TOP 10 MISTAKES TO AVOID

WHEN DRAFTING DISPUTE RESOLUTION PROVISIONS

BY RONA G. SHAMOON

AN ADR SPECIALIST SHARES 10 WAYS THAT DRAFTERS OF ADR PROVISIONS CAN AVOID MAKING SERIOUS MISTAKES.

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Dispute resolution provisions often get short shrift from transactional lawyers, who are mainly concerned with closing a business deal that will be profitable all around. Their involvement usually ends after the closing, so unless they have been educated to consider what might go wrong and the importance of providing appropriate dispute resolution provisions, more often than not, they just toss in a dispute resolution provision that was used in another deal on the premise that it worked before.

Photo of mini-people and nails: David Crockett/Veer
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Ideally, a dispute resolution specialist would be brought in during the contract negotiation process to work on the dispute resolution provisions, in much the same way that a tax lawyer would be brought in to deal with the tax implications of the deal. The job of a dispute resolution specialist is to try to focus the parties on the types of disputes that could occur and devise a suitable mechanism for their resolution. However, the real world is far from ideal. Either the transactional lawyer does not work with a dispute resolution specialist, or calls one in at the eleventh hour when the most that can be done is replace the most problematic provisions and try to insert a few improvements. What are the most problematic provisions? Every ADR specialist has her own list. This article sets out my top 10 pitfalls and how to avoid them. These drafting tips, which are based on my 18 years of practice as a dispute resolution specialist at a large law firm, would be applicable to virtually any business-to-business arbitration.

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1 *Pre-Arbitration Mechanisms with Indeterminate Duties and No Time Limits*

Many lawyers seem to believe that if a contract provides that the parties are supposed to negotiate or mediate in "good faith," they will miraculously and promptly do so to resolve their differences. Reality contradicts this belief. Most of the time one party wishes to have the dispute resolved expeditiously, and the other prefers to put off resolution as long as possible. Inevitably, the delaying party will take advantage of both the "good faith" requirement and the lack of any time limits in the dispute resolution provision for completion of negotiation or mediation, by arguing first that arbitration cannot commence because the other party has not negotiated "in good faith," or alternatively that the negotiation or mediation period has not ended. Thus, one pitfall is using words like "good faith," which can only inspire collateral litigation, and another is not putting a clear time limit on the period for negotiation and mediation. The lessons to be learned: Leave out "good faith" requirements and include unconditional time limits for the completion of each ADR process.

2 *Where to Arbitrate?*

The venue of the arbitration is another potential pitfall. I have seen many arbitration provisions that either lack a venue for the arbitration, or contain multiple venues, depending on who brings the arbitration. Venue is a critical component of an arbitration provision and should not be left out or decided on the whim of the party that initiates the arbitration. Nor should there be multiple conflicting venues. All of these situations can also be a source of collateral disputes.

Selecting the proper venue is particularly critical in international arbitrations. Venue should be in a country that is a signatory and ratifier of the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 1958 (the New York Convention) because this convention makes arbitration agreements and awards enforceable. Moreover, if possible, venue should not be in the home country of any party to the proceeding, since only the courts of the country in which the arbitration officially takes place will have the power to set aside the award.

3 *Omitting the Governing Rules, the Governing Law, and the Language of the Arbitration*

Leaving out critical components is another pitfall to be avoided. One critical component is the procedural rules that are to govern the arbitration. Despite the thousands of hours that have been spent drafting and revising the institutional and *ad hoc* rules of the various arbitral institutions, a surprising number of parties try to make up their own, leaving critical gaps that need to be filled by arbitrators and courts. Another critical component is the substantive law governing the dispute. If the law applicable to the substance of the dispute is not stated in their agreement, the parties are like-

ly to spend considerable time and money litigating which law will apply. In international arbitration, the language of the arbitration should also be specified, or the parties may end up in a collateral dispute over which language should be used for the parties' submissions.

4

Number of Arbitrators

People who are familiar with arbitration know that the only realistic choices for an arbitral panel are one arbitrator or three. An even number of arbitrators could produce a tie, and five arbitrators would create a nightmarish scheduling problem. When there are three arbitrators, only two can be appointed by parties to the arbitration. The third arbitrator must serve as the chair and, therefore, cannot be party-appointed. In the event that the arbitration potentially involves multiple parties (claimants and/or respondents) with disparate interests, it would be prudent to provide in the arbitration agreement that if all parties cannot agree on their party-appointed arbitrators, then all of the arbitrators will be chosen by the administering institution. As arbitral awards are largely not appealable on substantive grounds, I always recommend having three arbitrators for disputes involving large dollar amounts or other "bet the company" disputes.

