DRAFTING ARBITRATION CLAUSES:
Avoiding the 7 Deadly Sins

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From time to time, someone tries to define what a perfect arbitration clause would look like. Efforts to do so usually founder on one of the strengths of arbitration, which is its adaptability to the particular circumstances of the parties and the dispute. Therefore, while it is difficult to generalize about what would make a “perfect” clause, it is not nearly as difficult to identify some of the features that make for a bad one. This article identifies seven of the most damning “sins” that plague arbitration clauses and offers suggestions for addressing the most important issues drafters face.

Equivocation

Credit for identifying the sin of equivocation as the cardinal sin of arbitration-clause drafting goes to Laurence Craig, Rusty Park and Jan Paulsson, who so named it in their book *International Chamber of Commerce Arbitration.* The essence of this sin is the failure to state clearly that the parties have agreed to binding arbitration. Because arbitration is a creature of contract, if there is no contract, there is no agreement to arbitrate.

Craig, Park and Paulsson’s example of an equivocating clause has a certain Gallic simplicity:

*In case of dispute, the parties undertake to submit to arbitration, but in case of litigation the Tribunal de la Seine shall have exclusive jurisdiction.*

What this clause commits the parties to is nothing other than years of litigation about how to resolve any dispute that may arise. That is the sulfur and brimstone that threatens the drafter who puts such a clause in the client’s contract: The client will spend what will seem like an eternity, and a great deal of money, trying to resolve the dispute.

The overriding goal of the drafter of an arbitration clause should be to draft a provision that, if a dispute arises, will help the parties obtain an arbitration award without a detour through the court system. First and foremost, that means that the drafter must produce an enforceable agreement to arbitrate. For an American lawyer drafting an agreement that will involve a transaction in interstate commerce, that means an agreement that a court will recognize as coming within the meaning of Section 2 of the Federal Arbitration Act. This provision states:

A written provision in ... a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, ... shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract. Each state has its own arbitration act, but if the FAA applies to the arbitration clause (as it often does), it will preempt any inconsistent state law.

For an international lawyer, the touchstone of arbitration drafting is Article II.1 of the United Nations Convention
on the Recognition and Enforcement of Foreign Arbitral Awards, commonly known as the New York Convention. It provides:

Each Contracting State shall recognize an agreement in writing under which the parties undertake to submit to arbitration all or any differences which may arise between them concerning a subject matter capable of settlement by arbitration.

Thus, an unequivocal clause that does not firmly commit the parties to arbitrate their disputes will not be enforced under either the American or international standard.

Inattention

Anyone who regularly deals with arbitration has no doubt heard someone say, “No one really paid any attention to the arbitration clause,” explaining that the drafters decided at around 2:00 a.m. on the morning of the day of the closing that they should provide for arbitration and pasted in a copy of the nearest clause available.

What this describes is the sin of inattention: drafting an arbitration clause with insufficient attention to the transaction to which it relates. This is far from the ideal approach. An arbitration clause should be designed to fit the circumstances of the transaction and the parties’ needs. The drafter may well select a standard “off-the-shelf” clause prepared by one of the well-known arbitration institutions—one can do far worse—but the off-the-shelf clause should only be selected because it is right for the deal.

When advising a client about dispute resolution options and deciding on the type of clause to use, the drafter, at a minimum, should ask the following questions:

- What type of dispute resolution process is best suited to the client and the transaction?

Arbitration is not the only option. There are many alternative dispute resolution processes and there is always litigation. In particular circumstances it may be preferable to litigate in court, provided that the parties can agree on which court to designate and whether that court will have jurisdiction. Litigation, however, may not be an option in an international agreement.

- If arbitration is selected, does the client understand that the arbitration clause will commit the client to a binding process that involves certain trade-offs?

