

## *Excerpts from Drafting Dispute Resolution Clauses*

*American Arbitration Association*

Drafting clear, unambiguous clauses contributes to the efficiency of the ADR process. For example, arbitration agreements require a clear intent to arbitrate. It is not enough to state that “disputes arising under the agreement shall be settled by arbitration.” While that language indicates the parties’ intention to arbitrate and may authorize a court to enforce the clause, it leaves many issues unresolved. Issues such as when, where, how and before whom a dispute will be arbitrated are subject to disagreement once a controversy has arisen, with no way to resolve them except to go to court. Some of the more important elements a practitioner should keep in mind when drafting, adopting or recommending a dispute resolution clause follow.

- The clause might cover all disputes that may arise, or only certain types.
- It could specify only arbitration – which yields a binding decision – or also provide an opportunity for non-binding negotiation or mediation.
- The arbitration clause should be signed by as many potential parties to a future dispute as possible.
- To be fully effective, “entry of judgment” language in domestic cases is important.
- It is normally a good idea to state whether a panel of one or three arbitrator(s) is to be selected, and to include the place where the arbitration will occur.
- If the contract includes a general choice of law clause, it may govern the arbitration proceeding. The consequences should be considered...
- The parties are free to customize and refine the basic arbitration procedures to meet their particular needs. If the parties agree on a procedure that conflicts with otherwise applicable AAA rules, the AAA will almost always respect the wishes of the parties....
- The parties can provide for arbitration of future disputes by inserting the following clause into their contracts (the language in the brackets suggests possible alternatives or additions).
- 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.
- We, the undersigned parties, hereby agree to submit to arbitration administered by the American Arbitration Association under its Commercial [or other] Arbitration Rules the following controversy: [describe briefly]. We further agree that a judgment of any court having jurisdiction may be entered upon the award.

The standard clause is often the best to include in a contract. It makes clear that all disputes are arbitrable. Thus, it minimizes dilatory court actions to avoid the arbitration process. It is self-enforcing. Arbitration can continue despite an objection from a party, unless the proceedings are stayed by court order or by agreement of the parties. It provides a

complete set of rules and procedures. This eliminates the need to spell out dozens of procedural matters in the parties' agreement. It provides for the selection of a specialized, impartial panel. Arbitrators are selected by the parties from a screened and trained pool of available experts.

The parties should consider adding a requirement regarding the number of arbitrators appointed to the dispute and designating the place and language of the arbitration....For strategic or long-term commercial international contracts, the parties may wish to provide a "step" dispute resolution process encouraging negotiated solutions, or mediation in advance of arbitration or litigation. A model step clause and mediation clause follow.

*"In the event of any controversy or claim arising out of or relating to this contract, the parties hereto shall consult and negotiate with each other and, recognizing their mutual interests, attempt to reach a solution satisfactory to both parties. If they do not reach settlement within a period of 60 days, then either party may, by notice to the other party and the International Centre for Dispute Resolution, demand mediation under the International Mediation Procedures of the International Centre for Dispute Resolution. If settlement is not reached within 60 days after service of a written demand for mediation, any unresolved controversy or claim arising out of or relating to this contract shall be settled by arbitration in accordance with the International Arbitration Rules of the International Centre for Dispute Resolution."*

Usually, the effective management of time and expense in arbitration is best left in the hands of experienced case managers and arbitrators. Occasionally, however, parties wish to ensure that matters are resolved in a minimum of time and without recourse to the expense and time necessitated by common law methods of pre-hearing information exchange. The clauses that follow limit the time frame of arbitration (clauses presented in the alternative) and the amount of pre-hearing information exchange available to the parties. One word of caution: once entered into, these clauses will limit the arbitrator's authority to mold the process to the specific dictates of the case.

### **Other Provisions That Might be Considered**

#### **A. Specifying a Method of Selection and the Number of Arbitrators**

The parties may agree to have one arbitrator or three (which significantly increases the cost).

