DRAFTING AN ARBITRATION CLAUSE

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Dear Colleague:

You have asked me to suggest a model arbitration clause — preferably, a clause that can be used in all kinds of commercial contracts, in both domestic and international transactions.

There is good news and bad news.

The bad news is that there really is no one clause that will fit all contract situations.

The good news is that there is a logical process that you can follow to produce a good, serviceable clause — one that you will probably be able to use frequently again to provide a framework for the arbitration clauses that you draft in the future.

I suggest, in brief, that you start the drafting process with a simple model clause from one of the major arbitration institutions. You should then ask and answer a series of questions. Depending on the answers, you will probably want to add to, or perhaps subtract from, the language of the model clause.

The questions that I suggest you ask are listed more or less in the order of their importance — first, questions that are unavoidable; next, questions that (depending on the circumstances) could make the difference between a satisfactory and an unsatisfactory arbitral proceeding; and, finally, questions of procedure that could be important, but that are less likely to make or break an arbitration.

The process that I suggest takes some thought. Once you have carefully completed the process for one contract, however, you will have made decisions and will have drafted language that can serve as a starting point for future contracts — although you must keep in mind that, as circumstances change, your clause may also require changing.

Here's what I recommend.

1. *Start With A Model Clause*

Don't be creative, not just yet. Use something off-the-shelf. The following, which is based for the most part on the United Nations Commission on International Trade Law (UNCITRAL) model clause, is a good model to start with:

> Any dispute, controversy or claim arising out of or relating to this contract, or the breach, termination or invalidity thereof, shall be settled by arbitration in accordance with the _____ Arbitration Rules as at present in force. [The appointing authority shall be _____.] The number of arbitrators shall be _____. The place of arbitration shall be _____. [The language to be used in the arbitral proceedings shall be _____.] [Judgment on the award may be entered in any court having jurisdiction.]

When you have gone this far, you have already answered the first and most fundamental of your questions:

> **Do the parties want litigation or arbitration as the tie breaker if a dispute arises?**

The model clause will legally bind the parties to arbitration. It would be possible, alternatively, to provide for the resolution of disputes through litigation in a selected judicial forum. And, of course, it is possible for a contract to say nothing at all about dispute resolution. In that case, the parties by their silence have elected litigation as the tie breaker, in a court that one or the other will pick after a dispute arises, but that neither can predict in advance.

2. *Fill in the blanks in the model clause and deal with the bracketed sentences.*

In the course of doing this, you will necessarily ask and answer the following important questions:

(a) Should all disputes related to the contract be subject to arbitration? In addition to breach of contract, what about:

- Fraud in the inducement of contract?

- Antitrust (including Sherman Act) claims related to the contract?
- RICO claims related to the contract?
- Tort claims related to the contract?

A U.S. court, asked to enforce the suggested model arbitration clause, would probably hold that the broad language of the first sentence encompasses all such disputes. The courts of some other nations might not read the clause as broadly. Most courts would construe the clause more narrowly if it referred only to disputes "under" the contract.

(b) What arbitral rules will apply?

Commonly selected rules include, among others, the rules of the American Arbitration Association (AAA) (either the AAA's Commercial Rules or its more up-to-date International Rules); the International Chamber of Commerce (ICC); the London Court of International Arbitration (LCIA); UNCITRAL; and the CPR Institute for Dispute Resolution. All of these rules are well tested and satisfactory. They differ in important particulars, however, and the differences will affect your decisions on the language to be included in your arbitration clause.

(c) Will the arbitration be administered by an institution?

Arbitrations under the AAA, ICC and LCIA rules are administered by those institutions, which charge fees for their services. Arbitrations under the UNCITRAL and CPR rules are administered only by the parties and the arbitrators, unless the parties agree that an institution will administer the arbitration.

(d) How many arbitrators will there be?

If the parties fail to specify, the number will be determined by the administering institution or will be fixed by the terms of the chosen arbitral rules. In international arbitrations the usual number is three.

(e) Who will serve as appointing authority?

The role of an "appointing authority" is to name arbitrators if the parties fail to do so, and to consider challenges to arbitrators based on alleged lack of impartiality or independence. If the parties have chosen AAA, ICC, LCIA or CPR arbitration, those functions will be performed by the chosen institution. If they have chosen the UNCITRAL rules (which do not name an appointing authority in advance), the parties should designate an appointing

authority. Thus, if the parties have selected the UNCITRAL rules, they should use the first of the bracketed sentences in the model clause. Otherwise the sentence should be deleted. The AAA, ICC, LCIA and CPR Institute are among the institutions that may be named as appointing authority for UNCITRAL arbitrations.

(f) Where will the arbitration be held?

