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ARBITRATION

This is Part One of a four-part series by Williams & Connolly's Nick Boyle and Richard Olderman on how arbitration clauses, if properly drafted, may save companies huge amounts of time and money if disputes were to arise.

Securing the Benefits of Arbitration: Thoughtful Drafting of Arbitration Clauses**PART ONE**

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The promise of arbitration was that it would be faster and less expensive than regular civil litigation, with limited discovery, flexible scheduling and relaxed evidentiary rules, and that these advantages would make up for the lack of a jury trial and the narrowness of any appeal rights. Too often, as many a general counsel can attest, this promise is broken in practice, with arbitration proceedings turning into lengthy and costly affairs, with little to no prospect of undoing the outcome should the panel, or sole arbitrator, reach the wrong result. The ensuing backlash has led many companies, at least in the context of contracts with sophisticated counterparties, to abandon arbitration clauses and take their chances with the courts. The new received wisdom is that if alternative dispute resolution mechanisms are now just as expensive and time-consuming as trials, and offer no safety mechanism in the form of an appeal, why bother? See College of Commercial Arbitrators (CCA), *Protocols for Expeditious, Cost-Effective Commercial Arbitration* (2010) at 2 (“Literally all of the top general counsel from the largest corporations in the Bay Area were uniform in their frustration with arbitration and many have said . . . they’re not agreeing to it anymore.”).

This four-part article, dealing primarily with domestic arbitrations, suggests that arbitration should be given a second chance. The key is to pay attention to the drafting of the arbitration clause. As the Second Circuit has observed: “Arbitration is entirely a creature of contract. The rules governing arbitration, its location, the law the arbitrators will apply, indeed, even which disputes are subject to arbitration, are determined entirely by [the] agreement between the parties. Any arbitration proceeding is thus an extension of the parties’ contract with one another” *Sole Resort, S.A. de*

C.V. v. Allure Resorts Mgmt., LLC, 450 F.3d 100, 104 (2d Cir. 2006); see also *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 57 (1995) (“[P]arties are generally free to structure their arbitration agreements as they see fit.”) (internal quotation marks and citation omitted).

Unfortunately, when contracts are being drafted, the arbitration clause often receives a low priority. Several factors account for this, the principal one being the time spent negotiating the commercial terms of the agreement. The adoption of boilerplate arbitration provisions, perhaps taken from an earlier contract, is an easy way out. Parties to a commercial contract who do not provide thoughtful arbitration clauses expect to receive from the dispute resolution process a cost-efficient result under the applicable arbitral rules. But once a dispute arises, and the counterparty is no longer cooperative, the parties’ principal focus is prevailing in the dispute—and they may act in ways that delay the proceedings and multiply the costs.

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The promise of arbitration can only be consistently kept if contract parties abandon the standard bare-bones provision and agree to a substantive clause that places limits on the nature of the arbitration proceedings, particularly on discovery, and sets forth an appropriate, relatively accelerated time schedule for the arbitration, from its commencement to the close of the record. Spending time developing a thoughtful arbitration provision, perhaps even one that can become a standard for company contracts of a specific type, can—like the proverbial stitch in time—save a company a huge amount of time, and money, if a dispute were to arise.

This article largely draws from the model rules of three arbitral institutions: the American Arbitration Association (AAA); the Judicial Arbitration and Mediation Services Inc. (JAMS); and the International Institute for Conflict Prevention & Resolution (CPR). These are the most commonly used arbitral institutions in the U.S. The article focuses on nine aspects of arbitration, from the dispute to be resolved, to the overall case schedule to the ultimate arbitration award, and suggests arbitration clauses that reflect particularized drafting. While there are no one-size-fits-all provisions, the suggested clauses deal with matters worth considering when negotiating the contract. The ultimate drafting, of course, should be tailored to the client and the transaction at issue.

The Perils of Boilerplate Provisions.

Using boilerplate contractual arbitration provisions can cause the parties to inadvertently adopt procedures they would not ordinarily have chosen for their cases and can “create opportunities for counsel to expand, often excessively, the dimensions and density of the arbi-

tration.” CCA, *supra*, at 24. Because the arbitration statutes are often silent on key issues, the parties must fall back on the often vague default rules with regard to matters such as document production, depositions, electronic discovery and confidentiality. For example, the Federal Arbitration Act does not address discovery, although it provides authority to summon witnesses and to hold such witnesses in contempt if they do not comply (the parties, however, must apply to a federal court where the arbitration is seated to obtain enforcement). 9 U.S.C. § 7. Discovery under the AAA commercial arbitration rules is governed by Rule 21 (Preliminary Hearing) and Rule 22 (Pre-Hearing Exchange and Production of Information). Under Rule 22, the arbitrator may “require the parties to exchange document[ation] in their possession or custody” that is relevant and material to the issues in dispute. AAA, *Commercial Arbitration Rules and Mediation Procedures* (2013). The arbitrator manages “any necessary exchange of information among the parties with a view toward achieving an efficient and economical resolution.” *Id.* The International Chamber of Commerce Rules have no provisions expressly addressing discovery, and simply provide in Article 25 that the tribunal “shall proceed within as short a time as possible to establish the facts of the case by all appropriate means.” Int’l Chamber of Commerce, *Arbitration Rules* 30 (2016). While arbitral institutions encourage economy and efficiency, and their rules may prescribe certain time limits, the goals of efficiency and cost savings are best served by negotiating concrete limits and deadlines in advance. Otherwise, there is a real danger that, with a lack of specificity in the applicable arbitral rules, the arbitrators defer to the wishes of counsel and the proceedings end up mimicking civil litigation, with extensive discovery and motions practice, high cost, and contentious advocacy. As one commentator has observed, “[T]he arbitration experience has become increasingly similar to civil litigation, and arbitration procedures have become increasingly like the civil procedures they were designed to supplant, including prehearing discovery and motion practice.” Thomas J. Stipanowich, *Arbitration: The New Litigation*, 2010 U. Ill. L. Rev. 1, 9 (2010). This imitation of trial court litigation is not surprising; “[f]or lawyers accustomed to full-fledged discovery, anything less may seem tantamount to inviting claims of malpractice.” *Id.* at 12. The arbitration clause is your opportunity to avoid this danger and personalize the dispute resolution mechanism so that it reflects the benefits you seek and the risks you hope to avoid.

