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In Arbitration Agreements, **Critical Provisions** Are Often **Overlooked**

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In negotiating commercial agreements, parties often choose to have any dispute arising out of or relating to the agreement or the transaction resolved by arbitration. Many sophisticated clients, and their lawyers, believe that arbitration is a preferred method of dispute resolution because it is generally perceived to be faster and less formal, and therefore also less expensive, than other forms of litigation. While the decision to arbitrate often makes sense, what is frequently not given adequate attention is the appropriateness to include specific details to help tailor the arbitration remedy in effective and important ways. Topics such as the selection of arbitrators, discovery rights, if any, the nature of the hearing and time limits, just to name a few, are critical matters to address. This article highlights the terms that one should consider addressing at the time the arbitration agreement itself is negotiated, rather than once a dispute arises.

Provisions to Consider

Preliminarily, we note that those agreeing to arbitrate give up potentially important procedural safeguards: In particular, there are very limited rights to judicial review or appeal of an arbitration award.[1] Occasionally, what strikes the parties at the time as an efficient, cost-saving dispute resolution remedy, may be subject to "buyer's remorse" when a dispute actually arises.[2] Although the details of the process cannot substitute for the procedural safeguards that are given up, they can ameliorate the situation and improve the arbitration remedy.

To be sure, parties occasionally will negotiate in painstaking detail the procedures to be followed. However, it is far more common for the parties to insert into the contract a fairly standard dispute resolution clause. Such a clause will provide that any dispute will be settled by binding arbitration, typically conducted before the American Arbitration Association (AAA) or one of the other large, reputable alternative dispute resolution providers, that judgment on the arbitration award may be entered in any court of competent jurisdiction, and may specify the procedure for selecting arbitrators or the location of the hearing.

Relying on a standard arbitration clause, however, misses out on an opportunity to

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tailor the form of the arbitration to the parties' contract and the overall business relationship at issue. Parties may design almost any arbitration procedure that will serve their interests.[3] It is far preferable to address such issues in a time of peace and good feeling than once a dispute has materialized. Once a dispute arises, it is often impossible to agree on any aspect of the arbitration procedure, even ones that objectively would appear to be in both parties' interest. There is no universal, one-size-fits-all solution to drafting an arbitration clause. It may be appropriate to include a particular provision in one agreement, to include the exact opposite term in a different situation and to remain silent on that term in yet other agreements. We proceed below to consider some of these provisions.

Pre-Arbitration Talks

First, parties may wish to include a requirement for pre-arbitration negotiation or mediation as part of their dispute resolution procedure. Such a clause may provide that before an arbitration may be commenced, the party desiring arbitration is required to provide written notice of its dispute to the other party, who shall respond with its position within 10 business days and the parties will attempt to resolve the dispute, either with or without the assistance of a professional mediator, within 10 days thereafter. The advantage of such a procedure is that, if successful, it would eliminate much of the time, expense and distraction of a prolonged dispute or arbitration. The disadvantage is that it may introduce several weeks of delay before the arbitration may be commenced for a process that both sides view as futile. It also adds a procedural hurdle that could form the basis for objection or an issue in the arbitration itself.

The Arbitrators

Second, with respect to the design of the arbitration itself, consideration must be given to the number of arbitrators and method of their appointment. A single arbitrator may be more efficient and makes scheduling and administrative tasks easier. A panel of arbitrators, on the other hand, may be more likely to reach compromise decisions, whether on procedural issues such as discovery disputes or on the ultimate outcome of the arbitration. In the absence of an agreement, AAA practice, for example, is to appoint a single arbitrator to hear disputes involving less than $1 million and to appoint a panel of three arbitrators for any dispute with more than $1 million at stake.

When the agreement addresses the number of arbitrators, parties will often specify a panel of three arbitrators with each party appointing one arbitrator and the two party-appointed arbitrators selecting the third, neutral arbitrator. But with seemingly increasing frequency in domestic arbitrations, parties or their party-appointed arbitrators are unable to agree on the third arbitrator. In those circumstances, the parties must resort to selecting the neutral arbitrator from a list provided by the AAA or another organization, often with each party ranking the candidates from most desirable to least preferred. And in that situation, the neutral arbitrator may de facto become the sole decision-maker. With awareness of the likelihood of such an outcome, parties should consider whether or not the added expense and potential for delay from having a three-person panel is warranted.

