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Building A Better Dispute Resolution Provision

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Among the original promises of alternative dispute resolution was the creation of a quicker and more cost-effective system than traditional litigation. However, with more commercial contracts containing mandatory arbitration provisions, parties are sending more complex disputes to arbitration. Thus, arbitrations have become longer and far more expensive, and, at times, rival or even exceed the length and cost of traditional litigation.¹

If the goal of arbitration remains a more efficient dispute resolution mechanism than litigation, what can be done? One answer lies in the drafting of the alternative dispute resolution provision (the “ADR Provision”) itself. Arbitration is a creature of contract, and therefore, the parties have wide latitude in drafting an ADR Provision that will greatly streamline the arbitration process and avoid non-merits-based or ancillary litigation.

Drafting To Avoid Disputes Over Arbitrability

One of the most vexing and wasteful experiences in arbitration is being subjected to ancillary litigation regarding

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what is or is not arbitrable. Because the question of “arbitrability” is almost always for a court to decide,² a party that wishes to delay final adjudication of the merits can initiate litigation regarding the arbitrability of the

controversy at hand. Such disputes can add months, even years to the process, before ever reaching the merits. Moreover, these disputes could result in arbitration proceedings over the objection of a party on the issue of arbitrability, only to be followed by a motion to vacate by the losing party, on those very same grounds. This, again, can add years to any final resolution of a dispute and create uncertainty regarding the effect of any award. Accordingly, the best practice is to be as clear as possible about what is or is not arbitrable in the ADR Provision itself.

The simplest way to do this is to draft an arbitration clause as broadly as possible. Courts have held the following language to encompass virtually every conceivable dispute between parties: “Any controversy or claim arising out of or relating to this contract, or the breach thereof, shall be settled by an arbitration administered by the American Arbitration Association.” While there is nothing to prevent an adversary from bringing an action seeking to foreclose arbitration of a particular claim on the grounds that it exceeds the scope of the arbitration clause, such attempts will most likely fail, and, indeed, most practitioners will avoid such frivolous arguments given the clarity of the caselaw on this issue.

On the other hand, some practitioners have sought to increase certainty regard-



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ing what is or is not arbitrable by crafting ADR Provisions with subject matter exclusions, such as “Any controversy or claim arising out of or relating to this contract, or the breach thereof, except for disputes involving [intellectual property or tax obligations or torts, etc.] shall be settled by arbitration....” While it may seem that these types of clauses create more certainty as to arbitrability, the opposite is often true. A savvy adversary can litigate not only what is or is not arbitrable, but can do so on the theory that dispute categories such as “intellectual property” or “tax obligations” are susceptible to different meanings and are often completely and inextricably intertwined with claims that are clearly arbitrable (usually an underlying breach of contract). Thus, rather than clarifying the issues, carve-out provisions may create even more confusing issues with the consequence being months or even years of tangential and expensive litigation over arbitrability.

If parties are going to choose arbitration as the dispute resolution mechanism, resolving all categories of disputes arising under the subject contract is usually the best option, and parties should, therefore, employ the broadest possible ADR Provision, and, indeed, the standard clause suggested by the AAA. Courts are familiar with it, there are reams of caselaw interpreting it, and it is almost certain that what starts out in arbitration will remain there.

Drafting To Limit Disputes Over The Type And Scope Of Permissible Discovery And Motion Practice

Along with arbitrability disputes, some of the most problematic and costly aspects of arbitration concern disputes over discovery and permissible motion practice. These disputes also often become the sub-

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ject of wasteful ancillary proceedings, whether in front of an arbitration panel or a court. Unfortunately, the AAA Commercial Arbitration Rules and Mediation Procedures (the “AAA Rules”) are virtually silent regarding discovery, stating merely that at the request of a party, the arbitrator may direct the production of documents or the identification of witnesses to be called.³

Accordingly, arbitration can spawn even more discovery disputes than traditional litigation if the scope of discovery is not specifically delineated. For example, simple questions concerning party discovery (e.g., document demands, interrogatories, depositions, and experts) can result in interminable delays as panels listen to arguments concerning the need for or opposition to requested discovery. In litigation, however, the applicable federal or state procedural rules usually provide quick and clear-cut answers.

Even more difficult are questions concerning non-party discovery.⁴ While a discussion of non-party discovery in aid of arbitration is beyond the scope of this article, it is important to note that failure of parties to agree in advance on the scope of non-party discovery could result in extremely lengthy detours as parties engage in motions and appeals before courts, and perhaps in multiple jurisdictions. Even in cases where parties agree on the need for non-party discovery, numerous procedural problems can arise since permissibility of pre-hearing non-party discovery remains unsettled. For example, in the *ImClone v. Waksal* arbitration, while the parties themselves had no dispute over the need for non-party discovery, numerous motions and appeals erupted when the non-parties objected. Such a thorny issue would not have been present in traditional litigation, where the scope of permissible non-party discovery is more clearly defined.