How do you achieve the cost and time-saving benefits of a tailored discovery practice? We recommend that, when you draft the arbitration clause, you consider the following matters: (1) the dispute to be arbitrated; (2) overall case schedule; (3) appointment of arbitrator(s); (4) location, languages and law of the arbitration; (5) confidentiality; (6) limits on motion practice; (7) limits on discovery, both party and non-party; (8) the merits hearing; and (9) the award. But first, we consider a fundamental question regarding the applicable rules.

An Important Preliminary Consideration: What Rules Apply?

Most domestic commercial arbitrations are governed by the Federal Arbitration Act, 9 U.S.C. §§ 1-16 (FAA), which applies to disputes “involving commerce,” and is

applicable to both state and federal courts. The term “involving commerce” is broadly construed. *Citizens Bank v. Alafabco Inc.*, 539 U.S. 52, 53 (2003) (per curiam). Therefore, the FAA applies in most domestic arbitrations. (Note however that certain disputes—for example local real estate disputes or legal malpractice matters—may not meet this test, and in New York, arbitration of these issues will be governed by the New York Civil Practice Law and Rules (CPLR).) The FAA does not mandate that the arbitration be conducted under a specific set of procedural rules. Rather, the parties can specify in their agreement the procedural rules under which the arbitration will be conducted: they can elect whether the FAA, state law, or other rules such as those provided by arbitral institutions—e.g., AAA, CPR or JAMS—will apply.

Two points are worth mentioning, however. First, the contract should establish the procedural law and the substantive law that will apply to the arbitration. A generic choice-of-law provision (e.g., “New York law shall apply to the arbitration”) will generally be interpreted as mandating New York *substantive* law but not its procedural rules. In *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52 (1995), the Supreme Court held that the parties’ invocation of the NASD procedural arbitration rules, which implicitly authorized an award of punitive damages, trumped contrary New York law, which was the law of the agreement’s general choice-of-law provision. There should be no inconsistency between the choice-of-law clause and the arbitration rules specified in the contract.

Second, if the parties have agreed on the AAA Commercial Arbitration Rules, but the arbitration is considered an international proceeding (for example, the parent of your counterparty is a Japanese company), the invocation of the AAA rules will not carry the day. Instead, the International Commercial Arbitration Supplementary Procedures will automatically apply. This will mean different arbitrators and different rules than you originally anticipated.

Now that we have chosen the applicable rules, we shall turn to the nine aspects of arbitration worth considering when drafting the arbitration provision.

1. The Dispute to Be Arbitrated: the Standard Arbitration Clause and ‘Step Clauses.’

Every arbitration begins with a contractual arbitration clause. AAA suggests the following:

Any controversy or claim arising out of or relating to this contract, or the breach thereof, shall be settled by arbitration administered by the American Arbitration Association [in accordance with] its Commercial [or other] Arbitration Rules, and judgment on the award rendered by the arbitrator(s) may be entered in any court having jurisdiction thereof.

See AAA, *A Guide to Commercial Mediation and Arbitration for Business People*, 16 (2013) (italics omitted).

Contracting parties may wish to include “step-clauses,” which are provisions requiring negotiation and/or mediation before arbitration is initiated. (Under some applicable rules mediation is required). Step-clauses may be particularly useful when the parties have a long-standing, on-going commercial relationship, and where there may be factors transcending the scope of a particular dispute. On the other hand, these provisions may simply add more time and cost to the proceedings, may require a statute of limitations tolling agreement, and can decrease predictability as to who will decide a dispute and when and where it will be decided. Moreover, step-clauses can be rife with potential litigation issues concerning the enforceability of the provisions, the consequences of a failure to abide by them, and whether these issues are to be decided by the courts or the arbitrators. The guides of the leading arbitral institutions provide sample clauses if you believe pre-arbitration negotiation (a meet and confer, for example) and/or mediation would be productive. The AAA suggests the following clause:

If a dispute arises out of or relates to this contract, or the breach thereof, and if the dispute cannot be settled through negotiation, the parties agree first to try in good faith to settle the dispute by mediation administered by the American Arbitration Association under its Commercial Mediation Procedures before resorting to arbitration, litigation, or some other dispute resolution procedure.

See AAA, *Drafting Dispute Resolution Clauses, A Practical Guide*, 12-13 (2013). The clauses can be combined to create a multi-step process of negotiation, mediation and arbitration.