IF YOU'RE GOING TO INCLUDE AN ARBITRATION CLAUSE, MAKE IT A GOOD ONE!

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Here's how it usually works. The attorneys in corporate put a deal together and draft the contract. Typically they are concerned with the terms, the financial aspects, the liabilities, the protections. Then they throw in the boiler plate - the Integration Clause, the Notices Clause, the Severability Clause, the Headings Clause, the Multiple Counterparts Clause, the Governing Law Clause, the Arbitration Clause. *The Arbitration Clause! Whoa!* The Arbitration Clause is a complex contract unto itself, is not boilerplate, and should be accorded the careful drafting it deserves.

The Arbitration Clause is part and parcel of the alternative dispute resolution process. As such, the Arbitration Clause should be incisive and comprehensive, so that the Arbitration Clause itself does not become another source of contention between the disputants. An inartfully or incompletely drafted Arbitration Clause can create additional controversy. I'm reminded of the underlying premise of medical ethics: "First, do no harm." Not only should the Arbitration clause not be a source of contention, but ideally it should promote resolution of the dispute. Toward that end, the Arbitration Clause should provide mechanisms for resolving the dispute prior to actually initiating arbitration.

This article is for both corporate attorneys and litigators. Often the corporate attorneys draft the contract, but when things go awry (as I've heard they are wont to do), it is the litigators who are left to implement an incomplete or inartfully drafted Arbitration Clause. While there are occasions when parties enter into an arbitration agreement after a dispute has arisen, this article deals only with arbitration clauses in

contracts being written prior to a dispute. This article describes twelve points to consider when drafting an Arbitration Clause.

1. The Commencement Provision

A well-thought out Arbitration Clause should include a provision which specifies how the parties to the contract will notify each other that there is a controversy. This might cover both a limitations period and a procedural format. While the Notice Clause of the contract will specify to whom notice must be given, the Arbitration Clause should specify how to commence the arbitration procedure:

> If a controversy should arise, then not later than one (1) year from the date of the event which is the subject of dispute, either party may serve on the other a written notice specifying the existence of such controversy and setting forth in reasonably specific detail the grounds thereof ("Notice of Controversy"), provided that, in any event, the party shall have at least thirty (30) days from and after the date of the Notice of Controversy to serve a written notice of any counterclaim ("Notice of Counterclaim"). The Notice of Counterclaim shall specify the claim or claims in reasonably specific detail.

2. Self-Help Provision

Because the well-crafted Arbitration Clause should foster dispute resolution, it might provide for a cooling off period during which the parties can resolve the dispute themselves without resorting to arbitration:

> Following receipt of the Notice of Controversy (or any Notice of Counterclaim), there shall be a three-week period during which the parties will make a good faith effort to resolve the dispute through negotiation ("Period of Negotiation"). Neither party shall take any action during the Period of Negotiation to initiate arbitration proceedings.

3. Mediation Step

Again, in the spirit of dispute resolution, the Arbitration Clause may specify an opportunity for the parties to mediate the dispute prior to submitting it to arbitration. Mediation is essentially an assisted negotiation. The supervision of a trained neutral may

allow the parties to resolve the dispute. If the Arbitration Clause provides for mediation, the parties may want to put limits on the amount of time to be spent trying to resolve the dispute prior to arbitration:

> If the parties should agree during the Period of Negotiation to mediate the dispute, then the Period of Negotiation shall be extended by an amount of time to be agreed upon by the parties to permit such mediation. In no event, however, may the Period of Negotiation be extended by more than five (5) weeks or, stated differently, in no event may the Period of Negotiation be extended to encompass more than a total of eight (8) weeks.

4. Mediation Format

Since the parties enforcing an Arbitration Clause are already in conflict, they may have difficulty agreeing on anything. The mediation provision, therefore, should cover the eventuality that the disputants will be unable to agree on the format or procedures for the mediation:

> If the parties agree to mediate the dispute but are unable to agree within a week on the format and procedures for the mediation, then the effort to mediate shall cease and the Period of Negotiation shall terminate four weeks from the Notice of Controversy (or the Notice of Counterclaim, as the case may be).

5. Whose Arbitration Rules

After exhausting alternative remedies, the Arbitration clause should, of course, set forth the terms, conditions and procedures of the Arbitration. The first issue is determining what rules will govern the arbitration. It is standard in many agreements to use the rules of the American Arbitration Association. These rules are generally acceptable to both parties, having been developed and revised over many years and through many disputes. These time-tested rules have the added benefit of having been promulgated under the auspices of a non-profit organization.

> Following the termination of the Period of Negotiation, the dispute (including the main claim and any counterclaim) shall be settled by arbitration governed by the arbitration rules of the American Arbitration Association ("AAA"). The

> format and procedures of the arbitration are set forth below (referred to below as the "Arbitration Agreement").

