When Drafting Arbitration Agreements, Less Can Be More

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Arbitration is heralded as being quicker and more efficient and cost effective than a trial. This is in part because, in arbitration, many of the procedures are streamlined, simplified or eliminated altogether, reducing the time and complication required to resolve a dispute. Further, an arbitration award generally is final, but a trial may be appealed, adding time and a lack of finality to trial proceedings. However, while the potential time and cost-saving benefits of arbitration are clear, drafting an arbitration clause can be complex, and getting it wrong can cost time and money, making arbitration far less beneficial than was intended.

All too often a party "over" drafts the terms of the arbitration agreement, providing specifics that may make it difficult to interpret or enforce in practice, leading to litigation over the interpretation of the clause and negating much of the efficiency and cost-saving benefits of arbitration. This article addresses some of the mistakes when drafting arbitration clauses and offers suggestions for addressing the issues drafters commonly face.

Arbitrator Selection

One area that is rife with over drafting is the selection and qualifications of the arbitrator. Parties often consider the ability to choose the decision maker as one of the biggest advantages of arbitration. Being able to select arbitrators with specific expertise and competence contrasts with most court cases where a judge is assigned without regard to whether they possess specific qualifications suited or relevant to the dispute. But practitioners and parties should be wary of the downside of too much specificity or an overly complicated procedure, which can slow or even cripple the process. The recent decision in Burton Way Hotels Ltd. et al v. Four Seasons Hotels Limited, No. 11-00303 (C.D. Cal March 22, 2017), is illustrative of the negative impact of too many details in the arbitration selection process.

In the Burton Way case, the arbitration agreement provided that "[t]he Dispute shall be determined by Arbitration in Los Angeles before a panel of three neutral arbitrators" and "shall be administered by JAMS pursuant to this Arbitration Agreement." In addition, the parties inserted a particular judge into the process, to oversee the selection of arbitrators and settle disputes arising from the selection process. However, after the selection of the arbitrators and significant proceedings, the individual judge tasked with resolving disputes concerning the selection of arbitrators recused himself (in response to issues raised by Burton Way). Burton Way subsequently moved to void the entire arbitration agreement, arguing that the individual judge's role in the process for selecting and challenging arbitrators made him an integral part of the agreement such that his absence rendered the entire arbitration agreement null and void. Burton Way relied on cases in which a court had voided an arbitration agreement because of either the unavailability of an entire arbitral forum or the selected rules and procedures.

The District Court distinguished that line of cases, holding that because the parties selected JAMS, and provided that JAMS, the arbitration agreement and the California Arbitration Act will provide the rules governing the arbitration, the individual judge designated to resolve disputes concerning the selection of the arbitrator was neither the "arbitral forum" nor in any way central to deciding the dispute or choosing the applicable rules. Further, the parties had incorporated the CAA into their arbitration agreement, which provides in California Code of Civil Procedure section 1281.6, if "the agreed method [of appointing an arbitrator] fails or for any reason cannot be followed," then the court "shall appoint the arbitrator." Thus, the court held section 1281.6 provides a workable alternative, and therefore voiding the arbitration agreement is not warranted.

While the district court declined to negate the entire arbitration agreement, this decision highlights the risk of collateral litigation when parties are too specific in their drafting. Drafters should not invite a challenge to the arbitration agreement by imposing such level of detail that may become impossible to perform.

Practical Tips to Enhance Enforceability

By over specifying, a practitioner may find they have opened up their client up to a situation that allows the other side to delay or nullify the proceedings by challenging the arbitrators on the basis of the selection and qualification requirements. To that end, the following aid in avoiding litigation over the selection process:

- Avoid personal designations. Individuals can become unavailable or be conflicted out.
- Avoid potentially impossible qualifications. "10 years admitted as a lawyer, retired federal judge, with an MBA and fluent in Mandarin."
- Avoid subjective qualifications. "The arbitrator shall be an expert in real estate." What makes someone an expert could be extensively litigated.
- Expressly mention arbitration in the severance provision. Courts can use the severance provision that mentions arbitration to disregard a designation of an unavailable neutral.

Further, there is a strong public policy in favor of arbitration. Both the CAA and the Federal Arbitration Act ("FAA"), 9 U.S.C. § 5, provide gap filling measures that apply if the parties' selection process for the arbitrator fails to work as intended. For example, courts have expressly stated that section 1281.6 of the CAA is "a legislative means of implementing [California's] policy in favor of arbitration by permitting parties to an arbitration contract to expedite the arbitrator selection process." Moncharsh v. Heily & Blase, 3 Cal. 4th 1, 9, 832 P.2d 899, 902 (1992). Drafters should therefore consider using a catchall phrase such as, "any matter not addressed by this Arbitration Agreement shall be governed by the California Arbitration Act." This will help ensure that there is a statutory provision that applies if the parties' designated arbitrator or selection process becomes unavailable.

Key Takeaways

An arbitration clause is a contract, and like any other contract, is subject to interpretation by a judge (or an arbitrator) in the event of a dispute. Imperfections in an arbitration clause, including because it is overly specific or overly complicated, as was the case in Burton Way, or because of other issues, may unnecessarily extend and make more costly the proceedings, confuse the interpretation of clause, and lead to results neither anticipated nor intended by the parties. As evidenced in the Burton Way case, you can end up litigating collateral issues if your arbitration clause has similar issues, and the time and cost savings benefit your client had hoped to achieve through arbitration will quickly disappear.

With forethought, careful drafting and consideration of the operation of the arbitration clause in practice, an agreement to arbitrate can achieve both the intent of the parties and the efficiency and cost advantages over litigation in court. Removing uncertainty and resisting the temptation to put too much specificity into the agreement can be the first steps. Remember, less can be more when drafting an effective arbitration agreement.

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