Portfolio Media. Inc. | 111 West 19th Street, 5th floor | New York, NY 10011 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

Crafting Dispute Resolution Clauses That Work For You


Merril Hirsh


Nicholas Schuchert

The dispute resolution clause is the red-haired stepchild of contracts. It took months to negotiate this deal. We argued over every dollar, every obligation, every comma. At last, we're about to extend our hand in friendship. And there's some lawyer telling us to worry about what's going to happen if things go wrong. Do we really want to lose the magic of the moment by negotiating over how we will go about fighting each other?

Small wonder dispute resolution clauses are often added at the last minute and with the least thought. Didn't we have one in that XYZ deal? Let's cut and paste that. See, they talked about using the Federal Arbitration Act, the Federal Rules of Civil Procedure and even designated Fablungit Arbitration to conduct the proceeding. Those XYZ folks must have known what they were doing.

Of course, those XYZ folks probably knew how to cut and paste too — maybe from the ABC deal. And they didn't think much more about it either. Until ... there is a dispute.

The good news about dispute resolution is that it is what you make it. Craft dispute resolution clauses properly and carefully and generally you can customize a procedure to get what you want. The bad news is that you need not only to know what you want, but also how to get it. And as words like "properly" and "carefully" suggest, there are more traps for the unwary in this process than anyone deserves. This article isn't going to cover all the considerations or the traps, but we hope it will help to illustrate the problem.

What Do I Want?

So let's start with "what do I want?" The process of determining what you want requires some imagination. Most people would like to avoid disputes, if they can, and if they cannot, to have them resolved fairly, quickly, and for the least amount of cost. But what process fulfills those goals depends a lot on what the problems are likely to be and in what context.

For example, is the breach of the agreement likely to require time-sensitive relief? Can any problems be redressed with money, or will they require some type of injunction? If the problem involves money, how large are the stakes likely to be? Is this an ongoing business relationship (where the parties have an interest in continuing to work together, or perhaps in working together again), or is the deal one-off? Is this an international agreement, and if not, what U.S. courts might otherwise be involved with dispute resolution? There are

dozens of questions like this. Sometimes they are simple to answer. Sometimes not.

Then you need to craft the process to fit the circumstances. For example, do you want to try to negotiate this first? Do you want to mediate if the negotiation fails? Do you want to arbitrate if that fails? Will all that take too much time? What about having time limits or having negotiation or mediation happen concurrently with the arbitration, rather than in succession?

Then you need to think about how the process works. For example, how do you make sure you get a good arbitrator? Do you want a lot of discovery, a little, or none? Do you want some meaningful way of appealing a bad decision?

Do you want to have an institution (like the American Arbitration Association or the International Institute for Conflict Prevention and Resolution, or an international organization, like the ones in London, Singapore, Hong Kong or elsewhere) administer the arbitration? Institutions like these can fill in many of the gaps — for example, they have procedures for selecting arbitrators and established rules for conducting arbitrations, and offer the equivalent of clerk's offices to facilitate case management. But they can be expensive, may not have the arbitrator(s) you want on their roster, and may have rules you do not want. You can do it yourself — in an "ad hoc" arbitration, you can establish your own rules or adapt rules, and pick your own arbitrator. But that requires that you be prepared to order a la carte, rather than prix fixe.

Examples like these illustrate why "what you want" may not be so obvious.

How Do You Get It?

If figuring out what you want is more difficult than it might seem, getting it requires still more imagination. We recently published an article on one of these questions: if you want to be able to have a court review an arbitrator's decision for legal error or lack of substantial evidence, how do you do that?

If you are interested in the article, **click here**. But if you are interested in the problem, our point is that the answer is surprisingly complex. First, you need to arrange to have the arbitration award reviewed under state law instead of the Federal Arbitration Act (because the U.S. Supreme Court has ruled that the act permits only limited bases for vacating an arbitration decision, and none of those include that the decision is dead wrong). Then you need to determine what state arbitration law permits parties to contract for more searching review and craft the agreement in a way that ensures the law you want applies. Getting this right requires care and even imagination.

Why the XYZ Clause Might Not Be What You Want

The cut and pasted clause we described at the outset illustrates some traps between deciding what you want and getting it. Because the XYZ clause uses the Federal Arbitration Act, the parties are agreeing that generally an error of law or fact will not be a basis for vacating the arbitrator's decision. If you agree to apply the Federal Rules of Civil Procedure, you are agreeing to the full panoply of rights to interrogatories, requests for production (with e-discovery), and depositions you would expect in a court. Worse, Fablungit Arbitration does not exist. So if you seek to compel arbitration, you may not be able to get it. (Although the name was changed to protect the innocent, the story is real: parties have agreed to arbitrate before nonexistent entities, or before entities that no longer handle arbitration). And if there were a Fablungit Arbitration, you would want to know more about them, like how they pick their arbitrators, what rules they apply to proceedings, and how expensive they are.

A More Hopeful Note

The fact that what you want may not be obvious, and getting it may be tricky, are reasons for caution, but not despair. It is possible to craft extremely effective mechanisms to resolve disputes that do what you want at reasonable expense and facilitates the business you are trying to promote, rather than shattering it. It just requires more care than people usually have at the time they are finalizing a deal. When you are doing agreement, involve someone who does disagreement too.

—By Merril Hirsh and Nicholas Schuchert, Troutman Sanders LLP

Merril Hirsh is a partner in Troutman Sanders' Washington, D.C., office. Prior to joining the firm, he was a trial attorney in the Civil Division of the U.S. Department of Justice.

Nicholas Schuchert is an associate in the firm's Orange County office.