6. Arbitration Procedure

A good Arbitration Clause should specify the precise terms, conditions and procedures for commencing the arbitration. Again, it's a good idea to set time limits for initiating the process to prevent unnecessary delay:

> A notice of intention to arbitrate ("Notice of Arbitration") shall be served within thirty (30) days of the termination of the Period of Negotiation.

7. Which Arbitration Rules

In addition to specifying that the controversy will be submitted under the AAA's arbitration rules generally, it is also necessary to specify precisely which rules will apply. The AAA has a variety of rules that are industry or controversy specific. For instance, the dispute may be most appropriately arbitrated under the Commercial Rules, the Employment Rules, the Construction Rules, or the Securities Rules, etc. As mentioned above, the AAA Rules are familiar and time-tested and, therefore, usually not the source of added controversy. That said, the AAA's rules do change from time to time. It may be important to specify not only which category of rules, but also which version of the rules. You might also want to provide for a modification of the rules, particularly if the contract has some unusual aspects that require a specific procedural rule:

> The arbitration, including the Notice of Arbitration, will be governed by the National Rules for the Resolution of Employment Disputes of the AAA in effect on the date of the Notice of Arbitration, except that the terms of this Arbitration Agreement shall control in the event of any difference or conflict between such Rules and the terms of this Arbitration Agreement.

8. Arbitration Choice of Law

Although most contracts specify choice of law, the Arbitration Clause embodied within the contract should contain its own choice of law provision and specify the locale for the arbitration. This is critical particularly where the parties to the contract are from

different states or countries. The drafter will want to consider the convenience (or inconvenience) of the parties and the preferred law:

> The arbitrator shall reach a decision on the merits on the basis of applicable legal principles as embodied in the law of the Commonwealth of Massachusetts. The arbitration hearing shall take place in Boston unless the parties agree in writing to a different location.

9. Selection of Arbitrator(s)

The composition of the arbitral panel is largely within the control of the parties. This, in fact, is one of the main attractions of arbitration - litigators don't get to pick their judge, but disputants do get to pick their arbitrator! The parties need to agree on both the number of arbitrators and the qualifications of the arbitrator(s).

In drafting this provision, the attorney will want to consider many factors: Would the dispute be better heard before a single arbitrator or a panel of three? Should the drafter specify that disputes over a certain monetary amount are to be heard by a panel of three arbitrators? If that is the case, how is the panel to be selected - does each side pick one and the two chosen arbitrators select the third? (I personally have a problem with this type of selection method. All arbitrators must avoid even the appearance of bias. Does having each side pick an arbitrator automatically appear to align that arbitrator with that party? When the two chosen arbitrators are then asked to pick the third arbitrator, are they somehow transformed into advocates for "their" side? Frankly, I don't see the point of going through the exercise - either the parties should agree on all three arbitrators, or agree on a single, uncompromisingly neutral arbitrator.)

If a panel of three is to be used, what should its composition be? Three industry experts? Two industry experts and an attorney? Three arbitrators with complementary skills - e.g., an employment attorney, a broadcasting industry expert and a sports law attorney? Should at least one of the arbitrators be an attorney? The answers to these questions depend on the nature of the contract, the parties, the relationship of the

parties, the amount likely to be in controversy, the economic situation of the parties, the disparity in the financial resources of the parties, the novelty, complexity or sophistication of the issue(s) likely to be arbitrated, and a multiplicity of other factors.

These questions may be difficult to answer - particularly because the Arbitration Clause is being drafted as part of a pre-dispute contract, when the nature of the controversy that may arise in the future is unknown. One typical provision is:

> There shall be one arbitrator regardless of the amount in controversy. In order to be eligible to serve, the arbitrator shall be in the Boston area and have at least 10 years experience with employment law litigation. In the event the parties cannot agree on a mutually acceptable single arbitrator from the list submitted by the AAA, the AAA shall appoint an arbitrator who shall meet the foregoing criteria. At the time of appointment and as a condition thereto, the arbitrator will be apprised of the time limitations and other provisions of this Arbitration Agreement and shall indicate such dispute resolver's agreement to comply with such provisions and time limitations.

10. Specifying Discovery Rules

Although the parties to the contract are agreeing to submit to specific rules - in our example the Employment Rules of the AAA - the parties may nonetheless wish to supersede portions of those rules. For example, the parties to the contract may wish to circumscribe discovery:

> During the thirty (30) day period following appointment of the arbitrator, either party may serve on the other a request for limited numbers of documents directly related to the dispute. Such documents shall be produced within fifteen (15) days of the request. Following the thirty (30) day period of document production, there will be a forty-five (45) day period during which limited depositions will be permissible. Disputes as to discovery or prehearing matters of a procedural nature shall be promptly submitted to the arbitrator. The arbitrator shall make every effort to render a ruling on such interim matters within five (5) business days. The arbitrator shall make every effort to commence the hearing within thirty (30) days of the conclusion of the deposition period and, in addition, will make every effort to

conduct the hearing on consecutive business days to conclusion.

