PDHonline Course P101 (4 PDH)

Alternate Dispute Resolution

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MODULE #4

ADR Clauses

Every year, millions of business contracts provide for mediation and arbitration as ways of resolving disputes. A large number provide for administration by the American Arbitration Association, a public-service, non-profit organization offering a broad range of dispute resolution services throughout the United States. Hearings are usually held at locations convenient for the parties.

Typically, the parties' agreement to mediate or arbitrate is contained in a future-disputes clause in their contract. The clause may provide that any disagreement will be resolved under the Mediation or Arbitration rules of the American Arbitration Association or some other ADR institution.

The first section of this module contains a brief checklist of some of the more important elements a contracting officer should keep in mind when drafting or adopting any dispute resolution clause, no matter how basic. The second section describes clauses that may be appropriate for use in a general commercial setting, and which meet different needs and concerns in such a context.

A CHECKLIST for the DRAFTER

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 unaddressed. Issues such as when, where, how, and before whom a dispute will be arbitrated are all subject to disagreement. Once a controversy has arisen, there is no way to resolve them except to go to court. This defeats the whole purpose of ADR. Some of the more important elements a contracting officer should keep in mind when drafting, adopting, or recommending dispute resolution clauses are:

1. The clause might cover only certain types of disputes that may arise or all disputes.
2. It could specify only arbitration – giving a binding result – or provide an opportunity for non-binding negotiation or even mediation.

3. The arbitration clause should be signed by as many potential parties to a future dispute as possible.
4. To be fully effective, "entry of judgment" language in domestic cases is important.
5. It is normally a good idea to state whether a panel of one or three arbitrators is to be selected, and to include the place where the arbitration will occur.
6. If the contract includes a general choice of law clause, it may govern the arbitration proceeding. The consequences of this should be considered.
7. If the parties wish to exclude punitive damages, they should specifically so state, otherwise, the arbitrators may have the power to award these types of damages.
8. The parties are free to customize and refine the basic arbitration procedures to meet their needs. If the parties agree on a procedure that conflicts with other rules, usually the wishes of the parties will prevail.

CLAUSES APPROVED by THE AMERICAN ARBITRATION ASSOCIATION for GENERAL COMMERCIAL USE

Arbitration

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):

STD 1 Any controversy or claim arising out of or relating to this contract, or the Arbitration of breach thereof, shall be settled by arbitration administered by the American Arbitration Association in accordance with its Commercial [or other Arbitration Rules] and judgment of the award rendered by the arbitrator(s) may be entered in any court having jurisdiction thereof.

Arbitration of existing disputes may be accomplished by use of the following:

STD 2 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 preceding clauses, which refer to the time-tested rules of the AAA, have consistently received judicial support. The standard clause is often the best to include in a contract. By invoking the AAA's rules, such a clause meets the following requirements of an effective arbitration clause:

1. It makes it clear that all disputes are subject to arbitration.
2. It is self-enforcing. Arbitration can continue despite an objection from a party,
3. It provides a complete set of rules and procedures. This eliminates the need to spell out dozens of procedural matters in the parties' agreement.
4. 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. Under the AAA rules, a procedure is available to disqualify an arbitrator for bias.
5. It settles disputes over the locale of proceedings. When the parties disagree, locale determinations are made by the AAA as the administrator, precluding the need for intervention by a court.
6. It makes possible administrative conferences.
7. It makes available preliminary hearings. If the clause provides for AAA rules, a preliminary hearing can be arranged in large and complex cases to specify the issues to be resolved, clarify claims and counterclaims, provide for a pre-hearing exchange of information, and consider other matters that will expedite the arbitration proceedings.
8. It also makes mediation available. If the clause provides for any of the AAA's various rules.
9. It establishes time limits to ensure prompt disposition of contested issues. An additional feature of the various AAA rules is a special Expedited Procedure, which may be used to resolve smaller claims and other disputes which need a speedy resolution.
10. It provides for AAA administrative assistance to the arbitrator and the parties. To protect neutrality and avoid unilateral contact, most rules provide for the AAA to channel communications between the parties and the arbitrator. An AAA administrator may also provide guidance to help ensure a prompt conclusion of a proceeding.
11. It establishes a procedure for serving notices. Depending on the rules used and the type of the case, notices may be served by regular mail, addressed to the party or its representative at the last known address. Under the rules, the parties may use facsimile transmission, telexes, telegrams, or other written forms of electronic communication to give the notices.

12. Unless otherwise provided, it gives the arbitrator the power to decide matters equitably and to fashion appropriate relief. The AAA Commercial Rules allow the arbitrator to grant any remedy or relief that the arbitrator deems just and equitable and within the scope of the agreement of the parties, including specific performance.
13. It allows ex-parte hearings. A hearing may be held in the absence of a party who has been given due notice. Thus, a party cannot avoid an award by refusing to appear.
14. It provides for enforcement of the award. The award can be enforced in any court having jurisdiction, with only limited statutory grounds for resisting the award. If, in a domestic transaction, as distinguished from an international one, the parties desire that the arbitration clause be final, binding, and enforceable, it is essential that the clause contain an "entry of judgment" provision such as that found in the standard arbitration clause ("and judgment on the award rendered by the arbitrator may be entered in any court having jurisdiction thereof").