The arbitration clause can also specify by name the individual whom the parties want as their arbitrator. However, the potential unavailability of the named individual in the future may pose a risk. All of these issues and others can be dealt with in the arbitration clause. Some illustrative provisions follow.

➤ The arbitrator selected by the claimant and the arbitrator selected by respondent shall, within 10 days of their appointment, select a third neutral arbitrator. In the event that they are unable to do so, the parties or their attorneys may request the American Arbitration Association to appoint the third neutral arbitrator. Prior to the commencement of hearings, each of the arbitrators appointed shall provide an oath or undertaking of impartiality.

➤ Within 14 days after the commencement of arbitration, each party shall select one person to act as arbitrator and the two selected shall select a third arbitrator within 10 days of their appointment. [The party-selected arbitrators will serve in a non-neutral capacity.] If the arbitrators selected by the parties are unable or fail to agree upon the third arbitrator, the third arbitrator shall be selected by the American Arbitration Association.

➤ In the event that arbitration is necessary, [name of specific arbitrator] shall act as the arbitrator.

When providing for direct appointment of the arbitrator(s) by the parties, it is best to specify a time frame within which it must be accomplished. Also, in many jurisdictions, the law permits the court to appoint arbitrators where privately-agreed means fail. Such a result may be time consuming, costly, and unpredictable. Parties who seek to establish an ad-hoc method of arbitrator appointment might be well advised to provide a fallback, such as, should the particular procedure fail for any reason, “arbitrators shall be appointed as provided in the AAA Commercial Arbitration Rules.”

### **B. Arbitrator Qualifications**

The parties may wish that one or more of the arbitrators be a lawyer or an accountant or an expert in computer technology, etc. In some instances, it makes more sense to specify that one of three arbitrators be an accountant, for example, than to turn the entire proceeding over to three accountants. Sample clauses providing for specific qualifications of arbitrators are set forth below.

- The arbitrator shall be a certified public accountant.
- The arbitrator shall be a practicing attorney [or a retired judge] of the [[specify]] [Court].
- The arbitration proceedings shall be conducted before a panel of three neutral arbitrators, all of whom shall be members of the bar of the state of [specify], actively engaged in the practice of law for at least 10 years.
- The panel of three arbitrators shall consist of one contractor, one architect, and one construction attorney.
- The arbitrators will be selected from a panel of persons having experience with and knowledge of electronic computers and the computer business, and at least one of the arbitrators selected will be an attorney.
- In the event that any party’s claim exceeds \$1 million, exclusive of interest and attorneys’ fees, the dispute shall be heard and determined by three arbitrators.

Parties might wish to specify that the arbitrator should or should not be a national or citizen of a particular country. The following examples can be added to the arbitration clause to deal with this concern.

- The arbitrator shall be a national of [country].

- The arbitrator shall not be a national of either [country A] or [country B].
- The arbitrator shall not be of the nationality of either of the parties.

### **C. Locale Provisions**

Parties might want to add language specifying the place of the arbitration. The choice of the proper place to arbitrate is most important because the place of arbitration implies generally a choice of the applicable procedural law, which in turn affects questions of arbitrability, procedure, court intervention and enforcement. In specifying a locale, parties should consider (1) the convenience of the location (e.g., availability of witnesses, local counsel, transportation, hotels, meeting facilities, court reporters, etc.); (2) the available pool of qualified arbitrators within the geographical area; and (3) the applicable procedural and substantive law. Of particular importance in international cases is the applicability of a convention providing for recognition and enforcement of arbitral agreements and awards and the arbitration regime at the chosen site. An example of locale provisions that might appear in an arbitration clause follows.

- The place of arbitration shall be [city], [state], or [country].

### **D. Language**

In matters involving multilingual parties, the arbitration agreement often specifies the language in which the arbitration will be conducted. Examples of such language follow.

- The language(s) of the arbitration shall be [specify].
- The arbitration shall be conducted in the language in which the contract was written.

Such arbitration clauses could also deal with selection and cost allocation of an interpreter.