Arbitration has advantages, prominent among them privacy, as well as the possibility of crafting a process that will be speedier and more economical than litigation. It also provides the opportunity for the parties to choose a fair and neutral forum—and to participate in the selection of the decision maker and the rules that will be applied. On the trade-off side, the client should understand that it is giving up some rights provided by law to litigants. These may include the right to a jury trial, the right to an appeal and, under certain institutional arbitration rules (such as the arbitration rules of the International Centre for Dispute Resolution (an arm of the American Arbitration Association) and those of the CPR Institute for Dispute Resolution), the right to claim punitive damages, unless the contract provides otherwise.

The drafter should be especially cautious about giving in to the temptation to advise the client to agree to arbitrate some types of disputes and go to court for others. This may be inevitable in some countries that do not allow certain types of disputes to be arbitrated (e.g., patent disputes)—but dividing jurisdiction should be the subject of an advanced course in drafting. Do not try it at home.

- Have the parties considered providing for steps preceding arbitration, especially if the relationship between the parties is an ongoing one?

It may be that, in light of their prior relationship, the parties should agree to mediate or negotiate before heading into arbitration. They can always arbitrate after less adversarial techniques are unsuccessful. A “step clause” can be drafted with as many steps preceding arbitration as the parties desire.

- Have the parties considered where they may want to enforce an award or a judgment based on an award?

This is particularly critical in an international contract. The New York Convention and the Panama Convention make arbitration awards enforceable in most countries involved in international commerce, as long as the country where the arbitration takes place and the country where the award is to be enforced are parties to the same convention. No similar treaty to which the United States is a party makes judgments enforceable across national lines. Foreign judgments are enforced in the United States and U.S. judgments are enforced abroad only as a matter of comity.

The key is to pay sufficient attention to the underlying transaction so that the arbitration clause can be tailored to the client’s particular requirements and to possible disputes that may reasonably be anticipated. The drafter should consider in what country the client is most likely to need to enforce an eventual award (such as where
assets of the adversary are located) and determine whether that country is a participant to a treaty on the enforcement of arbitral awards. The arbitration should be sited in a country that is a party to the same treaty.

Omission

A drafter who omits a crucial (or even a useful) element from an arbitration clause commits the sin of omission. This can result in a clause that expresses an agreement to arbitrate, but fails to provide guidance as to how or where to do so. Here is an extreme example:

Any disputes arising out of this Agreement will be finally resolved by binding arbitration.

This clause is probably enforceable because it clearly requires the parties to arbitrate disputes. However, it does not achieve the goal of an arbitration clause, which is to stay out of court. Unless the parties can agree on the details concerning their arbitration, they will have to go to court to have an arbitrator or arbitral institution selected for them.6

Section 5 of the FAA provides a partial remedy for the incomplete arbitration clause. It provides:

If in the agreement provision be made for a method of naming or appointing an arbitrator or arbitrators or an umpire, such method shall be followed; but if no method be provided therein, or if a method be provided and any party thereto shall fail to avail himself of such method, or if for any other reason there shall be a lapse in the naming of an arbitrator or arbitrators or umpire, or in filling a vacancy, then upon the application of either party to the controversy the court shall designate and appoint an arbitrator or arbitrators or umpire, as the case may require, who shall act under the said agreement with the same force and effect as if he or they had been specifically named therein; and unless otherwise provided in the agreement the arbitration shall be by a single arbitrator.7

FAA Section 5 only gets the parties an arbitrator, however. In the arbitration, the parties will still have to resolve disputes about when, where and how to conduct the arbitration. It is far better to provide in the arbitration clause for the minimum fundamentals needed to get an arbitration under way without the intervention of a court. Ten essential provisions are:

- the agreement to arbitrate,
- what disputes will be arbitrated (broad or narrow clause),
- the rules that will govern the arbitration,
- the institution, if any, that will administer the arbitration,
- the place of arbitration,
- in an international agreement, the language of the arbitration,
- the applicable law, if not provided elsewhere in the agreement,
- the procedural law that will apply to the arbitration,
- the number of arbitrators and how they will be chosen, and
- an agreement that judgment may be entered on the award.8

There are many other subjects that can and should be dealt with in the arbitration clause, some of which will be touched on later, but these are the ones that must be addressed if the drafter wants to avoid the sin of omission.