Negotiation

The parties may wish to attempt to resolve their disputes through negotiation prior to arbitration. A sample of a clause that provides for negotiation follows:

NEG 1 In the event of any dispute, claim, question, or disagreement arising from or relating to this agreement or the breach thereof, the parties hereto shall use their best efforts to settle the dispute, claim, question, or disagreement. To this effect, they shall consult and negotiate with each other in good faith and, recognizing their mutual interests, attempt to reach a just and equitable solution satisfactory to both parties. If they do not reach such a solution within a period of 60 days, then, upon notice by either party to the other, all disputes, claims, questions, or differences shall be finally settled by arbitration administered by the American Arbitration Association in accordance with the provisions of its Commercial Arbitration Rules.

Mediation

The parties may wish to attempt mediation before submitting their dispute to arbitration. This can be accomplished by referring to mediation (which may be

terminated at any time by either party) in the arbitration clause.

MED 1 If a dispute arises out of or relates to this contract, or the breach thereof, and if the dispute cannot be settled through negotiation, the parties agree first to try in good faith to settle the dispute by mediation administered by the American Arbitration Association under its Commercial Mediation Rules before resorting to arbitration, litigation, or some other dispute resolution procedure.

MED 2 The parties hereby submit the following dispute to mediation administered by the American Arbitration Association under its Commercial Mediation Rules [the clause may also provide for the qualifications of the mediator(s), the method for allocating feed and expenses, the locale of meetings, time limits, or any other item of concern to the parties].

It is prudent to include time limits on steps prior to arbitration. Under a broad arbitration clause, the question of whether a claim has been asserted within an applicable time limit is generally regarded as an arbitral issue, suitable for resolution by the arbitrator.

The Large, Complex Case Program

The Large, Complex Case Dispute Resolution Program is designed primarily for business disputes involving claims of at least $1 million, although parties are free to provide for use of the "LCCP" Rules in other disputes. The key elements of the program are (1) selection of arbitrators who satisfy rigorous criteria to ensure that the panel is an extremely select one, (2) training, orientation, and coordination of arbitrators in a manner designed to facilitate the program; (3) establishment of procedures for the administration of those cases that elect to be included in the program; (4) flexibility of those procedures so that parties can more speedily and efficiently resolve their disputes.

The procedures provide for an early administrative conference and a preliminary hearing with the arbitrators. Documentary exchanges and other essential exchanges of information are facilitated. The procedures also provide that a statement of reasons may accompany the award, if requested by the parties. The procedures are meant to supplement the applicable rules that the parties have agreed to use. They include the possibility of the use of mediation to

resolve some or all issues at an early stage. The parties can provide for future application of the procedures by including the following arbitration clause in their contract:

LCCP 1 Any controversy or claim arising from or relating to this contract or the breach thereof shall be settled by arbitration administered by the American Arbitration Association under its [applicable] Arbitration Rules and the Supplementary Procedures for Large, Complex Disputes, and judgment on the award rendered by the arbitrator(s) may be entered in any court having jurisdiction thereof.

LCCP 2 We, the undersigned parties, hereby agree to submit to arbitration administered by the American Arbitration Association under its [applicable] American Arbitration Association under its [applicable] Arbitration Rules and the Supplementary Procedures for Large, Complex Disputes and following controversy [describe briefly]. Judgment of any court having jurisdiction may be entered on the award.

OTHER PROVISIONS to be CONSIDERED

This section contains various provisions which expand upon and are supplemental to the basic dispute resolution clauses. The listing of such provisions is not intended to be all-inclusive. Some drafters will choose to expand their dispute resolution clauses to reflect at least some of these ideas. Since it is important that practitioners be well informed when making choices in drafting, the section also sets forth, where appropriate, certain of the pros and cons of adopting the various supplemental provisions.

1. **Specifying a Method of Selection and the Number of Arbitrators-** Arbitrators are generally selected using a listing process. The AAA case administrator provides each party with a list of proposed arbitrators who are generally familiar with the subject matter involved in the dispute. Each side is provided a few days to strike any unacceptable names, number the remaining names in order of preference, and return the list to the AAA. The case administrator then invites persons to serve from the names remaining on the list, in the designated order of mutual preference. If the parties do not agree on the number of arbitrators, it will be left to the discretion of the AAA case administrator.

The parties may use other arbitrator appointment systems, such as the party-appointed method in which each side designates one arbitrator and the two thus selected appoint the chair of the panel. This method is not recommended because the use of party-appointed arbitrators can delay the process, produce compromise awards or deadlocks, and create an effective neutral arbitration. One way to address those problems is to agree that any party-appointed arbitrators serve in a completely neutral capacity.
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, from a timing standpoint. All of these issues and others can be dealt with in the arbitration clause. Some illustrative provisions follow.