11. Proceedings Transcript

Usually the parties to an arbitration do not elect to have a court reporter make a stenographic record of the proceedings. The primary reason for this is that the grounds for appealing an arbitrated decision are so limited and appeals so rare, that a stenographic record serves little purpose. Nonetheless, parties occasionally want a transcript of the proceedings. When one party wants a transcript and the other thinks it unnecessary, problems can arise. Typically the party requesting that the proceedings be recorded bears the cost of the court reporter and is under no obligation to provide the other side with a copy of the transcript. If however, a party wants to provide the arbitrator(s) with a transcript, the Arbitration Clause should require that party to provide the opposition with a transcript, as well. If both sides want a transcript, both sides pay:

Either party may, at its own expense, have the arbitration proceedings recorded by a certified court reporter or by supplying its own tape recorder.

11. Form of Award

The parties may wish to specify the form and timing of the arbitrator's award. Awards basically come in two forms: "reasoned awards" and "bare awards." While it goes without saying that the arbitrator must use reasoning to arrive at either form of award, only with the "reasoned" award is the arbitrator required to set forth findings of fact and conclusions of law on which the award is based. (This, by the way, is a primary difference between the AAA's Commercial Rules and its Employment Rules. The Employment Rules require a reasoned opinion; the Commercial Rules leave the type of award to the agreement of the parties.)

There are pros and cons to each type of award. Although the likelihood of overturning an arbitrated decision on appeal is small, there is, perhaps, a slightly greater chance that a (poorly) reasoned opinion will provide grounds for appeal. That said, a

reasoned award can be more costly to the parties, because the arbitrator spends more time writing the opinion.

In addition to deciding on the form of the award, the parties might want to specify the timing of the award just to ensure that the arbitrator renders a timely opinion.

> An award will be rendered within thirty (30) days of the close of the arbitration hearing and at the latest within eight (8) months of the date of the Notice of Arbitration. The award shall set forth the grounds for the decision (findings of fact and conclusions of law) in reasonably specific detail.

11. Appealability of the Award

While it is not required that an arbitration agreement set forth the law concerning the appealability of the award, the Arbitration Clause may nonetheless recite the understanding of the parties in the hope that it might decrease the likelihood that a party will appeal:

> The award shall be final and nonappealable except as provided in the AAA rules and except that a court of competent jurisdiction shall have the power to review whether, as a matter of law, based on the findings of fact by the arbitrator, the award should be confirmed, modified or vacated. Such judicial review shall be final and binding on the parties.

12. Cost of the Arbitration

The final major issue to address in a comprehensive Arbitration Clause is who is going to pay for the arbitration. There are many possible variations on this theme. Costs fall into two distinct categories: 1) the arbitrator's fees and the administering body's administration fees ("arbitration costs") and each party's attorney's fees and costs ("attorneys' fees"). Usually, each side bears its own attorneys' fees, while the arbitration costs are divided equally between the parties. Alternatively, the parties to the contract may structure the Arbitration Clause so that it discourages frivolous claims. If that is the goal, the Arbitration Clause may provide that all arbitration costs and attorneys' fees are to be borne by the non-prevailing party.

Sometimes in employment settings - particularly where there is a collective bargaining agreement or where there is a promulgated employee plan - the company may bear the lion's share of the arbitration costs and attorneys' fees. In these instances, the intent is that the cost of arbitration not chill the rank-and-file's ability to bring claims. Finally, the parties may want to leave the award of arbitration costs and attorneys' fees to the arbitrator. This may or may not bring about the desired effect. Many arbitrators are reluctant to award costs and fees, because as paid adjudicators they are essentially ordering a party to pay their own fee. Where the conduct has been egregious or the claim outrageously frivolous, however, an award of fees can occur.

The most typical fees and costs provision is:

> The cost of any arbitration, excluding attorneys' fees and expenses incurred by the parties, will be split evenly by the parties.

Conclusion

This article describes the Arbitration Clause only in a contract being drafted before a dispute arises. In situations where the controversy that may arise is reasonably predictable, the drafter should set forth precise terms and conditions of the arbitration, so that the Arbitration Clause does not become an additional source of controversy for the parties. In situations where the nature of a future controversy is unpredictable, particularly where the scope of the conflict may vary widely, the drafter should still cover all of the twelve points described above, but may want to build in added flexibility. This will permit the parties to tailor the arbitration to fit the controversy.

In conclusion, the well-drafted arbitration clause can go a long way towards helping the alternative dispute resolution process work its magic.

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