Inside Counsel

4 considerations for corporate counsel in drafting arbitration clauses

A party should negotiate the dispute resolution clause with an eye toward ensuring that it is best positioned in the event a dispute does arise

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Complex cross-border transactions often become complex cross-border disputes. Making the right choices in drafting arbitration clauses can impact not only the outcome of a dispute, but also the time and money spent resolving the dispute and the enforceability of an award. Yet, the dispute resolution clause is too often neglected. Occasionally, a party falls prey to outdated clauses passed down from one contract to the next without tailoring it to the transaction at hand or the nature of a potential dispute. Discussed below are important factors to consider in drafting arbitration clauses so that if a dispute arises, your client is best positioned to obtain a favorable resolution.

1. Negotiating a corporate "prenup"

Neuro and social scientists have established that human beings are on the whole innately optimistic. The "optimism bias" leads people to miscalculate the odds of everything from getting cancer to a divorce. Few enter into marriage with the expectation of divorcing a few years later. Yet, statistics show that many marriages fall short of "happily ever after." Likewise, sophisticated parties entering into cross-border agreements focus on the promise of the transaction and the business relationship being built while ignoring, like newlyweds, the possibility that the business relationship might sour. Just as prenuptial agreements protect assets during a divorce, a well-drafted dispute resolution provision protects a party's business interests should a dispute arise.

However, like negotiations over a prenuptial agreement, the process of negotiating a dispute resolution clause can, by itself, lead to conflict. A party that aggressively negotiates a dispute resolution clause may be perceived as expecting a dispute, lacking commitment to the deal, doubting the other party's trustworthiness or being a contentious business partner. As such, it may not be in the best interest of the business relationship to aggressively negotiate the dispute resolution clause. Negotiations also may be hampered by unequal negotiating power. Nevertheless, to the maximum extent possible, a party should carefully consider and negotiate the language of the dispute resolution provision prior to entering a cross-border contract.

2. Gaze into the crystal ball

A party to a contract is well advised to anticipate what potential disputes might arise during the life of the contract, and which side of a dispute it is most likely to be on. For instance, in a contract for the sale and purchase of goods, the seller might be sued for failing to provide the promised goods or failing to meet quality specifications. The purchaser might be sued for failing to pay for the goods. A party should assess the likelihood that it will be the claimant or the respondent, which could affect the preferable amount and type of discovery. How much money is likely to be at issue should a dispute arise? That might determine the most appropriate procedures to adopt, such as the number of arbitrators, the extent of discovery and the number and timing of pretrial hearings. Consider whether a dispute will turn on issues requiring an arbitrator with specific expertise or qualifications. Selection of the seat of the arbitration is also important because the law of the seat generally governs the bases for vacatur of an award. The law of the seat also governs arbitration procedures not addressed by the parties' agreement or any institutional rules adopted by the parties. While it is impossible to predict every kind of dispute that might arise, analyzing the most likely types of disputes can help determine which elements should be included in an arbitration clause.

3. Simple is beautiful

When in doubt or where extensive negotiations are not feasible, adopting a simple model clause promulgated by a leading arbitral institution is generally a safe approach. Model clauses are extensively used and tested and are understood by experienced arbitrators. The more a contract's language deviates from a model clause, the more that can go wrong when it comes time to interpret and implement the clause.

Model clauses typically include a broad agreement to arbitrate all disputes arising under the contract, incorporate institutional rules and prompt the parties to identify the law governing the contract, the seat of the arbitration, the number of arbitrators and the language of the arbitration. For example, the International Chamber of Commerce (ICC) model clause provides:

All disputes arising out of or in connection with the present contract shall be finally settled under the Rules of Arbitration of the International Chamber of Commerce by one or more arbitrators appointed in accordance with the said Rules.

The parties may also wish to stipulate in the arbitration clause:

- 'the law governing the contract;
- 'the number of arbitrators;
- 'the place of arbitration; and/or
- 'the language of the arbitration.

The International Centre for Dispute Resolution has similar language and recommended provisions. The institution's rules and the law of the arbitral seat provide procedures not expressly addressed in the arbitration clause. For example, the ICC rules provide procedures for, among other things, appointing arbitrators, initiating arbitration, joinder of parties and the hearing.

4. Bells and whistles

While a simple arbitration clause is indeed beautiful, if a party could gaze into a crystal ball and predict future disputes, it might choose to add various bells and whistles to the arbitration clause. For example, where a potential dispute is likely to turn on a highly technical or industry-specific question, the parties might agree that only persons with certain relevant qualifications or experience may serve as arbitrator. Or, where the parties have entered into a long-term agreement and want to preserve their business relationship despite a dispute arising, they might choose to incorporate mandatory mediation as a precondition to arbitration. Where a dispute between the parties might implicate sensitive business information, they might agree that each party must disclose only the information upon which it intends to rely and is under no obligation to produce other materials to the opposing party. These are only a few examples of potential bells and whistles that might be added to an arbitration clause. The provisions that are ultimately incorporated into the dispute resolution provision will depend on the specific needs of the client.

In addition to bells and whistles, a party should consider related clauses that might impact a dispute but that are not typically included in the arbitration clause. For example, arbitration proceedings are private, but not necessarily confidential absent explicit provisions on confidentiality. A party wishing to maintain confidentiality should include a broad confidentiality clause in its contract. Likewise, parties can include provisions that limit liability, provide for indemnification or limit the types of damages that may be awarded. These types of provisions are related to, but usually separate from, the arbitration clause.

Conclusion

Parties negotiating cross-border transactions may be loath to acknowledge the possibility that a dispute might arise. However, a party should negotiate the dispute resolution clause with an eye toward ensuring that it is best positioned in the event a dispute does arise. Taking the time during contract negotiations to anticipate potential disputes and tailor the arbitration clause accordingly can protect a party's interests and save time, money and frustration down the line.

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