

COMMERCIAL ARBITRATION DESIGN CONSIDERATIONS

STEPHEN ANTLE
Partner
Borden Ladner Gervais LLP



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Introduction

This is not a comprehensive discussion of commercial arbitration. It is a discussion of the factors one should consider in designing an arbitration to achieve arbitration's potential benefits in the resolution of a particular commercial dispute.

Potential Benefits of Arbitration

Why would a party consider using arbitration to resolve a commercial dispute? What are the potential benefits of arbitration?

Because arbitration can be a much simplified version of litigation, it has the potential to resolve disputes relatively quickly.

For the same reason, arbitration also has the potential to be more cost effective than litigation. However, depending on the economics of the dispute, it may be important to remember that in arbitration the parties must pay directly the fees of the arbitrator and the logistical costs of whatever space, reporting agency, etc. they require, rather than having those costs paid by the taxpayers at large as in litigation.

Generally speaking, rights of appeal from arbitral awards are much more limited than appeals from court decisions. This provides an element of increased finality, which may be desirable.

Because it is generally possible for parties to choose, or at least influence the choice of, an arbitrator, they may be able to ensure their arbitrator possesses expertise they consider necessary to fairly resolve their dispute. That expertise may be legal or industry specific. This tends to result in arbitral awards which are more predictable, or at least more acceptable.

Unlike litigation, which is generally open to the public, arbitrations are generally private and confidential. This may be generally important to business parties. It may have particular importance where sensitive financial information, business strategies or trade secrets are involved.

In considering the possibility of arbitration, the parties should consider these potential benefits. They should consider which are actually important to them. They should determine whether those potential benefits warrant an arbitration. If so, they should then consider how to design that arbitration to ensure that those potential benefits are realized.

Preliminary Points

Two preliminary points, before addressing the “design” issues. First, an agreement to arbitrate a dispute, whether an arbitration clause in an existing contract or a stand-alone submission to arbitration, is itself a contract. It is a separate contract from whatever contract may have given rise to the dispute itself. As a contract, it carries with it all the usual potential contractual issues of interpretation, performance and breach.

Second, unless the parties agree otherwise, an arbitration will likely be governed by the laws of the place where the arbitration is held. If the parties do wish some other law to govern the arbitration, they must agree on it.

Pre-conditions to Arbitration

The first design consideration is whether to require the satisfaction of any conditions precedent to the arbitration. The parties may wish to require such conditions. But they should do so carefully, fully aware of the potential difficulties they may cause.

For example, it is common for arbitration agreements to require “tiered” dispute resolution procedures, beginning with negotiation, continuing through mediation and culminating in arbitration if necessary. The benefits of such an approach, principally resolving disputes as consensually and with as little outside intervention as possible, are obvious.

However, there are also drawbacks. Such a process can establish unintended conditions precedent to the jurisdiction of an arbitrator (and if an arbitrator exceeds their jurisdiction their award may be set aside by the courts or rendered unenforceable). Such a process would require the parties to go through the procedures preceding arbitration in the structure before arbitrating. The language creating the tiered process might also refer to the parties acting in “good faith” or using their “best efforts” to resolve the dispute by negotiation or mediation.

Such conditions precedent can cause several problems. They can be superfluous. Generally speaking, if the parties want to settle, they will, whether or not they are

required by some agreement to negotiate or mediate in good faith. If the parties do not wish to settle, there is no real benefit to requiring them to go through the motions of negotiation or mediation before being entitled to arbitrate.

Such pre-conditions can give rise to delay and expense, and make the whole arbitration process uncertain. Generally speaking, a party wishing to take the position such pre-conditions had not been satisfied would object to the jurisdiction of the arbitrator. Although the arbitrator could make a preliminary ruling concerning their jurisdiction, that could be appealed to the courts. In any event, the issue might not practically be finally settled until it came time to enforce the arbitral award. There again the issue would likely have to be resolved in court. There is considerable jurisprudence about negotiating in good faith and using best efforts. Resolving these sorts of issues would likely require considerable time and expense.

In addition, it is not uncommon for a party to an arbitration to require some form of interim relief: an injunction, a preservation order, an order prohibiting the disclosure of confidential information or to enforce intellectual property rights. But, if there were a dispute about the jurisdiction of the arbitrator, the arbitrator would not likely be able to grant such interim relief. The arbitrator's jurisdiction would have to be clarified, again likely in court, before they could entertain an application for interim relief. By then the damage might have been done.

In addition, having to resolve any of these issues in court might well nullify one of the important potential advantages of arbitration: confidentiality.

Because of those potential drawbacks, if the parties do consider conditions precedent for arbitration, they should do so very carefully. If they do decide to establish such pre-conditions, they should draft them very carefully, to avoid, as far as possible, these sorts of difficulties.

Scope of Disputes to be Arbitrated

The next decision to be made is how to define the scope of the disputes to be submitted to arbitration. In the commercial context this issue often arises in terms of whether such disputes are to be limited to claims of breach of a particular contract or to extend to all claims, including things like tort claims, arising from a business relationship.

When the parties define the scope of the issues to be arbitrated, they define the jurisdiction of the arbitrator. If they use narrow language, the arbitrator may not have jurisdiction to deal with important aspects of the parties' relationship. The parties may find themselves in the unenviable position of having to arbitrate and litigate different aspects of their situation at the same time. That would largely negate the potential advantages of arbitration.

If the parties define the scope of issues to be arbitrated in uncertain language, they invite preliminary objections to the jurisdiction of the arbitrator, which may again have to be resolved in court. That would again give rise to delays and expense, uncertainty and breach of confidentiality, in much the same way as described above.

