cross-border commercial disputes, and with good reason. In a 2018 survey, Queen Mary University of London asked pariticpants in international arbitration to rate its most valuable characteristics. They ranked "avoiding specific legal systems/national courts" second highest (with 60% noting its value) and "enforceability of awards" highest (64%).

By creating a mechanism for private judging on terms agreed to by the parties and administered by independent and impartial arbitrators outside national courts, international arbitration allows commercial parties to dodge the inequalities inherent in submitting to the jurisdiction of unfamiliar local courts, as well as to elude real or perceived biases against foreigners that undermine confidence in a justice system. And because the 1958 New York Convention obligates its 166 state signatories to recognize and enforce the awards rendered by arbitral tribunals sitting in another of the 166 states, enforcing the outcome of international arbitration proceedings is generally far more certain than enforcing a foreign court's judgment, which lacks unifying international standards and, in turn, lacks predictability from jurisdiction to jurisdiction.

The globalization of trade has brought about stunning growth in the use of international arbitration during the 21st century, transforming it from a largely European practice to one that has taken hold globally—including in the Middle East. The UAE is the prime example. Among parties arbitrating before the International Chamber of Commerce (ICC), the longtime preeminent institution administering international arbitrations, the UAE has ranked in the top 10 among party nationalities for the past three years. In 2019 alone, more than 310 Emirati parties were involved in ICC arbitral proceedings. The ICC is setting up a case-management team in the Abu Dhabi Global Market, a UAE "free zone." The LCIA, another prominent arbitral institution, has a presence in another free zone, the Dubai International Financial Centre.

In Israel, the ICC-affiliated Jerusalem Arbitration Center was founded in 2013. But that initiative may have been too far ahead of the curve, as it failed to garner cases and subsequently closed. More recently, international arbitration in Israel has gained momentum, with increasing numbers of cases, prominent local law firms building practice groups and expertise, and a new arbitration law actively under discussion in the government.

While tech companies around the world have been slower to adopt international arbitration than companies in legacy industries like energy and infrastructure, the Israeli tech community may be starting to lead the way. Arbitrating parties have a say in selecting their arbitrators and thus can choose ones with specialized knowledge rather than having their case decided by a randomly selected judge. That makes arbitration a shrewd fit for tech disputes.

To ensure that future disputes will be resolved by international arbitration rather than before local courts, parties to a commercial agreement should include an arbitration clause obligating the parties to arbitrate. The clause should also specify such matters as the scope of disputes subject to arbitration (contract disputes only or other disputes, too), the institution (if any) to administer the arbitration, the procedural rules governing the arbitration, the number of arbitrators (one or three), the language of the arbitration, and the place of the arbitration. The parties should also specify the substantive law governing the parties' relationship that the arbitrators should apply. Institutions like the ICC and LCIA offer model clauses that can serve as a helpful default. Emirati and Israeli parties to collaborations can be expected to seek a neutral place for their arbitrations, such as London or

Geneva, and perhaps a neutral, well-developed commercial or corporate law to govern their activities, such as the law of England or possibly New York (for commercial contracts) and Delaware (for corporate governance documents).

Another type of international arbitration—investor-state dispute settlement—offers an array of additional protections to foreign investors. The rights in these arbitrations arise not from private parties' contracts but from agreements consummated between countries, such as bilateral investment treaties (BITs). Israel and the UAE have reportedly agreed to such a treaty, which will protect Emiratis and Israelis investing in each other's countries. Businesses should seek advice from counsel concerning the optimal way to organize their activities in the foreign country to ensure that the treaty's protections apply. Attentiveness to the BIT's details, such as carefully choosing the country in which an investment vehicle incorporates, can mean the difference between wide-ranging treaty protections or no such protections at all.

While international arbitration offers many efficiencies, it also entails compensation for the arbitrators and often for an administering institution like the ICC or LCIA, in addition to counsel fees. In a leading study of 254 international commercial arbitration cases conducted between 1991 and 2010 at a range of arbitral institutions, claimants spent an average $2.6 million on legal fees and out-of-pocket expenses, respondents an average $2.3 million. Investment arbitrations are often even pricier. Cross-border business litigation can be equally or more expensive, especially when involving U.S. discovery procedures. Resolution of contemporary commercial disputes is expensive—sometimes prohibitively so.

Managing Risk: Third-Party Funding

Third-party funding provides a solution to the high cost of dispute resolution. Until recently, claimants either bore the burden of legal spend themselves, or their lawyers agreed to assume that burden by working for no fee (or a reduced fee) in exchange for a larger contingent fee in the event of a successful outcome. Over the past decade, an innovative third option has emerged: funders that finance part or all of the costs of pursuing a claim in litigation or arbitration, in exchange for a portion of the recovery, if there is one. If the case results in a loss, the funded party owes nothing. The funder is a passive investor, and the claimant retains control over case decisions like settlement.

Funding has quickly grown to address an array of needs. Claimants with meritorious cases can access capital at any point in the life of a case. Where a claim is sufficiently valuable, some funders not only cover lawyer fees and out-of-pocket expenses but also provide working capital to help the claimant run its business. That capital can be advantageous for many companies, and a game changer for startups or individuals. Some defense-side funding has emerged, as well. And while funding began as a solution for claimants lacking the means to seek justice, funding has spread to flourishing companies that use it not out of necessity but rather strategically to offload legal expense and to spread risk.

As international arbitration has proliferated, so has the prevalence of funding to help pay for it. Jurisdictions like Singapore and Hong Kong moved from competing to attract international business, to vying to host international arbitrations, to clarifying the availability of third-party funding. The UAE has taken a similar path. Its DIFC and ADGM free zones offer hospitable investment and legal regimes, and now also offer well-developed regulations on the use of third-party funding. Though generations ago common-law jurisdictions barred third parties from financing lawsuits in which they had no personal interest, that tradition generally did not reach the Middle East. Even if it had, the modern trend among common-law courts (albeit varying from jurisdiction to jurisdiction) has been to consider such doctrines obsolete. A 2017 Israeli court decision went so far as to praise the existence of third-party funding which, the court explained, "prevent[s] a situation in which justified claims are waived only because of a shortage of funds." The court added: "There is no doubt that we should bless the establishment of the fund and even say that it is a shame that it did not arise before."

Middle East normalization portends unprecedented opportunities and, inescapably, cross-border disputes. Businesses in Israel, the UAE, and the broader region can expect international arbitration to continue expanding to provide the comfort of doing business in foreign lands without resort to local courts. Funders in turn will be increasingly busy in the Middle East, helping these businesses manage risk and secure access to justice.

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