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Crafting Arbitration Clauses

How to Avoid Unwanted Consequences

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In the recent decision of *AT&T Mobility LLC v. Vincent Concepcion*, 563 U.S. __ (April 27, 2011), the U.S. Supreme Court reaffirmed its long-standing support for arbitration, even in the face of efforts to limit it, holding that a California Supreme Court decision limiting class action arbitrations was pre-empted by the Federal Arbitration Act ("FAA"). The Court relied on prior decisions that, "place it beyond dispute that the FAA was designed to promote arbitration," and describing the FAA "as 'embod[ying] [a] national policy favoring arbitration.' *Buckeye Check Cashing*, 546 U.S., at 443, and 'a liberal federal policy favoring arbitration agreements, notwithstanding any state substantive or procedural policies to the contrary.' *Moses H. Cone*, 460 U.S., at 24 … " *Id.*

Despite the Court's endorsement of arbitration, the process has, by some accounts, become a victim of its own success. Parties increasingly complain that the purported benefits of arbitration — time and cost savings, efficiency, finality of the result — are being lost as counsel more often employ traditional litigation techniques that bog down the process.

While arbitrators and arbitration providers have taken steps to address these concerns by crafting expedited procedures and encouraging arbitrators to employ a hands-on, managerial approach to the process, counsel — particularly in-house and transactional attorneys — can play an important role in crafting a process that realizes the benefits of arbitration. Planning ahead is the key to avoiding undesired consequences. A well-crafted arbitration clause, written before a dispute arises and trust has broken down among the parties, can effectively address the concerns that have been expressed about arbitration.

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Consider Arbitrability

One of the first issues that should be considered is the subject of arbitrability. Drafters sometimes write arbitration clauses that are narrow in scope, or refer to specific types of disputes that are subject to arbitration (*e.g.*, referring to disputes regarding valuation, without reference to other matters; or referencing only tort or statutory claims, without considering equitable or other matters). When one party wants to invoke the arbitration clause, if it is not clear from its express terms that the dispute is covered, the matter may well end up in court, delaying the process and adding to the expense. If the parties intend all disputes to be resolved by arbitration, a broad statement such as, "Any controversy, claim or dispute arising out of or relating to … " should be used.

Scope of Arbitration

Parties should also address the scope of arbitration. Will the issue of arbitrability be decided by the court or the arbitrator? In *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938 (1995), the Supreme Court determined that arbitrators may decide that question, with the important caveat that delegation to the arbitrator must be "clear and unmistakable." *Id.* at 945. Without such an unambiguous expression of intent, the issue of arbitrability is subject to independent review by the court. If drafters wish the arbitrator, and not a court, to decide this preliminary issue, they should consider a phrase such as: "The Arbitrator, and not any federal, state, or local court or agency, shall have exclusive authority to resolve any dispute relating to the interpretation, applicability, enforceability or formation of this Agreement including, but not limited to any claim that all or any part of this Agreement is void or voidable." *See Rent-A-Center, West, Inc. v. Jackson*, 130 S.Ct. 2772, 2775, 2777, fn. 1 (2010).

The rules of most arbitration institutions specify that the arbitrator determines his or her own "jurisdiction," (*see* American Arbitration Association ("AAA") Commercial Rule R-7(a); JAMS Comprehensive Rule 11(c)), so if the parties have designated those rules to apply, some courts have held that the arbitrator's power to determine jurisdiction may be derived from those rules. *See Contec Corp. v. Remote Solution Co., Ltd.*, 398 F.3d 205, 207-209 (2nd Cir. 2005).

Venue

Disputes occasionally arise at the outset of an arbitration relating to the venue. If the clause has not addressed this, unnecessary time may be spent determining where the matter should be administered and heard. It is conceivable that one party will file a request for arbitration in the state where its company is domiciled, only to have the other side file a request in another state, with a different arbitration provider, or in state or federal court. Clearly specifying the place of arbitration will alleviate any later problems. Similarly, drafters should consider carefully the governing law of the dispute, both substantively and procedurally. They should know the implications of their choice, such as tax and enforceability ramifications.

Qualifications of Arbitrator

What should the qualifications of the arbitrator be? Sometimes parties want a single arbitrator who is well versed in the subject matter of the dispute (*e.g.*, "an attorney licensed in the state of New York, who shall have at least 10 years of securities law experience"). While that may be appropriate, it will certainly limit the pool

of arbitrators who might hear the matter, and should be thought about ahead of time. Also, do the parties want a single arbitrator or a panel of three? How will the three be appointed? Often, parties contemplate that each side will designate its own "party-appointed" arbitrator and those two will appoint a third. Will they all be neutral? The ABA Code of Ethics for Arbitrators in Commercial Disputes, Preamble and Canon IX presumes that named arbitrators are neutral unless parties have agreed for them to be non-neutral, a fact that parties sometimes do not consider until a matter is well underway. Some practitioners prefer a tripartite panel because they feel it limits the possibility of an aberrant decision. Others find that it is unnecessary, particularly if two of the arbitrators are "party-appointed," and potentially predisposed toward the side that appointed them. In any event, the choice should be discussed and considered at the time the clause is drafted.

