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Preventing a Runaway Arbitration with a Well-Drafted Arbitration Clause

By Patricia C. O'Prey and Gilda R. Turitz

To keep legal costs under control in commercial disputes, corporations frequently rely upon binding arbitration as a reputedly faster and less expensive alternative to traditional litigation. Typically, two major factors impacting those potential cost savings are restrictions on pre-hearing discovery in arbitration and restrictions on challenges to arbitration awards in post-hearing proceedings. When enforced, these restrictions offer a significantly streamlined process, finality and a shorter time to ultimate resolution than may exist in the litigation process. Another desirable aspect of arbitration is the parties' ability to select arbitrators with subject matter expertise relevant to the dispute, which is a quality that the decisionmakers in litigation—jury and/or judge—may not offer.

Despite the opportunities for cost-effective and efficient resolution that arbitration may offer, many in-house counsel and their outside litigators have experienced the arbitration process gone awry. A "runaway arbitration" is a costly, poorly managed, and time-consuming process that becomes bogged down by broad written, deposition, and electronic discovery and motion practice similar to traditional litigation; lengthy delays in getting to hearing; an arbitration hearing attenuated by postponements and interruptions; and post-award proceedings that erode the award's anticipated finality. When this occurs, the runaway arbitration may be at least as lengthy and costly as a courtroom trial, but without the procedural safeguards that the traditional court process offers.

In-house counsel are uniquely positioned to prevent a runaway arbitration by taking thoughtful steps to shape the process for a future unknown dispute both before and when it arises. These steps include careful drafting of the arbitration clause to address such issues as the scope of arbitrable claims, selection of the tribunal to hear the dispute, designation of applicable rules, the parameters for arbitrator selection, limitations on discovery, motions and the hearing, and the scope of post-award review. Once a dispute arises, in-house counsel should be involved in strategic decisions on arbitrator selection and the scope of discovery to ensure, to the extent possible, a well-managed and cost-effective process. In-house counsel's effective participation and collaboration with outside counsel to prepare for the hearing itself also will help prevent the arbitration from veering off-course and out of control. In this article, we will discuss issues in drafting arbitration clauses and ways to help prevent a runaway arbitration.

Issues in Drafting Arbitration Clauses

Arbitration is a creature of contract and the arbitration clause is the starting point for any arbitrable dispute that follows. During the negotiation and drafting of a commercial contract,

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however, in-house counsel's primary attention will be focused on the contract's substantive subject matter (e.g., the sale of goods or assets, provision of services, licensing product, merger or acquisition); the arbitration clause is rarely of foremost concern. As a practical matter, the clause may be inserted in an abbreviated fashion or as an afterthought, using boilerplate lifted from some other contract without consideration of factors that can have a dramatic impact on the way the arbitration is conducted (including the governing rules and the current state of the law concerning arbitration). Counsel may be reluctant to engage in extensive drafting or negotiation over the arbitration clause to avoid creating the impression that they are anticipating conflict, when the parties' focus should be on resolving deal points to close the transaction at hand. Counsel should carefully draft the arbitration clause in any contract because it will govern the process of adjudicating any future disputes and can have a dramatic impact on both the cost and outcome of the arbitration. In light of the strong public policy favoring enforcement of arbitration clauses, in-house counsel should consider the following issues.

Scope and Breadth of Arbitrable Claims
In-house counsel must consider whether the arbitration clause is sufficiently comprehensive to include all disputes that may arise out of the transaction, or if the drafted language potentially excludes certain claims. Moreover, where a transaction involves multiple related contracts—for example, a purchase and sale agreement for assets of a business, accompanied by promissory notes, security agreements, and consulting or employment contracts of the selling principals—counsel should ensure consistency in the approach and scope of arbitration clauses in all the relevant contracts. The failure to include an arbitration clause in one or more of the related contracts may lead to litigation to compel or resist arbitration. Ambiguity in the scope of the clause can lead to costly motion practice to determine the parties' intent regarding which claims to arbitrate and which are outside the scope of the clause. Such circumstances could have the undesirable result of some claims being litigated in court, while others involving the same contract or transaction are arbitrated, causing duplication of effort and potentially inconsistent outcomes between arbitration and court proceedings on the same set of facts.

Selection of Tribunal and Its Rules
In most arbitration clauses, the parties specify an institutional provider to administer the arbitration process and, frequently, a particular set of rules to govern the dispute. These rules may designate subject matter (e.g., commercial, employment or construction) or amount in controversy (e.g., appointing one arbitrator for an amount under a threshold, with all other disputes requiring three arbitrators), but otherwise are general in scope. Most rules grant substantial discretion to the arbitrator(s) over procedural matters such as motion practice and discovery (discussed further below). Therefore, before agreeing to a designated provider or a set of governing rules, in-house counsel should review the options with counsel experienced in arbitration to make informed choices that will impact resolution of a future dispute.

Selection of Venue for the Arbitration Hearing
The location of the arbitration hearing should be specified in the parties' agreement. In-house

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counsel should consider venue selection carefully, as it may involve substantial travel costs for counsel and the company's key witnesses. In addition, the parties will usually be responsible to pay for the out-of-pocket travel and lodging costs of the arbitrators; as a result, a lengthy hearing at a distant venue can add substantially to costs.

