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NEGOTIATING YOUR ARBITRATION AGREEMENT TO CONTROL THE EXPENSE AND PARAMETERS OF ARBITRATION[1]

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Lawyers who arbitrate commercial disputes are hearing a crescendo of complaints from their clients about the arbitration process. General counsel who had expected privately administered arbitrations to be faster and more economical than disputes litigated in courts have frequently been disappointed to find that the trend in commercial arbitration is to mimic the scope of litigation, with more discovery, more witnesses, and, ultimately, longer evidentiary hearings. Companies in arbitration also may be unpleasantly surprised by other aspects of the process that they did not anticipate, such as the consolidation of disputes over different transactions into a single arbitration, being forced to arbitrate in a distant or otherwise inconvenient venue, and their inability to maintain the confidentiality of the process.

Obviously, no dispute resolution mechanism is perfect. As long as there are disputes arising from commercial transactions, companies and the lawyers who represent them will attempt to tilt battlefields to their advantage. Nevertheless, one inherent virtue of arbitration is that companies can exert control over the scope and parameters of the process before a dispute ever occurs. Companies may do so at the outset of a transaction by agreeing to arbitrate any disputes that later arise and by negotiating specific terms of the arbitration agreement.

Arbitration, after all, is a "creature of contract," (*United Steelworkers of America v. American Manufacturing Co.*, 80 S. Ct. 1343, 1347 (1960) (Brennan, J., concurring)), and the Federal Arbitration Act "lets parties tailor some, even many features of

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mortgage and assessment obligations. Associations in every state should pursue their liens quickly when a homeowner falls behind on assessments, but state statutory schemes often place them at the end of the line in foreclosure proceedings.

Associations can soften the nearly inevitable blow of arrearages by raising assessments, temporarily or permanently, to build a healthy reserve fund. Associations should also take care to keep a property's budget lean, and avoid adding high-cost or high-maintenance amenities. Implementing more rigorous pre-purchase reviews of buyers will not cure current troubles, but could prevent future problems. Finally, associations can join with every other person in the real estate market in hoping that the U.S. housing market improves.

NEGOTIATING...

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arbitration by contract, including the way arbitrators are chosen, what their qualifications should be, which issues are arbitrable, along with procedure and choice of substantive law."[2] Nevertheless, in practice, a contractual arbitration clause typically consists of terse provisions by which the parties agree to arbitrate all disputes arising out of the interpretation or execution of the contract, without providing many specifics as to how any arbitration will be conducted. By neglecting to negotiate the terms of arbitration agreements, companies miss opportunities to control the parameters of future disputes that might arise.

LIMITING THE SCOPE OF DISCOVERY

Parties in arbitration increasingly bemoan the trend in arbitration toward more burdensome discovery. More and longer depositions mean higher attorney fees and more company personnel tied up in depositions and deposition preparation, and generally lead to longer and more expensive arbitration hearings. In some arbitrations, the increase in discovery may be justified by the complexity of the issues and/or the sums in dispute. The salient point here is that the parties to a transaction can exercise some control over the scope of any arbitration that might later take place by negotiating limits on discovery in their arbitration agreement.

For example, the arbitration agreement can include limits on the number of depositions that each party may take and the duration of each deposition. Moreover, such limits can be tied to the magnitude of the dispute; thus, the arbitration agreement can set a specific limit on the number of depositions in any dispute under, *e.g.*, one million dollars, but contain no such limits for larger disputes that justify greater discovery expense. In general, it is much easier to negotiate these sorts of limits at the outset of the transaction – when the arbitration agreement is being drafted and no dispute yet exists – than after a dispute arises and one party perceives a need for, or strategic advantage in seeking, a large number of depositions.

REGULATING THE CONSOLIDATION OF DISPUTES OVER DIFFERENT TRANSACTIONS

Most arbitration agreements do not explicitly instruct whether disputes arising out of distinct transactions may be consolidated or how a request for consolidation should be addressed, which may result in disputes over those very issues. It was long assumed by many that where a given contract contained an agreement to arbitrate any disputes, the scope of such arbitration would be limited to disputes arising out of that contract. However, recent court decisions have undercut that assumption.