Over-Specificity

The opposite of the sin of omission is the sin of over-specificity. Rather than providing insufficient detail, the drafter provides too much. Drafters occasionally take the job of crafting an arbitration clause as a challenge to show how many terms they can invent. This can produce a clause that is extremely difficult to put into practice. For example:

The Arbitration shall be conducted by three arbitrators, each of whom shall be fluent in Hungarian and shall have twenty or more years of experience in the design of buggy whips, and one of whom, who shall act as chairman, shall be an expert on the law of the Hapsburg Empire.

This may seem like a comic exaggeration, but if you substitute computer chips for buggy whips, with appropriate adjustment of the language and law in question, you will find this example chillingly similar to many that make their way to arbitration.

Basically, it is a big mistake to over-draft an arbitration clause. When the arbitration clause is excessively detailed, those layers of detail can make it difficult or impossible to arbitrate a dispute when one arises. The standard clauses recommended by the major arbitral institutions are used by many knowledgeable people because they have been tested by the courts and they do the job.

Unrealistic Expectations

A companion sin to over-specificity is the sin of unrealistic expectations. We have all encountered arbitration clauses along the following lines:

The claimant will name its arbitrator when it commences the proceeding. The respondent will then name its arbitrator within seven (7) days, and the two so named will name the third arbitrator, who will act as chair, within seven (7) days of the selection of the second arbitrator. Hearings will commence within fifteen (15) days of the selection of the third arbitrator, and will conclude no more than three (3) days later. The arbitrators will issue their award within seven (7) days of the conclusion of the hearings.

“Sometimes the drafter ... cannot be reconciled to ... letting go of the familiar security blanket of litigation.”
There are circumstances that may justify, indeed even require, tight time limits. It may be reasonable to provide for accelerated resolution of an urgent matter, such as the need for provisional relief of a dispute involving the use of a trademark or one that would delay a major construction project. But most commercial arbitration proceeds at a more stately pace. While clients and their attorneys understandably become impatient with that pace, they should be aware that too tight a timeframe for an arbitration can cripple the process before it gets started. The risk is, as usual, collateral litigation. American courts have been less rigid than their European counterparts in finding that a failure to meet a deadline in an arbitration agreement deprives an arbitrator of jurisdiction to proceed with the arbitration. However, drafters should not invite a challenge on that basis by imposing unrealistic deadlines on the parties, the case administrator, or the arbitrator.

Litigation Envy
Sometimes the drafter of an arbitration clause cannot be reconciled to the thought of letting go of the familiar security blanket of litigation. What sometimes results is a clause that calls for the arbitration to follow court rules. This is the sin of litigation envy. Take the following clause, which the author once had to deal with as the chair of an ad hoc arbitration panel:

The arbitration will be conducted in accordance with the Federal Rules of Civil Procedure applicable in the United States District Court for the Southern District of New York, and the arbitrators shall follow the Federal Rules of Evidence.

Trying to conduct the arbitration under rules designed for an entirely different kind of proceeding produced predictable and needlessly expensive wheel-spinning. The arbitrators had to decide whether and how to apply the local rules of the Southern District, whether a pre-trial order was required, whether the parties were obligated to make the mandatory disclosures required by the Federal Rules, and other controversies about discovery of the sort that people resort to arbitration to escape.

Whether administered or non-administered arbitration is desired, there are many good sets of procedural rules available that can be incorporated in an arbitration clause. Any one of them is preferable to requiring an arbitration to be conducted according to the rules governing litigation.

Drafters also manifest litigation envy when they are reluctant to trust the result and provide for expanded review of the arbitration award. Here is an example:

The award of the arbitrators may be reviewed for errors of fact and law by the United States District Court for the District in which the arbitration is held.

