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Arbitration Clauses: Who, What, When, Where, Why & How?

Foley Hoag Webinar

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I. WHY (& WHY NOT)

In any dispute, the most important contract clause is often the one determining who decides the case. Well-drafted arbitration clauses deter disputes. Best practice is to draft a standard clause for iterative transactions. Woe to the corporate lawyer whose client is hit with class action or punitive damages because he or she failed to consider arbitration.

Pros of arbitration

- Avoid biased court system:
  - International – National courts of other party generally unacceptable
  - Domestic – Elected judiciaries and local juries often biased
- Confidentiality – though default rules vary by provider so add contract clause
- Speed – AAA study found 1 year faster than similar cases in federal courts
- Less cost – Presumption against depositions, narrower document exchange usually outweigh cost of arbitrator's fees
- Option for technically expert decisionmakers vs. lay judges or juries
- More enforceable globally than court decision

Cons of arbitration

- Discovery from non-parties is at best cumbersome and at worst unavailable
- No binding precedent (if desired)
- Public parties may oppose secrecy
- If you want to bury counterparty in litigation expense
- If you have bargaining power to require venue in your home court, but note that other jurisdiction may be less likely to honor such venue choice than an arbitration clause
- The decisionmaker may not be an expert in the law governing the contract

Who should have to arbitrate

- Parties to contract
  - Possible to make arbitration an option for one but not other party. N.B. California invalidation, potentially other jurisdictions

- Subsidiaries and affiliates – may be involved, likely don't want end run, so make explicitly covered (or deliberately choose not to).

- Same for a party's directors, officers, agents, and employees arising from such capacities.

Who should have to arbitrate

- Possible consolidation and joinder provisions for multiparty or multi-contract arbitrations, e.g. customer vs. retailer vs. distributor vs. manufacturer, or construction contractors and sub-contractors, or parent company guarantee

- Consider other players – e.g., distributor contract may require retailer to arbitrate claim versus manufacturer. It may be in your client's interest to require arbitration to discourage lawsuits against other parties in which your client would have to provide indemnity or discovery

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III. WHAT

- "Agreement" usually must be in writing but like any other contract, so clickwrap, UCC, battle of forms all apply

- Clarify that agreement to arbitrate is binding and arbitrator's decision is final (not merely advisory or prelude to court).

- Broad form - "Arising out of or relating to this agreement, including the interpretation, validity or invalidity, performance or breach thereof." Broad form creates a presumption of arbitrability. May wish explicitly to include third-party claims.
  - Under U.S. law, reference to interpretation delegates interpretation of scope to arbitrator, not court. Determination by the arbitrators of the scope of their jurisdiction is typically the default rule outside the U.S..

III. WHAT

- Consider carve-outs:
  - For prejudgment security, although note that most arbitrators can order preliminary injunction that can be confirmed in court in the U.S. but not all other jurisdictions as an interim award.
  - U.S. courts will issue preliminary injunctions without express concurrent power or a carveout, but other jurisdictions may not
  - Exercise care with carve-outs because they can lead to fights over scope and costly piecemeal proceedings, which courts will require despite inefficiency
  - Carveouts for small claims and/or workers compensation claims often desirable
  - N.B. ICC Rule 29(6) saying no emergency arbitrator if parties' agreement provides otherwise
- Selection of AAA and similar rules granting arbitrator authority to determine jurisdiction constitutes clear delegation to arbitrator to determine scope of jurisdiction. Avoids court fight over scope

Pick a provider

- AAA/ICDR – Leading U.S. provider by market share
- CPR – Solid reputation for administration
- JAMS – Emphasis on former judges
- Delaware Rapid Arbitration Act, Chancery Court appoints arbitrator absent agreement
- ICC – Popular in Europe, Latin America, Asia
- London Court of International Arbitration
- Regional international – Stockholm, Singapore, Hong Kong, Dubai, CIETAC
- Ad hoc is an option but can have administrative and enforcement speed bumps

Seat/Situs (Place of Arbitration)

- Location with court with track record of enforcing awards, e.g., New York, London, Paris, Hong Kong
- If exotic situs suggested, confirm country has a developed national arbitration law and arbitration caselaw, is party to New York Convention, has favorable law and enforcement track record
- China enforcement in flux, select a provider carefully

Hearing location

- Arbitrators can choose to hold hearing in location other than named seat unless contract clearly forbids
- Some agreements split seat and hearing locale. Risk that named hearing locale will be deemed seat or panelists in locale will misapply law of seat
- Avoid potentially unreasonable hearing locale such as thousands of miles from consumer with small claims
- Attorney practice issue – some states, e.g. California, limit arbitration practice of attorneys not licensed there