### **E. Governing Law**

It is common for parties to specify the law that will govern the contract and/or the arbitration proceedings. Some examples follow.

- This agreement shall be governed by and interpreted in accordance with the laws of the State of [specify]. The parties acknowledge that this agreement evidences a transaction involving interstate commerce. The United States Arbitration Act shall govern the interpretation, enforcement, and proceedings pursuant to the arbitration clause in this agreement.

- Disputes under this clause shall be resolved by arbitration in accordance with Title 9 of the US Code (United States Arbitration Act) and the Commercial Arbitration Rules of the American Arbitration Association.

- This contract shall be governed by the laws of the state of [specify].

### **F. Conditions Precedent to Arbitration**

Under an agreement of the parties, satisfaction of specified conditions may be required before a dispute is ready for arbitration. Examples of such conditions precedent include written notification of claims within a fixed period of time and exhaustion of other contractually established procedures, such as submission of claims to an architect or engineer. These kinds of provisions may, however, be a source of delay and may require linkage with a statute of limitations waiver (see below). An example of a “condition precedent” clause follows.

➤ If a dispute arises from or relates to this contract, the parties agree that upon request of either party they will seek the advice of [a mutually selected engineer] and try in good faith to settle the dispute within 30 days of that request, following which either party may submit the matter to mediation under the Commercial Mediation Procedures of the American Arbitration Association. If the matter is not resolved within 60 days after initiation of mediation, either party may demand arbitration administered by the American Arbitration Association under its [applicable] rules.

### **G. Preliminary Relief**

If the parties foresee the possibility of needing emergency relief akin to a temporary restraining order, they might specify an arbitrator by name for that purpose in their arbitration clause or authorize the AAA to name a preliminary relief arbitrator to ensure an arbitrator is in place in sufficient time to address appropriate issues. Specific clauses providing for preliminary relief are set forth below.

➤ Either party may apply to the arbitrator seeking injunctive relief until the arbitration award is rendered or the controversy is otherwise resolved. Either party also may, without waiving any remedy under this agreement, seek from any court having jurisdiction any interim or provisional relief that is necessary to protect the rights or property of that party, pending the establishment of the arbitral tribunal (or pending the arbitral tribunal’s determination of the merits of the controversy).

Pending the outcome of the arbitration, parties may agree to hold in escrow money, a letter of credit, goods, or the subject matter of the arbitration. A sample of a clause providing for such escrow follows.

➤ ESCROW 1 : Pending the outcome of the arbitration [name of party] shall place in escrow with [law firm, institution, or AAA] as the escrow agent, [the sum of \_\_\_\_\_], a letter of credit, goods, or the subject matter in dispute]. The escrow agent shall be entitled to release the [funds, letter of credit, goods, or subject matter in dispute] as directed by the arbitrator(s) in the award, unless the parties agree otherwise in writing.

### **H. Consolidation**

Where there are multiple parties with disputes arising from the same transaction, complications can often be reduced by the consolidation of all disputes. Since arbitration is a process based on voluntary contractual participation, parties may not be required to arbitrate a dispute without their consent. However, parties can provide for the consolidation of two or more separate arbitrations into a single proceeding or permit the joinder of a third party into

an arbitration. In a construction dispute, consolidated proceedings may eliminate the need for duplicative presentations of claims and avoid the possibility of conflicting rulings from different panels of arbitrators. However, consolidating claims might be a source of delay and expense. An example of language that can be included in an arbitration clause follows.

➤ The owner, the contractor, and all subcontractors, specialty contractors, material suppliers, engineers, designers, architects, construction lenders, bonding companies, and other parties concerned with the construction of the structure are bound, each to each other, by this arbitration clause, provided that they have signed this contract or a contract that incorporates this contract by reference or signed any other agreement to be bound by this arbitration clause. Each such party agrees that it may be joined as an additional party to an arbitration involving other parties under any such agreement. If more than one arbitration is begun under any such agreement and any party contends that two or more arbitrations are substantially related and that the issues should be heard in one proceeding, the arbitrator(s) selected in the first-filed of such proceedings shall determine whether, in the interests of justice and efficiency, the proceedings should be consolidated before that (those) arbitrator(s).