There is considerable disagreement in the arbitration community as to whether it should be possible to expand judicial review of an award. Currently there is a split in the federal circuit courts concerning whether to an enforce an arbitration agreement that expands the grounds upon which Section 10 of the FAA would permit a court to review an award. Accordingly, one should approach the subject of expanding court review of awards with great care.

Overreaching

Sometimes the drafter of an arbitration clause cannot resist the temptation to tilt the arbitration process in favor of his or her client. This is the sin of overreaching. Where this sometimes comes up in a painfully obvious way is in contracts of adhesion. A notorious example is the clause the Hooters chain of restaurants used in employment agreements. Some of the overreaching elements in that agreement were listed by the 4th Circuit:

- The employee and Hooters each were to select an arbitrator, and the two so selected were to pick the third arbitrator, but all three had to be chosen from a list created by Hooters, which had exclusive and unrestricted control over who was on the list.
- Nothing in the arbitration clause or the Hooters’ rules required the arbitrators to be impartial or independent of Hooters.
- The employee was required to file with her claim a list of all fact witnesses, specifying the facts known to each, but Hooters was not required to file any notice of its defenses.
- Hooters was permitted to move for summary disposition, but the employee was not.
- Hooters could amend its position, but the employee could not.
- Hooters could record the hearing, but the employee could not.
- Hooters could modify the arbitration rules at will and without notice to the employee.
- Hooters, but not the employee, had the option to cancel the agreement to arbitrate.

One eminent witness stated before the trial court, “This is without a doubt the most unfair arbitration provision I have ever encountered.” The 4th Circuit concluded that the appropriate remedy for such a one-sided clause was not to enforce it. The court stated:

The parties agreed to submit their claims to arbitration—a system whereby disputes are fairly resolved by an impartial third party. Hooters by contract took on the obligation of establishing such a system. By creating a sham system unworthy of the name of arbitration, Hooters completely failed in performing its con-
tectual duty ... [and] also violate[d] the contractual obligation of good faith .... Hooters’ ... performance under the contract was so egregious that the result was hardly recognizable as arbitration at all.14

The temptation to overreach in drafting the arbitration clause should be strongly resisted. It is not only wrong, but it is also counterproductive.

**Doing it Right**

If one knows what to avoid in drafting the arbitration clause, how does the drafter go about drafting it correctly? Here is a do-it-yourself kit for drafting a simple arbitration clause.

The beginning drafter is well advised to begin with a standard clause by one of the many respected arbitral institutions. The Web sites of the principal arbitral institutions provide recommended provisions for both administered and non-administered arbitration that have been tested by the courts and that work. The arbitration clause used here for illustration starts with the clause from the Commercial Arbitration Rules of the American Arbitration Association (AAA) (numbered items 1-4). The steps below correspond to these numbers in the “basic clause” pictured below.

- **Step 1**: Define what is arbitrable.
- **Step 2**: Commit the parties to arbitration.
- **Step 3**: Pick a set of rules (and, in this case, an arbitration institution to administer the case).
- **Step 4**: Provide for entry of judgment. This is essential to enforcement in the United States.16

**Recommended Clauses**

After Step 4 you basically have the AAA standard clause, which is enforceable and can stand on its own. There are, however, some additional details that it is wise to add. These details are added by going through the following steps (see the corresponding numbers in the basic clause on this page).

**Step 5**: Specify the language in which the arbitration will be conducted. Obviously, this is most important in an international arbitration.

**Step 6**: Specify the location of the arbitration.

**Step 7**: Specify the procedural law that will govern the arbitration. This is important in domestic clauses when one wants the FAA to trump state arbitration law.17

**Step 8**: Specify the number of arbitrators. The parties usually will require only one arbitrator in small domestic disputes, but in large cases and international disputes, they often will want a panel of three. The parties can choose the method of arbitrator selection stated in step 8 in the sidebar, or provide for each party to select one arbitrator and the third arbitrator (the chair) to be appointed by the two party-appointed arbitrators. Other variations are also possible.