V. WHEN

- Contract statute of limitations. Clarify that distinct from arbitration clause so stale claims don't get pushed to court
- Consider requiring pre-demand escalation clause. Potential predicates:
  - Advance notice of (30-90) days before demand for arbitration filed
  - Line executive meeting in X days
  - Senior executive meeting in Y days
  - Mediation in Z days

  Parties can always agree to postpone or waive predicates if clear not useful. Helpful to make a requirement so no party is afraid to raise settlement as sign of weakness
- Timetables for completion
  - Some tribunals offer expedited proceedings explicitly. Others don't.
  - Don't put contractual timetables without consulting a litigator for reality check, otherwise absurd results that harm client. Generally recommend against.

VI. HOW

- Consider points below – but try to keep it simple. Best practice is to develop standard clauses for iterative relationships (e.g., customers, vendor)
- Specify selected institutional rules applicable to the tribunal, but more specific provisions of the contract arbitration clause control in case of conflict with the institutional rules
- Law governing arbitration – need not be law of seat but usually makes sense to align (if indicated expressly)
- Law governing contract and claims. Distinct from arbitration clause but useful to clarify in agreement as may be a factor in arbitrator selection
- Language in which arbitration will be conducted – prefer English. Parties to bear costs if need translation

Number of arbitrators

- One arbitrator is easier and cheaper but greater risk of outlier award
- Three arbitrators is more expensive but safer
- If party-appointed arbitrators, effectively only one neutral decisionmaker at cost of three
- May specify one arbitrator for claims or counterclaims less than, e.g., $1 million; otherwise three

- Option to leave to discretion of administrators, which have different practices, but better to specify

Confidentiality

- Rules vary. Some make entire proceeding confidential, others impose confidentiality only on arbitrators and leave parties free to make document public unless confidentiality is required as a condition of production, necessitating extensive litigation if one party continues to publicize
- Better to have agreement that all proceedings and documents and testimony therein are confidential except as necessary to confirm or vacate award

Discovery

- Option to duplicate Federal Rules – not recommended
- Stipulate no depositions or limit number per side – consider carefully for circumstances. Increasing background presumption against depositions so silence is a good option.
- Arbitrators have authority to shift costs of depositions, but contract may require

Summary disposition/summary judgment

- Not all tribunal rules contemplate expressly
- Value in specifically authorizing summary judgment or disposition in contract so confirmation objection is waived and arbitrators don't believe the parties expect an evidentiary hearing in all cases

Reasoned versus simple award

- May wish to defer choice to hearing but note interplay with timetable
- Reasoned award will become public if confirmed, including disclosure of potentially embarrassing facts
- Arbitrators will generally issue reasoned award if one party requests unless contract specifies otherwise
- Rules and laws often require reasoned award

Confirmation and vacatur venue options

- Option of any court of competent jurisdiction
- Alternative to specify court for confirmation/vacatur
- Default under FAA is where award was made or underlying events occurred

Fees and Costs

- Contract requirement for arbitrators to award attorneys' fees and costs to prevailing party deters misuse of litigation for leverage
- Some smaller parties fear fee-shifting and may insist that parties will bear their own costs and fees
- Without agreement arbitrators may shift fees where substantive law so provides or (under AAA rules) both parties have requested fees
- Under ICC and some other rules, arbitrators have discretion to award attorneys' fees unless contract prohibits even if underlying law does not provide for fee-shifting
- Arbitrators have power to apportion administrative costs and their own fees as they wish unless parties' agreement specifies otherwise

VI. HOW

- Appeal
  - AAA, JAMS, and CPR now offer option of arbitration appeal, but must be selected by both parties, typically in arbitration agreement itself since agreement is difficult once dispute has begun. If you want right to appeal, specify in agreement and choose a provider that offers it.
  - Specify standard of review, e.g., de novo or as appellate court would review
  - May be desirable if only one arbitrator is decisionmaker as a check on outlier award but does add time and expense
- Limitations on remedies
  - Common to exclude punitive and/or consequential damages
  - Ensure that limitations are permitted under governing law
  - Phrase as a limit on powers of arbitrator to ensure judicial review if oversized damages are awarded; otherwise it is likely unreviewable legal error
- Unconscionable terms may void obligation to arbitrate – don't overreach
- Other resources online, e.g. AAA and ICC websites.
- Don't just cut and paste or adopt counterparty's edits. Call an experienced arbitrator!

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Thank you!

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