When Drafting An Arbitration Clause, Specificity Matters

by Hon. John P. DiBlasi J.S.C. (Rtd.)

The purpose of placing an arbitration clause in a contract is to streamline the resolution of any disputes under the agreement. Alternative dispute resolution (ADR) avoids the time, cost and uncertainty of litigating in court when a dispute arises. In drafting an arbitration clause, the goal is make the clause itself clear and to the point. The last thing you want is to have disagreements over the interpretation of the arbitration provision itself. That would defeat the purpose of same with the result of litigating the meaning of the clause itself. This is a brief synopsis of some of the items that should be considered when drafting the arbitration clause. A general observation is that specificity is a must.

In the first instance the parties should decide the types of disputes that should be subject to arbitration. Do you want a provision that encompasses any and all disputes, or are there certain areas of disagreement that you want to retain the right to litigate in a court of law? There are no simple answers to these questions. In some circumstances, you may want to reserve your rights to litigate certain disputes in a court of law with the right to appeal any adverse decisions. For simple disputes under the agreement, consideration may be given to a streamlined ADR process where the amounts of potential damages are limited.

The parties should also consider whether, as a precondition to the exercise of the right to arbitrate, an attempt be made to mediate and resolve the dispute without the necessity of arbitration. This is a good idea as there is very little to lose and much to gain if the matter can be resolved without further effort. If the mediation clarifies the positions of the parties, that, in of itself, is valuable. Further, having the mediation clause in the agreement avoids the problem of a party believing that they will look weak if he/she suggests that the dispute be mediated at the outset.

A threshold question is what constitutes an attempt to resolve the dispute? Many agreements I have reviewed contain a general description of such. However, consideration should be given to outlining a formal mediation process with a neutral from a designated panel with a mutually agreed upon process that may very well be set forth in an ADR provider's rules. The arbitration clause should contain very specific notice provisions with respect to the exercise of this right including time limits within which the mediation must be held; an agreement to use a roster of mediators from an ADR provider from which the parties may choose a neutral; a provision that would deal with the possibility that the parties may not be able to agree on a neutral; and a default provision which allows a party to proceed directly to arbitration if the other fails to cooperate.

With respect to the rules governing procedure and the law to be applied, care must be given in drafting the agreement selecting same. In a case involving interstate commerce,

it would be wise to provide a stipulation to the effect that the Federal Arbitration Act (FAA) is to apply. A choice of law should be included and a consent to jurisdiction provision which will apply to the extent that it is not inconsistent with the FAA. Obviously, the choice of law is an extremely important decision and should be given careful consideration when drafting the arbitration clause. Specificity with respect to the location where the arbitration will be held should also be addressed. This is not something that should be left up to negotiation once the right to arbitrate is exercised. Again, disagreement over something as simple as location can lead to a delay in the process. While it is often impossible to foresee the best location for arbitration, consideration should be given to what would be most convenient for the parties and, more significantly, to any witnesses that may have to testify.

One of the critical issues is a decision by the parties as to whether the arbitration provision provides for a determination by a single arbitrator or tri-panel of arbitrators. If a tri-panel arbitration is provided for, a further decision is required as to whether all the panelists are mutually agreed upon by the parties to the arbitration, or whether it will be a tri-panel "party" arbitration where each party selects an arbitrator, and thereafter the party arbitrators select the umpire.

A sub-issue in the party arbitration is whether the parties will have input, via their party arbitrator, with respect to the selection of the umpire; or whether once selected, the party arbitrators will independently select the umpire.

Clearly the most efficient, least costly and most expeditious alternative is to provide for a single arbitrator. However, many parties are unwilling to put all of their eggs in one basket. While more expensive and logistically more difficult, many prefer a tri-panel. Some parties prefer a party arbitration as they are able to select one neutral that may be pre-disposed to their position and have the two party arbitrators select the umpire. As a general comment, the party arbitration can often result in more complications than the simple tri-panel. The selection process of the neutrals can become more unwieldy as the party arbitrators may have difficulty in agreeing on the umpire. Further, prior to making a decision as to whether to provide for a party arbitration, counsel should carefully review the Code of Ethics for Arbitrators in Commercial Arbitrations promulgated by the American Bar Association. There are separate specific provisions regulating the conduct of the party arbitrator which should be considered.

Another consideration is to set forth the discovery process with specific timelines and limitations. While the parties are always free to agree to a modification of this provision, it is important to have some basic framework in place.

The arbitration clause should specify the scope of the panel’s decision-making process. The right to award attorneys’ fees, pre and post judgment interest, interim relief, and the ability to award summary judgment are some of the items that should be considered. In

addition, a provision regarding the sharing of costs of the arbitration should be included along with the right of a party to seek an award of same from the panel if a party refuses to pay same.

Careful thought should be given to the nature and scope of the default provision as applicable to the arbitration clause. One could engage in a lengthy discussion of what might be entailed, but clearly the provision(s) should be carefully tailored to the specific type of default with time, notice and remedies that may be pursued.

Finally who is going to administer the arbitration process? In the absence of a provision, the parties will have to self-administer the arbitration which again opens up numerous areas of potential disagreement. The better practice would be to select an independent ADR provider, such as NAM (National Arbitration and Mediation), to administer everything. The provider will aid in coordinating the entire procedure which would include the selection of the arbitrators, the scheduling and the billing. The parties of course, will need to agree to abide by the rules of the specific ADR provider to the extent that they are not inconsistent with the FAA and choice of law provisions discussed supra.

This is a thumbnail sketch and in no way a complete list of all the items to be considered in drafting an arbitration clause. However the singular goal is to be as specific as possible to avoid litigating the very provision itself and delaying the ADR process.

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