### **I. Document Discovery**

Under the AAA rules, arbitrators are authorized to direct a prehearing exchange of documents. The parties typically discuss such an exchange and seek to agree on its scope. In most (but not all) instances, arbitrators will order prompt production of limited numbers of documents which are directly relevant to the issues involved. In some instances, parties might want to ensure that such production will in fact occur and thus provide for it in their arbitration clause. In doing so, however, they should be mindful of what scope of document production they desire. This may be difficult to decide at the outset. If the parties address discovery in the clause, they might include time limitations as to when all discovery should be completed and might specify that the arbitrator shall resolve outstanding discovery issues. Sample language is set forth below.

➤ Consistent with the expedited nature of arbitration, each party will, upon the written request of the other party, promptly provide the other with copies of documents [relevant to the issues raised by any claim or counterclaim] [on which the producing party may rely in support of or in opposition to any claim or defense]. Any dispute regarding discovery, or the relevance or scope thereof, shall be determined by the [arbitrator(s)] [chair of the arbitration panel], which determination shall be conclusive. All discovery shall be completed within [45] [60] days following the appointment of the arbitrator(s).

### **J. Depositions**

Generally, arbitrators prefer to hear and be able to question witnesses at a hearing rather than rely on deposition testimony. However, parties are free to provide in their arbitration

clause for a tailored discovery program, preferably to be managed by the arbitrator. This might occur, for example, if the parties anticipate the need for distant witnesses who would not be able to testify except through depositions or, in the alternative, by the arbitrator holding a hearing where the witness is located and subject to subpoena. In most cases where parties provide for depositions, they do so in very limited fashion, i.e., they might specify a 30-day deposition period, with each side permitted three depositions, none of which would last more than three hours. All objections would be reserved for the arbitration hearing and would not even be noted at the deposition except for objections based on privilege or extreme confidentiality. Sample language providing for such depositions is set forth below.

➤ At the request of a party, the arbitrator(s) shall have the discretion to order examination by deposition of witnesses to the extent the arbitrator deems such additional discovery relevant and appropriate. Depositions shall be limited to a maximum of [three] [insert number] per party and shall be held within 30 days of the making of a request. Additional depositions may be scheduled only with the permission of the [arbitrator(s)] [chair of the arbitration panel], and for good cause shown. Each deposition shall be limited to a maximum of [three hours] [six hours] [one day's] duration. All objections are reserved for the arbitration hearing except for objections based on privilege and proprietary or confidential information.

#### **K. Duration of Arbitration Proceeding**

Parties sometimes underscore their wish for an expedited result by providing in the arbitration clause, for example, that there will be an award within a specified number of months of the notice of intention to arbitrate and that the arbitrator(s) must agree to the time constraints before accepting appointment. Before adopting such language, however, the parties should consider whether the deadline is realistic and what would happen if the deadline were not met under circumstances where the parties had not mutually agreed to extend it (e.g., whether the award would be enforceable). It thus may be helpful to allow the arbitrator to extend time limits in appropriate circumstances. Sample language is set forth below.

➤ The award shall be made within nine months of the filing of the notice of intention to arbitrate (demand), and the arbitrator(s) shall agree to comply with this schedule before accepting appointment. However, this time limit may be extended by agreement of the parties or by the arbitrator(s) if necessary.

#### **L. Remedies**

Under a broad arbitration clause and most AAA rules, the arbitrator may grant “any remedy or relief that the arbitrator deems just and equitable” within the scope of the parties’ agreement. Sometimes parties want to include or exclude certain specific remedies. Examples of clauses dealing with remedies follow.