If you fail to provide for the number of arbitrators, the applicable arbitration rules will make that determination for you (assuming that you have provided for a set of arbitration rules), although it may not be the number you would have chosen.

5

Expedited Appointment of the Arbitrator for Expedited Disputes

Selecting an arbitrator can often take weeks and selecting three arbitrators can take much longer, sometimes even months. If expedited resolution is important, I suggest that the parties agree before any disputes arise on a pre-approved panel of arbitrators who would be tapped in the event of a dispute. If this approach it taken, it is essential to jointly contact these individuals to see if they will be available. If that approach is not possible, the parties should agree to an expedited method of appointment, such as providing that the appointment be made from a list provided by the designated arbitral institution, and limiting the number of names that may be stricken from the list by each party.

6

Overly Precise Arbitrator Qualifications

The perfect arbitrator for a dispute may exist only on paper, or may be one of only a handful of individuals, some or all of whom may be disqualified by a conflict or unavailable when you need them. Always resist the temptation to be overly specific when it comes to arbitrator qualifications.

7

Unrealistic Discovery

I literally shudder when I see the words "Federal Rules of Civil Procedure" in an arbitration provision. Providing for the FRCP to apply in arbitration, particularly to discovery, can lead to a ridiculously burdensome and drawn-out process. If your client expects arbitration to be fast and efficient (and they always do), limiting discovery is a necessity, not merely an option to consider. Before placing limits on discovery, however, you must determine what information your client will need in the event of a dispute, and make sure that there is an appropriate mechanism in place for the collection of such information. Thus, explicitly providing for discovery of certain specific types of electronic information, or for depositions of certain key individuals, may be essential to your client in proving its case.

8

Unrealistic Timing

You would be amazed at how many arbitration provisions provide for three arbitrators, broad discovery, and an award issued within 30 days of the filing of the arbitration! Of course, that is unrealistic. It can take months to agree on a panel of arbitrators, and even after the panel is assembled, much needs to be done before the hearing on the merits. Even if an expeditious award is required, the time period allocated for the entire arbitration must be realistic. Moreover, the drafter should include a safety valve to enlarge the time (for example, in the discretion of the arbitrators) in order to prevent the award from being challenged under Section 10(a)(4) of the Federal

Arbitration Act on the ground that the arbitrators "exceeded their powers" by taking longer to issue the award than the period allotted in the arbitration agreement. In an international dispute, enforcement of an award could be denied under Article 5(c) of the New York Convention, which provides that an award may be refused enforcement if "the award deals with a difference not contemplated or not falling within the terms of the submission to arbitration.…"

9

Appeal Mechanisms

I have never understood the attraction of appeal mechanisms. In *Hall Street Associates, L. L. C. v. Mattel, Inc.* (552 U.S. 576, 2008), the U.S. Supreme Court effectively curtailed the ability of parties to provide for expanded judicial review of arbitration awards by federal courts, leaving only the mechanism of having an award reviewed by a second arbitral tribunal. Unlike appellate courts, however, appellate arbitral tribunals that take a second look at an award are often no more knowledgeable than the original panel that issued the award. Moreover, the second panel will not have the advantage of hearing and seeing witnesses testify. In addition, if the parties provide for an appeal mechanism, the loser is almost guaranteed to take advantage of it. The best insurance against a bad award is having a panel of three competent arbitrators for potentially significant cases.

10

Vague Scope of Arbitrable Disputes

Limiting the scope of arbitrable issues is truly a major pitfall. The safest arbitration clauses (meaning those least likely to be successfully challenged) are broadly drafted to provide for arbitration of all disputes. If only certain disputes are to be arbitrated, these must be very clearly defined to avoid collateral disputes about whether or not a particular dispute is covered by the arbitration clause.

Also, avoid at all costs any attempt to split claims by limiting the relief that arbitrators can award to damages and reserving injunctive relief to the courts. The only relief that is properly reserved to the courts is preliminary injunctive relief *prior to the appointment of the arbitral tribunal.* An alternative source of such provisional relief is found in certain institutional arbitration rules. For example, the AAA International Arbitration Rules provide for an "emergency arbitrator" to be appointed at a party's request, prior to the constitution of the tribunal, to respond to a request for emergency injunctive relief. (The parties to a dispute arbitrated under the AAA Commercial Arbitration Rules may explicitly provide in their arbitration clause that the AAA Optional Rules for Emergency Measures of Protection apply to their arbitration proceedings.) In any event, an award of permanent injunctive relief (including but not limited to specific performance) should be reserved for the arbitral tribunal. ■