Arbitration provisions

How to draft an effective arbitration clause

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The purpose of an arbitration clause is to resolve disputes by means of a private proceeding that is generally perceived as quicker and less expensive than the court system. Yet many contracting parties do not fully analyze the arbitration clauses in their contracts, and so do not draft such provisions in a comprehensive and precise manner. These lapses can lead to costly and time-consuming disputes.

"Any party entering into an arbitration agreement, therefore, would be wise to carefully analyze the arbitration clause thoroughly, with a view to ensuring that it will accomplish all of the party's goals," says Courtney D. Tedrowe, a commercial litigation partner at Novack and Macey LLP.

Smart Business spoke with Tedrowe about what it takes to draft an effective arbitration clause.

What are the key considerations in drafting an arbitration clause?

Broadly speaking, there are two categories of issues to consider when drafting an arbitration clause. The first of these concerns the extent to which the court will be involved in pre-arbitration and post-arbitration issues. The second category concerns the parameters and procedures of the arbitration proceeding.

Why consider the court's involvement in pre- and post-arbitration proceedings?

Just because you have an arbitration clause doesn't mean that you will avoid court proceedings. Not infrequently, a party will oppose the arbitration demand on the grounds that it does not fall within the scope of the arbitration clause. Under the Federal Arbitration Act, courts are required to ensure that the claim is arbitrable. However, the arbitration clause can specify that the arbitrator decides such substantive 'arbitrability' issues, effectively limiting the court's role from the very outset.

The parties may also restrict the court's involvement in post-arbitration proceedings. Some post-arbitration judicial action is inevitable, since courts, not arbitrators, have the power to reduce the arbitration award to an enforceable judgment and to decide any challenges to the award. Here, the parties can use the arbitration clause to limit the grounds of appeal, further reducing the chances that the award is vacated, and minimizing the risk of lengthy appeals.

How should the arbitration clause be drafted to provide for procedural matters?

Parties can agree to pretty much whatever they want when it come to procedures. Typically, agreements simply select an organization's rules, such as the American Arbitration Association, JAMS or ADR Systems.

There are two big pitfalls here. First, most organizations have more than one set of rules with sometimes very different deadlines, discovery options and evidentiary rules. When drafting the clause, be sure that you select not just the organization, but the specific set of rules most favorable to the particular situation.

Second, organizations change their rules regularly, meaning parties will likely be bound to use the rules in effect at the time of the dispute, which may have changed.

Can parties modify the applicable rules?

Yes. For example, although the rules of evidence do not typically apply in arbitration, parties may specify that they will apply, or that only certain rules of evidence apply. Parties also have the ability to craft the discovery process to their particular situation. The arbitration clause can set forth, among other things: whether parties may take depositions and, if so, how many; whether documents requests and interrogatories will be allowed and, if so, how many; and the parameters of any other discovery method.

The clause may also deal with the hearing location; pre- and post-arbitration motions, such as motions to dismiss; and the arbitrator's power to fashion specific remedies.

How much freedom do the parties have to control the arbitrator selection process?

Parties have complete control over who arbitrates their dispute. The specific arbitrator could be identified in the clause, or the clause can set forth the rules by which an arbitrator is selected, either expressly or by selection of a particular organization's rules. ●