- The arbitrators will have no authority to award punitive or other damages not measured by the prevailing party's actual damages, except as may be required by statute.
- In no event shall an award in an arbitration initiated under this clause exceed \$\_\_\_\_\_.
- In no event shall an award in an arbitration initiated under this clause exceed \$\_\_\_\_\_ for any claimant
- The arbitrator(s) shall not award consequential damages in any arbitration initiated under this section.
- Any award in an arbitration initiated under this clause shall be limited to monetary damages and shall include no injunction or direction to any party other than the direction to pay a monetary amount.
- If the arbitrator(s) find liability in any arbitration initiated under this clause, they shall award liquidated damages in the amount of \$\_\_\_\_\_.
- Any monetary award in an arbitration initiated under this clause shall include pre-award interest at the rate of \_\_\_\_% from the time of the act or acts giving rise to the award.

#### **M. "Baseball" Arbitration**

"Baseball" arbitration is a methodology used in many different contexts and is particularly effective when parties have a long-term relationship.

- The procedure involves each party submitting a number to the arbitrator(s) and serving the number on his or her adversary on the understanding that, following a hearing, the arbitrator(s) will pick one of the submitted numbers, nothing else.

A key aspect of this approach is that there is incentive for a party to submit a highly reasonable number, since this increases the likelihood that the arbitrator(s) will select that number. In some instances, the process of submitting the numbers moves the parties so close together that the dispute is settled without a hearing. Sample language providing for "baseball" arbitration is set forth below.

- Each party shall submit to the arbitrator and exchange with each other in advance of the hearing their last, best offers. The arbitrator shall be limited to awarding only one or the other of the two figures submitted.

#### **N. Arbitration within Monetary Limits**

Parties are often able to negotiate to a point but are then unable to close the remaining gap between their respective positions. By setting up an arbitration that must result in an award within the gap that remains between the parties, the parties are able to eliminate extreme risk, while gaining the benefit of the extent to which their negotiations were successful. There are two commonly-used approaches. The first involves informing the arbitrator(s) that the award should be somewhere within a specified monetary range. Sample contract language providing for this methodology is set forth below.

➤ Any award of the arbitrator in favor of [specify party] and against [specify party] shall be at least [specify a dollar amount] but shall not exceed [specify a dollar amount]. [Specify a party] expressly waives any claim in excess of [specify a dollar amount] and agrees that its recovery shall not exceed that amount. Any such award shall be in satisfaction of all claims by [specify a party] against [specify a party].

A second approach is for the parties to agree but not tell the arbitrator(s) that the amount of recovery will, for example, be somewhere between \$500 and \$1,000. If the award is less than \$500, then it is raised to \$500 pursuant to the agreement; if the award is more than \$1,000, then it is lowered to \$1,000 pursuant to the agreement; if the award is within the \$500-1,000 range, then the amount awarded by the arbitrator(s) is unchanged. Sample contract language providing for this methodology is set forth below.

➤ In the event that the arbitrator denies the claim or awards an amount less than the minimum amount of [specify], then this minimum amount shall be paid to the claimant. Should the arbitrator's award exceed the maximum amount of [specify], then only this maximum amount shall be paid to the claimant. It is further understood between the parties that, if the arbitrator awards an amount between the minimum and the maximum stipulated range, then the exact awarded amount will be paid to the claimant. The parties further agree that this agreement is private between them and will not be disclosed to the arbitrator.

#### **O. Assessment of Attorneys' Fees**

The AAA rules generally provide that the administrative fees be borne as incurred and that the arbitrators' compensation be allocated equally between the parties and, except for international rules, are silent concerning attorneys' fees; but this can be modified by agreement of the parties. Fees and expenses of the arbitration, including attorneys' fees, can be dealt with in the arbitration clause. Defining the term 'prevailing party' within the contract is recommended to avoid misunderstanding. Some typical language dealing with fees and expenses follows.

➤ The prevailing party shall be entitled to an award of reasonable attorney fees.

➤ The arbitrators shall award to the prevailing party, if any, as determined by the arbitrators, all of its costs and fees. "Costs and fees" mean all reasonable pre-award expenses of the arbitration, including the arbitrators' fees, administrative fees, travel expenses, out-of-pocket expenses such as copying and telephone, court costs, witness fees, and attorneys' fees.