Administration

Another decision is whether the arbitration will be administered by an arbitral institution (*e.g.*, AAA, JAMS, the International Chamber of Commerce ("ICC"), etc.), or whether it will be self-administered or "ad-hoc." There are ramifications to each choice. If parties wish to arbitrate their dispute with little intervention and assistance, they can choose to do so, either by crafting their own rules for the process or by utilizing other processes such as the UNCITRAL Arbitration Rules, which have been promulgated by the United Nations Commission on International Trade Law, or CPR's Non-Administered Arbitration Rules. If parties choose that route, their agreement should include procedural guidelines for initiating the proceedings, choosing the arbitrator, resolving challenges to the arbitrator or process, enforceability of the award, etc. On the other hand, relying on an institutional provider to administer the arbitration simplifies the drafting of the arbitration clause, and parties can rely on the provider to appoint an arbitrator from a panel of approved neutrals with appropriate experience, conduct conflict of interest checks, establish procedural ground rules for discovery and motion practice, handle billing and collection of fees for services, provide hearing rooms, and assist with issues that may not be appropriate for an arbitrator to decide, such as requests for disqualification, disputes about arbitrability or venue before an arbitrator is appointed.

Discovery

One of the biggest criticisms of arbitration is that discovery gets out of control, particularly e-discovery. Arbitration providers have attempted to address this through the introduction of protocols (*e.g.*, JAMS Recommended Arbitration Discovery Protocols for Domestic, Commercial Cases; JAMS Optional Expedited Procedures; CPR Protocol on Disclosure of Documents and Presentation of Witnesses in Commercial Arbitration). But drafters should give thought to the scope of discovery, such as whether requests for documents should be restricted in some manner; whether production of electronic documents can be tailored to eliminate the need to retrieve documents from backup servers, tapes or other media without some showing of compelling need; whether interrogatories and requests to admit will add value to the process; and the number of depositions that should be permitted. Arbitrators can play a role in limiting overly broad discovery and by giving early attention to the discovery process, but since arbitration is governed by agreement of the parties, most arbitrators will acquiesce to unlimited discovery if all parties request it.

Powers of the Arbitrator

What powers should the arbitrator have? Arbitrators derive their power from the arbitration clause and whatever rules apply. Typical rules give arbitrators broad power to "grant any remedy or relief that is just and equitable and within the scope of the parties' agreement." (JAMS Rule 24(c); *see* AAA Rule R43(a). If parties desire to restrict the arbitrator's ability to award punitive damages or other non-compensatory damages, they should include specific language prohibiting it. Similarly, parties should consider whether the arbitrator should have the power to award costs and fees. Attorneys' fees may only be awarded if the clause or applicable law permits. Some provider rules (*e.g.*, JAMS Comprehensive Rules 24(g)) authorize an award of attorneys' fees. Drafters may determine it is best to deny the arbitrator the power to award fees or costs, but if the issue is silent, parties may find themselves litigating the issue before the arbitrator or at later confirmation proceedings before a trial court.

The Arbitration Award

Thought should also be given to the arbitration award itself. Do the parties want a reasoned award? Most arbitrators will state their reasons for their decision, and this can be advantageous to parties who want to know how the decision was reached, and also to provide guidelines for future conduct. But sometimes parties do not want a reasoned award because it may provide grounds for litigating the enforceability of the award, leading to further litigation. And what level of review do the parties want? The Federal Arbitration Act ("FAA") limits the grounds for vacatur of arbitration awards to situations, where there was corruption or fraud, evident partiality by the arbitrators, or where the arbitrator(s) refused to hear relevant evidence or where the arbitrators exceeded their powers. (9 U.S.C. §§ 10 and 11.) Neither parties nor courts can expand the scope of judicial review under the FAA beyond these statutory grounds. *Hall Street Assocs., L.L.C. v. Mattel, Inc.*, 552 U.S. 576, 586-590, 128 S.Ct. 1396, 1404-1406 (2008). JAMS Comprehensive Arbitration Rules and Procedures, Rule 34, allows parties to agree to an optional appeal procedure before an award becomes final.

Other Factors

Other factors to consider in drafting an arbitration clause include whether interim relief should be permitted, whether negotiation or mediation should be a condition precedent to the commencement of an arbitration, whether dispositive motions will be considered, deadlines, and confidentiality of the process.

This list is not exhaustive, but is meant to illustrate that using boilerplate arbitration clauses may lead to unintended consequences, and care should be taken at the clause-drafting stage, so that the benefits of arbitration, including efficiency of the process, leading ultimately to cost savings, can be realized. You are in the unique position to craft the kind of arbitration you want to have, but it will take careful consideration of the issues discussed above.