The arbitration will be held at the place the parties designate. If they fail to designate, a place will be chosen (pursuant to the governing procedural law or arbitral rules) by an arbitral institution, the arbitrators or a court. The choice of place is too important, however, to be left uncertain. The choice of place can greatly influence arbitral procedures and the enforceability of an arbitral award, and can determine the extent to which the courts may assist or interfere with the arbitration. Good practice demands that the place of arbitration be stated in the arbitration clause. The place should be one whose laws are hospitable to arbitration. In an international transaction, the place of arbitration should a nation that has ratified the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards or the comparable Inter-American Convention.

Some drafters use "home and home" clauses. These provide that, if one party starts an arbitration, the arbitration will be held in the other party's country. Such clauses may produce mischievous results. For one thing, an unwary party who agrees to such a clause may find, when he or she wishes to assert a claim, that he or she must either proceed in an unfamiliar place under procedural laws that may be unfavorable, or else abandon his or her right to relief.

(g) What procedural law will govern the arbitration?

Except in rare circumstances, the law of the place of arbitration governs procedures — including such matters as the interpretation, validity and enforcement of arbitration agreements, interim judicial relief, discovery and appeals of awards. In the United States, this generally means that the Federal Arbitration Act and judicial decisions under that Act govern. State laws also play a role in the United States and other federal systems. In the United States, federal law preempts inconsistent state law in international and interstate transactions.

(h) What will be the language of the arbitration?

Unless the answer is clear from the circumstances, it is best for the parties to specify a language. The second of the bracketed sentences in the model clause may be used. If the parties do not choose the language or languages, the arbitrators will.

(i) Will the award be enforceable in courts in the United States and elsewhere?

Assuming the dispute was arbitrable and within the arbitrators' jurisdiction, and that the arbitration proceedings were fair, the courts of most nations are required by their national laws to enforce awards rendered in their own territories, and by international conventions to enforce awards rendered in other countries. If the clause covers an interstate transaction in the United States, the last of the bracketed sentences in the model clause should be used to satisfy a requirement of the Federal Arbitration Act.

3. *Consider additional key questions that could make or break an arbitration.*

It is not necessary to deal expressly in the arbitration clause with all of the additional questions that are noted below. The answers to many will be found in the governing procedural law, or in the rules chosen. If they are not, however, or if you find any of the answers unsatisfactory, you should deal with the most important of these additional questions in terms that you add to the arbitration clause. You may also want to call the parties' attention to important provisions of the chosen rules by including some of those provisions in the language of the clause. This is not legally necessary, but it can provide helpful guidance to parties who may not have copies of the relevant laws or rules instantly available to them when they refer later to the arbitration clause.

Some questions that, depending on the circumstances, could involve "make-or-break" issues are set out below.

(a) How will arbitrators be selected?

The governing rules will describe how arbitrators are to be chosen. All major rules, however, give the parties the right to vary the rules and to design their own procedures for choosing arbitrators. If there are three arbitrators, it is generally advantageous for each party to be able to name one member of the panel. Thus, under most rules, if there are to be three arbitrators and if the parties have not specified the method of their selection, each party is permitted to appoint one. If parties choose the AAA Commercial or International Rules, however, and if they wish each party be able to appoint one of three arbitrators, they must expressly agree to that procedure.

(b) Must the arbitrators be neutral?

Yes, under most rules. Under the AAA Commercial Rules, however, an arbitrator appointed unilaterally by one party need not be neutral, and is not

expected to be, unless the parties have so agreed. The common practice, especially in international transactions, is for the parties to agree, where the rules do not so provide, that all arbitrators shall be neutral.

(c) What will be the governing substantive law?

The parties may choose the governing law and should do so. If the parties do not select the governing law, the arbitrators will make the choice, applying choice-of-law rules that may not be knowable in advance. The governing substantive law need not be that of the place of arbitration. Typically, it is not. If the parties agree, as they are free to do, that the arbitrators shall decide under general principles of fairness (*ex aequo et bono*), regardless of legal rights, the outcome becomes more difficult to predict. For parties seeking to vindicate legal rights, or to negotiate settlements based on an analysis of legal rights, such uncertainty is not a good thing.

(d) What discovery (production of documents, interrogatories, depositions) will be possible?

The answer depends, first, on what the parties agree. If they say nothing, their rights to discovery will depend principally on the governing procedural law and, to a lesser degree, on the chosen rules. The laws of the United States and England give arbitrating parties the right to discovery of relevant documents, although not the same wide discovery as under the Federal Rules of Civil Procedure. In the United States, arbitrators, as well as the courts, may order discovery from non-parties as well as parties.

(e) What statute of limitations, if any, applies?