**Optional Additions**

After all eight steps are taken, the clause will normally contain all that is needed. However, there are some optional provisions that could be considered.

**Step 9**: Provide for mediation first. Because mediation offers the possibility of reaching a mutually agreed-upon settlement, it may be useful to include a “mediation first” clause. This dispute resolution clause is adapted from the AAA standard clause:

(a) If a dispute arises out of or relates to this contract, or the breach thereof, and if said dispute cannot be settled through negotiation, the parties agree first to try in good faith to settle the dispute by mediation under the Commercial Mediation Rules of the American Arbitration Association, before resorting to arbitration.

(b) Any dispute arising out of or relating to this contract, or the breach thereof, that cannot be resolved by mediation within 30 days shall be finally resolved by arbitration administered by the American Arbitration Association under its Commercial Arbitration Rules, and judgment upon the award rendered by the arbitrators may be entered in any court having jurisdiction. The arbitration will be conducted in the English language in the City of New York, New York, in accordance with the United States Arbitration Act. There shall be three arbitrators, named in accordance with such rules.

**Step 10**: Provide for a reasoned award. The drafter may want to specify whether the arbitrators should provide reasons for their award in the written decision, which is not required unless the parties request it. This can be accomplished by adding a sentence at the end of clause (b) above.

The award of the arbitrators shall be accompanied by a statement of the reasons upon which the award is based.

**Step 11**: Address the substantive law. If the substantive law that will govern is not dealt with elsewhere in the document (or in a document incorporated by reference),
the drafter could include a governing law provision in paragraph (b) above by adding the following:

_The arbitrators shall decide the dispute in accordance with the substantive law of the state of New York._

This wording has the effect of requiring the arbitrators to apply the law. Care should be taken not to add a substantive law clause if one already exists, since to do so could produce an ambiguous clause.

Step 12. Address the need for interim relief. In any dispute there is a possibility that one party will need to obtain emergency relief before the arbitrators are appointed. To authorize the appointment of an emergency arbitrator, the parties may specifically provide in their arbitration agreement that the AAA's Optional Rules for Emergency Relief will apply. (These rules are part of the AAA Commercial Dispute Resolution Procedures but they do not apply unless the parties' agreement so states.9)

_The parties also agree that the AAA Optional Rules for Emergency Measures of Protection shall apply to the proceeding._

The parties could provide, instead, for interim relief by a court, as is explicitly permitted under the AAA Commercial Rules (Rule R-36(c)).

Other Issues

The parties can also address other issues in the arbitration clause, including:

• whether claims by or against parents or affiliates are covered or not covered by the arbitration agreement;10

• issues arising from the presence of multiple parties, such as whether or not related arbitration proceedings may be consolidated, or whether provisions (other than those stated in the selected arbitration rules) should apply to selecting the arbitrator.

The usual solution in commercial disputes is for the administering institution to select all the arbitrators when there are more than two parties.

• whether there should be limits on the authority of the arbitrators to award punitive or similar damages, although some courts have refused to enforce such limits.11

The drafter should not try to limit the arbitrators’ authority to award statutory remedies because the result may be either to invalidate the arbitration clause or leave an adversary free to pursue a parallel court proceeding for such remedies.12

• whether to address the scope of discovery.

Institutional arbitration rules usually address the need for information exchange, so the drafter should know what the selected rules provide. Many international lawyers choose to provide for discovery under the International Bar Association (IBA) Rules on the Taking of Evidence in International Commercial Arbitration.13 These rules articulate a middle ground between the type of “discovery” practiced in common law and in civil law jurisdictions, and it has gained widespread acceptance.

• whether there is a need for a waiver of sovereign immunity.14

• whether special confidentiality protection is needed.

Most institutional arbitration rules require the institution and the arbitrators to maintain confidentiality, but not the parties. The principal countervailing concern is to preserve the ability of the parties to comply with legal obligations, such as securities law disclosures.