For example, in *Employers Insurance Co. of Wausau v. Century Indemnity Co.*,[3] the Seventh Circuit Court of Appeals rejected a company's attempt to obtain a declaratory judgment that it was entitled to two separate arbitrations to resolve disputes arising out of two different contracts. The Court of Appeals held that the "question of whether an arbitration agreement forbids consolidated arbitration is a procedural one, which the arbitrator should resolve."[4] Key to the court's decision was the undisputed fact that the two "Agreements' arbitration clauses are silent as to whether consolidated arbitration is permissible."[5] Noting that there was no question as to whether each of the disputes was arbitrable, the court reasoned that the "only question is the kind of arbitration proceeding their Agreements allow. This comes down to a matter of contract interpretation, which the arbitrator is well qualified to address."[6]

[2] Hall Street Associates v. Mattel, Inc., 128 S. Ct. 1396, 1404 (2008).
[3] 443 F.3d 573 (7th Cir. 2006).
[4] *Id.* at 577.
[5] *Id.* at 576.
[6] *Id.* at 578.

Controversies over consolidation can thus be avoided – or, least, greatly reduced – at the contract-drafting stage. Companies entering into contracts that contain agreements to arbitrate should consider drafting specific language that expressly prohibits or permits consolidation with other disputes, between the parties or otherwise, depending on what the parties want and are willing to negotiate.

ENSURING THE CONFIDENTIALITY OF ARBITRATION

Confidentiality is often considered to be one of the principal advantages of private arbitration. By resolving disputes away from public courthouses, companies can avoid negative publicity and can attempt to avoid being bound by public judgments. However, no company should assume that an arbitration will be confidential unless the arbitration agreement so specifies. Although some industries have a custom of confidential arbitration, an arbitrator may be loathe to impose confidentiality where the parties' arbitration agreement does not expressly require it and the opposing party objects to keeping the proceedings confidential. Accordingly, if maintaining the confidentiality of potential disputes is of value to a company, it should negotiate the inclusion of a confidentiality provision in its arbitration agreements.

In contemplating and negotiating such provisions, companies should consider the need to articulate exceptions to confidentiality, such as to provide information to outside auditors and/or government regulators. Companies should also be aware that, if and when a party seeks to have an arbitration award confirmed, vacated, or modified in court, the court may refuse to seal the record of an arbitration even where the parties agreed to keep that record confidential.[7]

PROVIDING FOR THE NUMBER OF ARBITRATORS, THEIR QUALIFICATIONS, AND THE METHODOLOGY FOR THEIR SELECTION

In addition to focusing on important aspects of the arbitration process that many arbitration agreements fail to address, companies agreeing to arbitrate disputes should pay close attention to the provisions that most arbitration agreements contain but that many companies do not attempt to negotiate to their potential advantage. Indeed, no terms of an arbitration agreement are more important than the provisions for the number of arbitrators, their qualifications to serve, and the methodology by which they will be selected.

Most arbitration agreements provide for a single arbitrator or a panel of three or more arbitrators, and instruct how that arbitrator or arbitrators are to be selected. Whether the parties decide to use a single arbitrator or a panel, at least one arbitrator will need to be a "neutral," that is, someone reasonably free of bias for or against each party. Thus, the selection of that neutral is obviously of the utmost importance in any arbitration. There are various methodologies that can be specified in the arbitration agreement for the selection of the neutral, including the ranking of nominees on lists provided by organizations such as the American Arbitration Association ("AAA"); an exchange of slates by the parties, with each party striking all but one nominee on the other party's slate and a drawing of lots to choose between the final two candidates; and appointment of the neutral by a court. The key for any company at the time of entering into an arbitration agreement is to think through how each possible selection methodology might play out in the event of an actual dispute. Factors to consider include the company's reputation and influence in the given industry, as well as that of the other party to the arbitration agreement, and whether the AAA and/or other organizations are able to identify arbitrator candidates with expert knowledge of the particular industry.