➤ Each party shall bear its own costs and expenses and an equal share of the arbitrators' and administrative fees of arbitration.

➤ The arbitrators may determine how the costs and expenses of the arbitration shall be allocated between the parties, but they shall not award attorneys' fees.

### **P. Reasoned Opinion Accompanying the Award**

In domestic commercial cases, arbitrators usually will write a reasoned opinion explaining their award if such an opinion is requested by all parties. While some take the position that reasoned opinions detract from finality if they facilitate post-arbitration resort to the courts, parties sometimes desire such opinions, particularly in large, complex cases or as already provided by most applicable rules in international disputes. If the parties want such an opinion, they can include language such as the following in their arbitration clause.

- The award of the arbitrators shall be accompanied by a reasoned opinion.
- The award shall be in writing, shall be signed by a majority of the arbitrators, and shall include a statement setting forth the reasons for the disposition of any claim.
- The award shall include findings of fact [and conclusions of law].
- The award shall include a breakdown as to specific claims.

### **Q. Confidentiality**

While the AAA and arbitrators adhere to certain standards concerning the privacy or confidentiality of the hearings (see the AAA-ABA Code of Ethics for Arbitrators in Commercial Disputes, Canon VI), parties might also wish to impose limits on themselves as to how much information regarding the dispute may be disclosed outside the hearing. The following language might help serve this purpose.

- Except as may be required by law, neither a party nor an arbitrator may disclose the existence, content, or results of any arbitration hereunder without the prior written consent of both parties.

The preceding language could also be modified to restrict only disclosure of certain information (e.g., trade secrets).

### **R. Appeal**

The basic objective of arbitration is a fair, fast and expert result, achieved economically. Consistent with this goal, an arbitration award traditionally will be set aside only in egregious circumstances such as demonstrable bias of an arbitrator. Sometimes, however, the parties desire a more comprehensive appeal, most often in the setting of legally complex cases. Some sample clauses incorporating appeal provision are

- “Notwithstanding any language to the contrary in the contract documents, the parties hereby agree: that the Underlying Award may be appealed pursuant to the AAA’s Optional Appellate Arbitration Rules (“Appellate Rules”); that the Underlying Award rendered by the arbitrator(s) shall, at a minimum, be a reasoned award; and that the Underlying Award shall not be considered final until after the time for filing the notice of appeal pursuant to the Appellate Rules has expired. Appeals must be initiated within thirty (30) days of receipt of an Underlying Award, as defined by Rule A-3 of the Appellate Rules, by filing a

Notice of Appeal with any AAA office. Following the appeal process the decision rendered by the appeal tribunal may be entered in any court having jurisdiction thereof...”

**S. Mediation-Arbitration**

A clause may provide first for mediation under the AAA’s mediation procedures. If the mediation is unsuccessful, the mediator could be authorized to resolve the dispute under the AAA’s arbitration rules. This process is sometimes referred to as “Med-Arb.” Except in unusual circumstances, a procedure whereby the same individual who has been serving as a mediator becomes an arbitrator when the mediation fails is not recommended, because it could inhibit the candor which should characterize the mediation process and/or it could convey evidence, legal points or settlement positions ex parte, improperly influencing the arbitrator. Sample:

If a dispute arises from or relates to this contract or the breach thereof, and if the dispute cannot be settled through direct discussions, the parties agree to endeavor first to settle the dispute by mediation administered by the American Arbitration Association under its Commercial Mediation Procedures before resorting to arbitration. Any unresolved controversy or claim arising from or relating to this contract or breach thereof shall be settled by arbitration administered by the American Arbitration Association in accordance with its Commercial Arbitration Rules, and judgment on the award rendered by the arbitrator may be entered in any court having jurisdiction thereof. If all parties to the dispute agree, a mediator involved in the parties’ mediation may be asked to serve as the arbitrator.