ARBSEL 1 The arbitrator selected by the claimant and the arbitrator selected by the 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.

ARBSEL 2 Within 15 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. 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.

ARBSEL 3 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 procedure fail for any reason, "arbitrators shall be appointed as provided in the AAA Commercial Arbitration Rules."

2. 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:

QUAL 1 The arbitrator shall be a certified public accountant.

QUAL 2 The arbitrator shall be a practicing attorney [or a retired judge] [of the [specify] Court].

QUAL 3 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.

QUAL 4 The panel of three arbitrators shall consist of one contractor, one architect and one construction attorney.

QUAL 5 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.

QUAL 6 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.

3. 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.

An example of locale provisions that might appear in an arbitration clause:

LOC 1 The place of arbitration shall be [city], [state], or [country].

4. **Governing Law-**
It is common for parties to specify the law that will govern the contract and/or the arbitration proceedings. Some examples follow:

GOV 1 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.

GOV 2 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.

GOV 3 This contract shall be governed by the laws of the state of [specify].

5. **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 condition's 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:

CONPRE 1 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 Rules 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.

6. **Document Discovery-**

Under the AAA Rules, arbitrators are authorized to direct a pre-hearing 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.

DOC 1 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 completed within [45] [60] days following the appointment of the arbitrator(s).

7. **Depositions-**

The AAA does not encourage depositions and generally (except as may be provided by local statutes), arbitrators do not have authority to order depositions. Generally, arbitrators prefer to hear and be able to question witnesses at a hearing. 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 a 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:

DEP 1 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], to a maximum of [three hours] [one day's] duration. All objections are reserved for the arbitration hearing except for objections based on privilege and proprietary or confidential information.

9. Duration of Arbitration Proceeding-

While AAA Commercial Arbitration Rules normally provide for an award within 30 days of the closing of the hearing, 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 was 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:

TIME 1 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.

10. Assessment of Attorney's 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 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. Some typical language dealing with fees and expense follows:

FEE 1 The prevailing party shall be entitled to an award of reasonable attorney fees.

FEE 2 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.

FEE 3 Each party shall bear its own costs and expenses and an equal share of the arbitrators' and administrative fees of arbitration.

FEE 4 The arbitrators may determine how the costs and expenses of the arbitration shall be allocated between the parties, but they shall not award attorney's fees.

11. Reasoned Opinion Accompanying the Award-

In domestic cases, arbitrators usually will not write a reasoned opinion explaining their award unless such an opinion is requested by all parties. While reasoned opinions can detract from finality if they facilitate post-arbitration resort to the courts, parties sometimes desire such opinions, particularly in large complex cases. If the parties want such an opinion, they can include language such as the following in their arbitration clause:

OPIN 1 The award of the arbitrators shall be accompanied by a reasoned opinion.

OPIN 2 The award shall be in writing, shall be signed by a majority of the arbitrators, and shall include a statement regarding the reasons for the disposition of any claim.

OPIN 3 The award shall include findings of fact.

OPIN 4 The award shall include a breakdown as to specific claims.

11. Confidentiality-

While the confidentiality of the hearings is protected by AAA rules and the arbitrators are expected to adhere to ethical standards concerning confidentiality, 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.

CONF 1 Except as may be required by law, neither a party nor an arbitrator May disclose the existence, or results of any arbitration hereunder without the prior written consent of both parties. The preceding language could also be modified to restrict only the disclosure of certain information (e.g., trade secrets).

12. Appeal-

The basic objective of arbitration is a fair, fast and expert result, achieve economically. Consistent with this goal, an arbitration award traditionally will be set aside only in egregious circumstances such as the demonstrable bias of an arbitrator. Sometimes, however, the parties desire a more comprehensive appeal, most often in the setting of legally complex cases. Providing a mechanism for such an appeal almost assures that the losing party will use it. While parties can attempt to provide for an appeal in the court system pursuant to traditional standards of court review, the authority is mixed as to whether courts will accept appeals from arbitration on such a basis. Another approach is to provide for an appeal to another panel of arbitrators who would apply whatever standard of review the parties might specify. Set forth below is an example of arbitration clause language providing for this latter type of appeal.

APP 1 Within 30 days of receipt of any award (which shall not be binding if an appeal is taken), any party may notify the AAA of an intention to appeal to a second arbitral tribunal, constituted in the same manner as the initial tribunal. The appeal tribunal shall be entitled to adopt the initial award as its own, modify the initial award or substitute its own award for the initial award. The appeal tribunal shall not modify or replace the initial award except [for manifest disregard of law or facts]

[for clear errors or law or because of clear and convincing factual errors]. The award of the appeal tribunal shall be final and binding, and judgment may be entered by a court having jurisdiction thereof.