• whether to authorize arbitrators to award attorney’s fees.

Some institutional arbitration rules, such as the ICDR International Rules, allow the arbitrators to award attorney’s fees to a prevailing party. Others, such as the AAA Commercial Arbitration Rules, do not. Almost all arbitration rules permit the parties to provide otherwise in their arbitration agreement.

The list of optional provisions could be extended almost indefinitely. To avoid drafting an over-specific arbitration clause, which can get the drafter’s client into trouble, the safest course is to start with a standard, proven clause that the courts have regularly enforced. Then, add to it only necessary, consistent provisions that are tailored to the particular transaction. Do not overload the clause with excessive detail, unrealistic deadlines, bias toward either party, or matter already dealt with satisfactorily in the arbitration rules that will apply. The result should be a serviceable, if not necessarily perfect, arbitration clause, free, at least, from the seven deadly sins that drafters are often tempted to commit.

ENDNOTES

3 In New York, for example, Article 75 of the N.Y. Civil Practice Law & Rules.
4 Published following 9 U.S.C. § 201.
5 Lists of signatories to both conventions may be found following 9 U.S.C.A. §§ 201 and 301.
9 E.g., In re Arbitration No. AAA13-161-0511-85 under Grain Arbitration Rules, 867 F.2d 130, 134 (2d Cir. 1989).
10 Many of the organizations listed in the sidebar on page 35 promulgate arbitration rules, which can be downloaded from the organization’s Web site.
11 Compare Lapine Technology Corp. v. Kyocera Corp., 130 F.3d 884 (9th Cir. 1997), with UHC Management Co. v. Computer Sciences Corp., 148 F.3d 992 (8th Cir. 1998).
14 Id. at 939.
15 Id. at 940.
17 The perils of not doing so are illustrated (and largely created) by Volt Information Sciences, Inc. v. Stanford
University, 489 U.S. 468 (1989).
18 See www.adr.org.
21 *Investment Partners v. Glamour Shots*, No. 01-60651 (July 15, 2002 5th Cir.) (prohibition on punitive damages does not preclude arbitrator from awarding treble damages).

**Useful Web Sites for Drafters of Arbitration Agreements**

- [www.adrworld.com](http://www.adrworld.com) ADRWorld (news about ADR)
- [www.adr.org](http://www.adr.org) American Arbitration Association
- [www.abanet.org](http://www.abanet.org) American Bar Association
- [www.asil.org](http://www.asil.org) American Society of International Law
- [www.abnyc.org](http://www.abnyc.org) Association of the Bar of the City of New York
- [www.bcicac.com](http://www.bcicac.com) British Columbia International Commercial Arbitration Centre
- [www.camex.com.mx](http://www.camex.com.mx) Centro de Arbitraje de Mexico
- [www.cpradr.org](http://www.cpradr.org) CPR Institute for Dispute Resolution
- [www.hkiac.org](http://www.hkiac.org) Hong Kong International Arbitration Centre
- [www.ibanet.org](http://www.ibanet.org) International Bar Association
- [www.adr.org/icdr](http://www.adr.org/icdr) International Centre for Dispute Resolution (AAA)
- [www.iccwbo.org](http://www.iccwbo.org) International Chamber of Commerce Court of Arbitration (ICC)
- [www.lcia-arbitration.com](http://www.lcia-arbitration.com) LCIA (formerly London Court of International Arbitration)
- [www.nafta-sec-anela.org](http://www.nafta-sec-anela.org) NAFTA Secretariat
- [www.nai-nl.org](http://www.nai-nl.org) Netherlands Arbitration Institute
- [www.nccusl.org](http://www.nccusl.org) National Conference of Commissioners on Uniform State Laws
- [www.uncitral.org](http://www.uncitral.org) UNCITRAL
- [www.wto.org](http://www.wto.org) World Trade Organization