It is highly recommended, therefore, that parties explicitly outline the scope of discovery in their ADR Provision. While it may be difficult to predict exactly what discovery may be necessary should a future dispute arise, the parties’ choice to arbitrate rather than litigate should indicate that the process needs to be streamlined. To that end, parties need to best estimate the financial and legal implications of any disputes that may arise and use that to inform how much discovery is necessary.

In a potentially complex dispute, for

example, it might be advisable to provide for depositions and to specify a reasonable number that will be allowed in the ADR Provision. Since the AAA Rules do not provide the right to depositions, failure to set forth such rights in the ADR Provision creates a risk that such discovery will be prohibited. Moreover, if the potential dispute is likely to require expert testimony – as in the case of a complex intellectual property or securities dispute – then the right to utilize expert witnesses and take discovery of them should be set forth in the ADR Provision.

Indeed, the exchange of documents, the use of interrogatories, and any other discovery devices should be specified. Remember, should there come a time when such discovery becomes unnecessary, the parties can choose to forego it. If the parties fail to provide for wanted discovery mechanisms, however, they risk losing the opportunity to obtain potentially valuable discovery at the whim of the arbitrator.

Additionally, if parties feel that motion practice, specifically dispositive motions, might be appropriate, it is imperative that they cover this in the ADR Provision and specify the type, timing, and procedure thereof (including whether there are rights to reply, etc.). For example, the AAA Commercial Arbitration Rules do not provide for dispositive motion practice. In fact, some practitioners have argued that since the AAA Employment Arbitration Rules do provide for dispositive motions,⁵ the absence of such provision in the Commercial Rules evinces the AAA’s intent to exclude such procedures from commercial arbitrations.

Drafting Forum, Claim And Remedy Provisions

Most parties and practitioners already include choice of law and venue selection language in their ADR Provisions (and they should be specific about this), but forum selection is sometimes overlooked. As important as it is to be careful in drafting the ADR Provisions as they relate to arbitrability and discovery and motion procedures, forum selection can be equally important and can influence how particular issues and disputes are resolved. Parties should pay particular attention to what, if any, rules and procedures the forum has in place. For instance, the AAA maintains an active administrative function, while the Insti-

tute for Conflict Prevention & Resolution (“CPR”) leaves administration of the arbitration to the arbitrators themselves. Further differences become apparent when the specific rules enforced by the forum are examined.

This can be of paramount importance when parties attempt to agree on the manner in which disputes may be brought in arbitration. Parties may desire to exclude class treatment or consolidation or joinder of claims. Forum rules (and choice of law) can play a significant role here. Where the AAA has rules governing arbitrations of class claims, the CPR does not.

Further, parties may wish to attempt to exclude punitive damages or statutorily prescribed damages (such as multiplied damages) from the authority conveyed to the arbitrator. Such remedy waivers need to be explicit and should be consistent with the rules of the forum selected.

Conclusion

Parties need to carefully examine their goals in drafting ADR Provisions and need to remember that arbitration was designed to be a more efficient and economic process than litigation. If that remains a goal of the parties, the ADR Provision should be drafted with efficiency in mind and with an eye towards avoiding non-merits-based disputes. On the other hand, the more that parties attempt to make arbitration look like litigation by building in all of the procedural rights and protections afforded by state and federal court rules and procedures, the less efficient and cost-effective it will be.⁶

¹ See *Odjell ASA v. Celanese AG*, 328 F.Supp.2d 505 (S.D.N.Y. 2004).

² See *First Options v. Kaplan*, 514 U.S. 938 (1995).

³ See AAA Rules, R-21.

⁴ See *ImClone v. Waksal*, 22 A.D.3d 387, 802 N.Y.S.2d 653 (1st Dep’t 2005).

⁵ See AAA *Employment Arbitration Rules and Mediation Procedures*, R. 27.

⁶ Some practitioners have made the choice that arbitration is simply not an effective alternative to litigation, no matter how well drafted the ADR Provision is, and to that end have come up with a new alternative – the “modified litigation clause” – engaging in litigation but with contractual limits on the scope of the court proceedings, such as waivers of certain types of motions, limited discovery (particularly e-discovery), and fee-shifting provisions, all of which are intended to combine the desired benefits of arbitration – namely a streamlined proceeding – with the certainty that the well-established state and federal rules of procedure provide. See *Fishman, Eric*, “When Arbitration Makes Matters Worse,” *Legal Times*, October 23, 2006, Vol. XXIX, No. 43.