When the arbitration agreement provides for party-appointed arbitrators who in turn select the neutral, parties may wish to specify in the arbitration agreement whether, once appointed, the entire panel will act as neutrals or whether ex parte communications are permitted with the party-appointed arbitrators. Some believe that being able to communicate with their party-appointed arbitrators provides greater input and insight into the process, which enables the parties to adjust their cases to respond to concerns of the arbitrators or possibly even to attempt to negotiate a resolution. The neutral arbitrator, however, may be less likely to seek and consider the views of the party-appointed arbitrators if they are partisans. This may mean that the neutral will hesitate to share her own impressions about the case with the party-appointed arbitrators if they are having ex parte communications with the party who appointed them. Thus, in the absence of an agreement, it is not unusual for neutral arbitrators to order that ex parte communications concerning the case must cease upon appointment of the full panel.

In light of the difficulties often faced in selecting arbitrators once a dispute arises, another option parties may wish to consider is naming a specific person as the arbitrator. This is often a preferred method when there is an ongoing contractual relationship (such as in the collective bargaining setting) and the frequency of disputes supports the use of a regular tribunal. In that situation, though, the parties certainly need to specify a procedure for appointing an alternate if the agreed-upon arbitrator turns out to be unavailable for any reason if a dispute arises. As an alternative, the agreement may specify the qualifications of the person to serve as arbitrator—for example, a partner at a Big Four accounting firm or a managing director of an investment bank or financial advisor, or a retired federal or state judge.

Discovery

Third, the parties should consider addressing the scope of discovery to be permitted. One major advantage of arbitration is that discovery is more limited, less time consuming and less costly than litigation. In the absence of an agreement, most arbitrators will direct full exchange of document discovery, comparable to what would be allowed under the Federal Rules of Civil Procedure, but will not permit depositions or other forms of discovery such as interrogatories or requests for admission.[4] Some arbitrators, however, will grant broader discovery, including depositions. If the agreement addresses these points, the uncertainty will be removed. For example, one might agree to a limited number of depositions, such as one or three per side. The parties may also agree on a reasonable amount of time for discovery to be completed, which may also serve to keep discovery more focused and efficient than what might be permitted in a litigation.

Motions

Fourth, is motion practice to be permitted? This is an area where traditional litigation may allow for considerable time and cost savings, if a court action would be subject to resolution on a motion to dismiss or a motion for summary judgment. Some arbi-

trators will entertain such motions, but most will not and will rule after conducting the evidentiary hearings. Thus, parties may want to provide for dispositive motions in their agreement if they can anticipate the kinds of disputes that are likely to arise between the parties. For example, in a dispute over the proper interpretation of a contract, if the contract itself is unambiguous, a judge would be able to rule on the meaning of the contract without holding a trial, and there is no reason to preclude an arbitrator from doing the same.

Hearings

Fifth, the parties should consider the conduct of the hearings themselves. Specifically, it may be desirable to agree in advance whether the evidence presented in the arbitration should be by live examination of witnesses for both their direct and cross-examinations, whether direct testimony will be submitted by affidavit or witness statement followed by the live cross-examination of the witness, or in limited circumstances whether all evidence could be submitted in written form, through affidavits and submission of documents. There are, not surprisingly, additional variations on these possibilities, such as having live direct and cross-examination of fact witnesses, but written expert witness reports followed by live cross-examination of expert witnesses.

The advantage of all live examinations is that it may allow the arbitrators to better assess witness demeanor and credibility. On the other hand, it takes much longer for the arbitrator to listen to the witness testify live on direct examination than it does for the arbitrator to read a written affidavit or witness statement that attaches the relevant documents for the arbitrator's consideration. Live direct examinations potentially also makes it more difficult to prepare for cross-examination of the witness, especially if there has been no provisions for discovery through depositions. Submitting direct testimony by witness statement and then tendering the witness to be cross-examined has its own advantages and disadvantages. Many lawyers, and some arbitrators, believe it is harder for witnesses to get into a comfort zone and to place the testimony in its proper context, when they submitted written testimony and immediately are subjected to cross-examination. In addition, having the witness' affidavit for his direct testimony several days or weeks in advance makes it considerably easier to prepare for cross-examination. It provides ample opportunity for opposing counsel to go through each sentence or each word in the affidavit in detail to search for potential inaccuracies. And, perhaps most significantly, for those who favor written direct testimony, following that approach greatly reduces the amount of time required for live hearings.