Unless the parties expressly agree, the answer will not be clear in most cases. Generally speaking (arbitrations under the English Arbitration Act of 1996 are an exception), one can not assume that a state or national statute of limitations on law suits will automatically apply. Parties that wish more certainty may provide that arbitrations must be brought within a specific period after a claim arises; or they may incorporate by reference the limitations period of the laws of a stated jurisdiction.

(f) May damages include pre-award interest?

If the parties do not agree on this point, the governing substantive law may answer the question for them. Typically, however, if the parties have not agreed, the award of pre-award interest is a matter left to the discretion of the arbitrators.

(g) In addition to monetary damages, what relief may the arbitrators award? e.g.:

- Injunctions
- Punitive damages
- Specific performance.

The governing procedural law or the chosen arbitration rules may answer this question. If they do not, and if the parties foresee a need for the arbitral award to provide relief other than money damages, they should specifically authorize the arbitrators to grant such additional forms of relief.

(h) Do the parties wish to limit the powers of the courts to review awards?

If the arbitration is in the United States, U.S. courts will have only limited powers under the Federal Arbitration Act to review arbitral awards. U.S. courts will not set awards aside for errors of fact or law (generally speaking, the arbitrators' decisions of fact and law are final), but they may set awards aside on such grounds as the arbitrators' lack of jurisdiction or fundamental unfairness in the arbitration proceeding. It is unlikely that the parties, by agreement, can further restrict this limited power of judicial review in the United States. Some U.S. courts (in decisions of questionable validity) have held, however, that the parties by agreement may expand the scope of judicial review.

Courts in other countries have similar powers to review awards rendered in their countries. These powers vary from country to country. In some countries, national law permits parties who are non-nationals to limit judicial review by agreement. In an arbitration in England, Switzerland or Belgium between parties who are not nationals of, or based in, the host state, the parties can — by use of an "exclusion agreement" in their contract — opt out of all or nearly all judicial review in the host country.

If enforcement of an award is sought outside the country where the award was made, the enforcing court will have the power under national law and international convention to review awards against similar standards — such as fairness, the arbitrators' jurisdiction, and public policy — and to refuse to enforce the awards if they fail to meet those standards.

(i) May an arbitration under the contract be consolidated with related arbitrations under other contracts?

Unless all of the parties have agreed to consolidation, the courts in nearly every major jurisdiction consider themselves to be without power to order consolidation of arbitrations that arise under separate contracts. (The Netherlands, by statute, is an exception to this rule, as are Massachusetts and Florida, in different ways.) Consequently, where a single venture or transaction involves multiple parties or more than one contract, the drafters of the contracts must seriously consider including clauses in each of the contracts that permit the consolidation of arbitrations of disputes between more than two parties or under more than one contract.

The issue is both important and recurrent. For example, a building owner may claim that a prime contractor did not properly perform a contract; and the prime contractor may claim that a subcontractor caused the problem. The dispute under the prime contract (between the owner and the prime) and the dispute under the subcontract (between the prime and the subcontractor) involve a common party, and both may turn on the same material facts or questions of law. It ought to be possible, as it would be in litigation, to consolidate the arbitration of a dispute under the prime contract with the arbitration of a related dispute under the subcontract. Otherwise, there could be inefficiency, and the two separate proceedings could produce inconsistent results. Consolidation of the arbitrations will generally not be possible, however, unless all parties have agreed to it.

The same issue arises in other multiparty arrangements, such as: vessel owner, charterer and shipper; purchaser, contractor and guarantor; and joint ventures and a party contracting with the joint venture.

Drafting language to provide for the consolidation of related arbitrations is not simple. The consolidation provision should address the following issues:

- To what contracts may the consolidation procedures apply?
- Under what circumstances may arbitrations be consolidated?
- Who decides which arbitrations are to be consolidated?
- How many arbitrators will there be in the consolidated arbitration, and how will they be selected?
- What procedures will apply in the consolidated arbitration?

- Will an award in the consolidated arbitration be binding on parties that elect not to participate in the consolidated arbitration?

4. *Consider supplementing the arbitral rules with additional procedural provisions.*

Review the rules and the relevant procedural law with other procedural questions in mind. If the rules and laws do not provide an answer, if you are not satisfied with the answer you find, or if you simply wish to call attention to particular provisions in the rules by stating them in the arbitration clause, you may want to add a sentence or two to the arbitration clause. Here are some of the questions you may want to consider:

(a) Should the parties be required to negotiate, or to attempt mediation or another form of ADR, before commencing arbitration?

It is common for an arbitration clause to provide that no claim may be filed in arbitration until the parties have made a good faith effort to settle their dispute by agreement through some form of Alternative Dispute Resolution. Such a provision may or may not turn out to be helpful when a dispute arises. Some disputes may not be ripe for ADR at the outset. And even without such a provision, the parties are always free at any time to agree to try to resolve their dispute through negotiation, mediation or the like. The provision does, however, at least commit them in advance to try.