Related to the methodology for neutral selection is the question of whether to provide for a single arbitrator or a panel of arbitrators. Employing multiple arbitrators obviously means incurring multiple arbitrator fees and expenses. Nevertheless, a panel of arbitrators arguably enhances the expertise brought to bear on any issue in dispute. A single arbitrator may be more prone to miss arguments or evidence, or to forget to address issues raised by the parties, than a panel applying their collective attention to a case. After all, unlike judges, arbitrators may not have the luxury of law clerks and other staff to help them research cases, craft decisions, and keep track of the voluminous paperwork that complex disputes generate. Thus, even the most seasoned arbitrators may be more apt to make mistakes without the benefit of a panel's collective attention, experience, and wisdom. One option for companies drafting arbitration agreements is to tie the number of arbitrators to the amount of money at issue, *e.g.*, by having a single arbitrator preside over smaller-dollar disputes, but requiring a panel for larger arbitrations.

[7] *See, e.g.*, Global Reinsurance Corp. v. Argonaut Insurance Co., Nos. 07 Civ. 8196 & 07 Civ. 8350, 2008 U.S. Dist. LEXIS 32419 (S.D.N.Y. April 18, 2008).

An arbitration panel can be chosen according to any of the methodologies elaborated above, or can include at least one arbitrator appointed by each party. A provision for party-appointed arbitrators gives each party the opportunity to ensure that at least one member of the panel will be someone whom that party considers an expert on the matters in dispute. Many arbitration agreements that provide for a panel require all of the arbitrators to be neutral. Whether "party-appointed" arbitrators must be neutral toward the respective parties is another issue for negotiation in the arbitration agreement.

With respect to all arbitrators, the arbitration agreement should specify the mandatory qualifications on which the parties can agree. Arbitration agreements typically require that all arbitrators be "disinterested," *i.e.*, that they have no pecuniary interest in the outcome of any dispute, and that one or all of the arbitrators be "neutral," as noted above. But the parties can negotiate more rigorous qualifications, such as excluding arbitrator candidates who have not attained a threshold level of experience or seniority in the given industry and/or requiring that arbitrators be retired from active service in that industry.

INDICATING CHOICE OF LAW

Parties entering into any arbitration agreement should consider whether they wish to indicate a specific choice of law. Determining which jurisdiction's law applies to a given dispute might effectively determine the outcome of that dispute. Therefore, if a company has an expectation that the law of a particular jurisdiction will govern a transaction, it should consider seeking to make explicit in the arbitration agreement that any disputes arising out of the transaction will be decided accordingly. Some arbitration agreements expressly relieve the arbitrator(s) of any obligation to follow the "strict rules of law," and/or provide that disputes should be resolved according to the "custom and practice" of the industry. Parties to arbitration agreements should thus consider carefully whether, and to what extent, they are comfortable authorizing future arbitrators to resolve disputes according to the arbitrators' own business judgment.

CHOOSING THE ARBITRATION VENUE

Perhaps the most frequently overlooked term in arbitration agreements is the venue provision. Companies routinely agree to arbitrate disputes in locations that are more convenient for their trading partners. In so agreeing, companies add to their future arbitration costs and cede leverage to their future opponents in the event of arbitrable disputes. Indeed, arbitration agreements frequently provide that any arbitration will take place in the city in which a specified party is located, which can lead to the other party incurring significantly greater expense. If the parties cannot agree on a mutually convenient location, one way to avoid building a hometown advantage for one party into the arbitration agreement is to leave the venue to the discretion of the arbitrator(s).

CONCLUSION

Commercial arbitration is a "creature of contract," and the parties to commercial transactions may negotiate the terms of their contracts to control the scope and parameters of future arbitrations. By doing so, companies may limit the expense of dispute resolution, as well as ensure the procedures that arbitrators will follow to adjudicate disputes. Accordingly, the time to think through the ramifications of the specific terms in any arbitration agreement is when that agreement is negotiated, which is typically before any dispute arises.

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