Awards

Finally, parties should consider specifying in the arbitration provision the form the arbitration award should take, whether a "standard award" or a "reasoned award." A standard award simply states which party prevailed and the amount of damages, if any, that must be paid. A reasoned award, as the name implies, is one in which the arbitrator explains in detail the reasons for her decision, and can take anywhere from a few pages to 40 or 50 pages or more.

Here, too, there may be advantages and disadvantages to each. A standard award is particularly difficult to appeal or seek to have vacated by a court. Because it does not specify the reasons for the result that was reached, many courts conclude that a standard award should be confirmed and judgment entered if there is any colorable basis for the outcome.[5] With a reasoned award, on the other hand, courts will typically consider whether the specific reasons offered by the arbitrator were "totally irrational" or in "manifest disregard of the law." While this is still a very high standard, it can be more readily attacked and defended with a reasoned award than a standard award. Parties who may become repeat litigants may have other reasons to prefer a standard award. For example, with a standard award there is little risk that an arbitrator will make credibility findings or other comments concerning witness demeanor, relevant facts or legal theories that could have an unwelcome side effect on potential future disputes.

Conclusion

As the foregoing discussion reveals, a full consideration of these issues in the pre-dispute phase can be involved and complicated. It may also prolong negotiation of the arbitration remedy itself. However, at the time the contract is being negotiated, the parties might agree on procedures that would meet both sides' interests in the event of a dispute, but would be more difficult once a dispute has arisen. And, while it is unlikely that any single arbitration agreement would necessarily elect to address every one of these issues, each should be considered in tailoring an appropriate contract for the parties' contractual and business relationships involved.

1. In actions governed by the Federal Arbitration Act, an arbitration award will be vacated only where the arbitrators acted in manifest disregard of the law or where the fairness of the proceedings was infected by bias, corruption or evident partiality of the arbitrator. See, e.g., *Wien & Malkin v. Helmsley-Spear*, 6 N.Y.3d 471, 480, 813 N.Y.S.2d 691, 696 (2006) (recognizing that an award may be vacated on the basis of the arbitrators' "manifest disregard of the law"). Vacatur under New York law is similarly limited, requiring a showing that the award was "totally irrational" or that the arbitrator was biased or corrupted. See, e.g., *Henneberry v. ING Capital Advisors*, 10 N.Y.3d 278, 284, 857 N.Y.S.2d 3, 7 (2008) (interpreting CPLR 7511(b) as justifying vacatur due to an "excess of power" where an award "violates a strong public policy, is irrational or clearly exceeds a specifically enumerated limitation on the arbitrator's power") (quoting *Matter of New York City Tr. Auth. v. Transport Workers' Union of Am., Local 100, AFL-CIO*, 6 N.Y.3d 332, 336, 812 N.Y.S.2d 413, 415 (2005)).

2. Whether to include binding arbitration as a dispute resolution procedure in a contract, or instead to provide for any dispute to be litigated in state or federal court, is one that should be carefully considered in the context of each particular transaction. For cross-border transactions, especially those where one of the parties is from a developing nation, it is widely agreed that binding arbitration before one of the well-regarded international dispute resolution organizations, such as the International Chamber of Commerce, is the most preferable method of dispute resolution. The terms of arbitration agreements for international disputes, which may involve consideration of such issues as choice of language for the arbitration, nationality of the arbitrators, country where the hearings will be held, countries where the arbitration award may be entered and potentially applicable multi-lateral and bilateral arbitration treaties, are likewise beyond the scope of this article.

3. The primary exception is that parties may not contractually agree to an expanded scope of judicial review of an arbitration award. See *Hall Street Associates v. Mattel*, 552 U.S. 576 (2008).

4. Most arbitrators will require expert witnesses to provide expert witness reports, as well as disclosure of their qualifications and prior service as an expert.

5. See, e.g., *STMicroelectronics, N.V. v. Credit Suisse Securities (USA)*, 648 F.3d 68, 78 (2d Cir. 2011).