(b) Must the arbitrators have any special qualifications?

Generally, the rules permit the parties to prescribe qualifications for arbitrators. The ICC and LCIA rules limit appointments of arbitrators of the same nationality as one of the parties. Sometimes parties require arbitrators to have certain technical expertise. Expertise as an arbitrator is generally the most important qualification, however. Excessively demanding or vague statements of qualifications may invite efforts to have arbitrators declared disqualified.

(c) Will there be a pre-hearing conference?

A pre-hearing conference, to identify the issues in dispute and to establish procedures, is generally a good idea. All major rules permit them, and most arbitrators favor pre-hearing conferences whether or not the parties have agreed to one in advance. The ICC requires a comparable pre-hearing process to define the "terms of reference" that will govern the arbitration.

(d) Will there be a hearing?

Yes, under all rules, if either party wants one. No, if the parties so agree.

(e) Will evidence and argument be submitted in advance of the hearing?

It depends on what the parties agree or the arbitrators order.

(f) What rules of evidence will apply?

Generally, arbitrators will admit most proffered evidence "for what it's worth." It is possible for the parties to agree in advance on more clearly defined rules of evidence.

(g) Will witnesses be subject to cross-examination?

In the United States, a right to cross-examine may exist under state law. Cross examination is the general practice in common law jurisdictions. It is less common elsewhere.

(h) May the arbitrators appoint experts of their own choosing to advise them?

Most rules (the AAA Commercial Rules are an exception) permit arbitrators to appoint their own experts. The parties may see the experts' reports and question the experts at the hearing. Parties that wish to avoid the appointment of experts by the tribunal are free to accomplish this through appropriate language in their arbitration clause.

(i) Before the arbitration or while an arbitration is pending, may the parties seek interim relief, e.g., attachments of property, preliminary injunctions, from the courts?

Generally, yes, under national procedural law and arbitral rules, but there are exceptions and uncertainties. In at least one U.S. Circuit (the Third), the courts hold that, after they have referred an international dispute to arbitration under the New York Convention, they are without power to provide further judicial assistance in support of the arbitration while it is ongoing. Parties that wish to be sure they can apply to the courts for interim relief before and during arbitrations should consider one or more of the following: (1) provide in the arbitration clause that the parties consent to interim measures; (2) select arbitration rules (e.g., UNCITRAL, ICC, AAA International, CPR) that expressly authorize applications to the courts for

interim judicial relief; (3) avoid jurisdictions where the courts have shown themselves reluctant to grant interim relief.

(j) Will arbitral proceedings and awards be confidential?

Generally, yes — but check the rules to be sure. Where the rules are silent or incomplete, the parties may wish to agree expressly on confidentiality.

(k) Must the award include a statement of reasons?

Generally, yes — but not under the AAA Commercial Rules, unless the parties otherwise agree.

(l) In what currency will an award be paid?

The arbitrators will decide, unless the parties specify.

(m) How will the costs of arbitration be apportioned?

The rules or the governing arbitration law will likely provide some guidance, but will give the arbitrators wide discretion. Parties may wish to provide more specific guidance in their arbitration clause.

(n) How will the arbitrators' fees be determined?

The AAA, ICC and LCIA fix arbitrators' fees in accordance with their rules, or at least provide guidance, in their rules and through informal consultations, to arbitrators who fix their own fees. The parties may wish to agree at the beginning of an arbitration on their own guidelines for fixing arbitrators' fees, particularly if they choose not to use an arbitral institution to administer the arbitration. If the rules are silent, and if the parties do not otherwise agree, the arbitrators will fix their own fees.

(o) Should the arbitrators be required to complete the arbitration within a fixed period of time?

If the chosen rules do not fix a deadline, such a provision may be a good idea, especially if there is no arbitral institution to help motivate the arbitrators to do their work efficiently. You had better include an escape clause, however — such as a provision that the arbitrators may extend the time for cause. If there is no escape clause and the arbitrators miss their deadline, their award, when finally made, could be deemed unenforceable as contrary to the parties' agreement.

(p) Should there be a "performance to continue during arbitration" clause?

Some drafters borrow this concept from the standard U.S. Government contract disputes clause, and provide that the parties are to continue contract performance notwithstanding the pendency of a dispute. The concept can be particularly useful in construction contracts.

5. *Do Not Be Afraid To Ask For Help.*

Don't think you have to do the legal research necessary to answer all of the foregoing questions. The research has already been done by others. Talk to staff members of arbitral institutions and practitioners in relevant jurisdictions. Keep their institutional or home town biases in mind, however, when you evaluate what they tell you.

And, please, feel free to call me. We should be able to run through the pertinent questions in a fairly quick phone call, and to agree without much difficulty on what your clause should contain.

With best regards,

Markham Ball

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