Selection of Arbitrators

Because an advantage of arbitration is the ability to select arbitrators with relevant subject matter expertise, the parties may wish to specify in the arbitration clause the qualifications required for the arbitrators, such as allowing only for retired judges, attorneys with specific experience (*e.g.* at least ten years of commercial leasing experience), or arbitrators with a particular professional license (*e.g.*, civil engineers, architects, real estate appraisers, brokers). Also, before doing so, if a particular Tribunal has been selected in the clause, in-house counsel should be satisfied that the selected tribunal maintains rosters of neutrals that will satisfy the specified qualifications. Highly qualified arbitrators who are specialized in the subject matter of the dispute can hone in on the truly material information, allowing a more expedited process with substantially less hearing time, as well as refereeing the course of discovery needed for a fair and efficient arbitration.

Time When Hearing Must be Held

In the arbitration, the parties can specify a time frame in which the arbitration must be commenced (e.g., within six months of filing the demand) and a maximum length of time for it to be completed, such as specifying the number of hearing days or hours. This will help avoid a runaway arbitration. Counsel should be cautious about including overly restrictive provisions in their clause, however, because the benefit of those restrictions may be undercut by the impossibility of predicting whether such time limitations ultimately will serve the corporation's interests in a later dispute of indeterminate scope. As a result, in-house counsel should consider including a caveat that any specified time frames may be modified by the parties' stipulation or in the arbitrator's discretion upon a showing of good cause. Such an approach balances the need for time limitations against the potential prejudice to the parties if those limitations, given the facts and circumstances of the dispute, require adjustments to the process to ensure fairness.

Scope of Discovery

Pre-trial discovery can often be the most expensive phase of litigation. That factor alone causes parties to insert an arbitration clause in their contract in the hope of avoiding the attorney's fees, hard costs and management time associated with traditional discovery such as interrogatories, requests for admission, unlimited rounds of document demands, and depositions. In most arbitration, discovery is allowed as a matter of course (particularly document exchanges), or the arbitrator may have broad discretion to permit discovery that either or both parties seek. If the arbitration clause is specific regarding which methods of discovery are permitted or prohibited, most arbitrators will honor those parameters unless the rules require otherwise or manifest inequities would result. If the arbitration clause is silent on discovery, however, the arbitrator, guided by the tribunal's rules, may exercise discretion to allow very broad, costly and time-

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consuming discovery. Therefore, in-house counsel should consider drafting a clause that specifies limits on discovery to prevent this aspect of a future dispute from "running away." But, as in the case of time restrictions, once a dispute presents itself, limitations on discovery may not serve the parties' needs. The drafter should therefore consider including a "safety valve" to allow modification by stipulation or to give the parties and the arbitrator appropriate flexibility to ensure fairness.

Because depositions are some of the most costly discovery devices, serious consideration should be given to addressing depositions specifically in the arbitration clause. Some alternatives include prohibiting depositions all together, restricting each party to a single deposition of the other party (corporate or a single witness, specifying either a total number of depositions or hours of deposition per side, or limiting the length of individual depositions, such as the seven-hour limit provided for in the federal rules. Prohibiting or overly restricting depositions in a commercial arbitration of any complexity, however, may not ultimately be a time- or cost-saving strategy. In the absence of depositions, counsel arbitrating the case may call more witnesses or spend more time on foundational and less important testimony while incurring fees both for counsel and the arbitrators. Leaving flexibility, or a "safety valve," in the clause to allow the arbitrator to consider and order discovery, including depositions, that may be necessary or desirable could result in a more streamlined and cost-efficient arbitration, notwithstanding the expense of depositions.

Given the prevalence of electronic communications and e-discovery in general, and their corresponding expenses, in-house counsel should consider limiting certain types of e-discovery, such as providing that the production of back-up tapes will not be required. Before drafting any clause involving e-discovery, in-house counsel should research and be aware of the most current rulings and best practices in this rapidly evolving area, particularly as they may be applied in arbitration. In-house counsel should also become familiar with the most current rulings and best practices relating to e-discovery as well as the corporation's policies regarding e-discovery, including electronic storage, retrieval and documents destruction policies, in order to avoid memorializing requirements that the corporation may find difficult to satisfy in a future arbitration. Because of the expense associated with e-discovery, in-house counsel should consider including a clause that allows the arbitrator to allocate or shift costs to either party as may be equitable under the circumstances.

Post-Award Judicial Review

Another concern about a runaway arbitration is a runaway result. A poor result in an arbitration that seems completely at odds with the law usually cannot be effectively challenged after the arbitration has concluded, even if it would have made a promising appeal after a trial. To protect the corporation, in-house counsel should consider whether to include a judicial review provision in the agreement to arbitrate. Whether such a clause is enforceable varies by jurisdiction; "manifest disregard of the law" is considered a valid ground for vacating an award in some jurisdictions but not in others. Counsel should therefore operate on the assumption that, in

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