To avoid these difficulties the parties should consider carefully in advance the kinds of disputes which might arise from their relationship and make conscious decisions about

which they wish to arbitrate. They should then reflect that decision in appropriate language. There is customary language, tested in court, for this purpose. Some common examples are:

Any controversy or claim arising out, of or relation to, this contract or the breach thereof.

All disputes arising out of, or in connection with, this agreement, or in respect of any legal relationship associated therewith or derived there from.

Any dispute, controversy or claim arising under, out of or relating to, this contract and any subsequent amendments of this contract, including, without limitation, its formation, validity, binding effect, interpretation, performance, breach or termination, as well as non-contractual claims.

Generally, it is preferable to use more comprehensive, rather than more limiting, language. The risk and expense of having to both arbitrate and litigate a dispute should be avoided. If there is a good reason to limit the scope of disputes to be arbitrated, that limitation should be stated in the clearest possible language.

Number of Arbitrators

Arbitrations are usually adjudicated either by a single arbitrator or a panel of three. The applicable arbitration legislation will likely provide a default choice, likely a single

arbitrator. Nevertheless, it is always preferable for the parties to state clearly the number of arbitrators they wish to use.

Different factors favour a single arbitrator and a panel of three. Arbitrators must be paid by the parties. Preferably they will be experienced, and therefore in demand. The more people involved in the arbitration, the more calendars must be coordinated to schedule hearings. All these factors increase the cost and time, and decrease the efficiency, of an arbitration by a panel of three, and favour the appointment of a single arbitrator.

However, there is some logic to the proposition that three heads are better than one. With a panel of three arbitrators the risk of a fundamentally ill-conceived award is reduced. Where there is a panel, generally each party will appoint one, and those two, or some designated arbitral institution, will appoint the third as chair. So each party will directly appoint one of the decision makers. That appointment can reflect the view of that party about the background and experience which are desirable in an arbitrator. A panel of three arbitrators also permits a blend of experience, for example a chair with legal and arbitral experience, and arbitrators having relevant technical, business or cultural background.

Qualifications of Arbitrator(s)

One of the potential advantages of arbitration over litigation is that the parties have at least some input into the choice of their decision maker. To realize this potential advantage the parties should consider what, if anything, ought to be said in their arbitration agreement about the qualifications of the arbitrator(s).

Generally, arbitrators are required to be “independent” and “impartial”. Independence requires that arbitrators not have a financial, professional or personal connection with any of the parties. Impartiality requires that they have an open mind about the parties and the issues. Such requirements are likely to be found in the legislation governing the arbitration or the rules of the relevant arbitral institution. But, if not, the parties should ensure they adequately address these issues.

Arbitrators should have legal and arbitral training. Arbitration is an adversarial legal process. Except in extraordinary circumstances, arbitrators are required to adjudicate arbitrations according to the applicable law. They are not to adjudicate based on their perceptions of fairness, or their own experience or expertise. Their awards must be based on the application of the law to the evidence presented to them. Arbitrating a dispute therefore requires knowledge and experience in receiving evidence and dealing with objections and other legal procedural matters.

Again, if the parties do not agree on an arbitrator, the applicable arbitration legislation or the rules of the relevant arbitral institution will likely provide for the appointment of an arbitrator. The institutions involved in those processes normally recognize the importance of legal and arbitral experience. However, the parties should consider specifying such qualifications.

Parties often believe it is essential that arbitrators have specific commercial, technical or scientific background relevant to the subject matter of the arbitration. In my view, that belief is fundamentally misconceived.

Again, arbitrators must normally decide arbitrations by applying the relevant law to the evidence introduced before them. No matter what expertise they have, they cannot decide the arbitration according to their own experience, knowledge or opinions. To do so would be to decide the arbitration based on “evidence” which was not before them, and would make their award liable to be set aside. Rather than choosing an arbitrator with relevant business, technical or scientific experience, the parties should prove those sorts of facts through the opinion evidence of qualified experts.

The parties should also bear in mind that many arbitration rules permit arbitrators to appoint independent experts to advise them, if necessary. This may be particularly useful in technology-related disputes.

Procedural Rules

The parties must choose a set of procedural rules to govern the arbitration. There are numerous sets of rules drafted by Canadian and international arbitral institutions. The parties are also free to modify any of those sets of rules by agreement, or to draft their own rules from scratch. Likely the best way to proceed is to adopt a tested set of procedural rules from an arbitral institution, and to agree on any modifications required by the particular nature of the dispute.

It is in this area, designing the procedural rules for the arbitration, that many of the potential cost, time and efficiency benefits of arbitration can be realized. The parties should consider the following kinds of issues:

- Should they require the equivalent of litigation pleadings, and if so how minimal or elaborate should they be?
- What should be the scope of any required disclosure of documents?
- Should there be any form of pre-hearing “examination for discovery”?
- What should be the timeframes for the procedural steps leading to the hearing?
- Should the evidence of witnesses at the hearing be given by written statement or affidavit and cross-examination, rather than by *viva voce* testimony?
- Should the arbitrator be required to deliver their award within a specified time, say 60 days after the hearing?
- What limits should be placed on the parties’ rights to seek judicial intervention in the arbitration, and to appeal the award?

It is obvious from this list that arbitral procedure can differ significantly from civil litigation procedure. That is precisely the point. In arbitration the parties have the freedom to design a process which incorporates only what is essential to fairly resolve their particular dispute, and so to realize the potential benefits of arbitration discussed above.

It should also be obvious that realizing many of those potential benefits will depend on the willingness of the parties (and the arbitrator) to make themselves available to deal intensively with resolving the dispute, and to focus on what is essential to do so.

Administered versus *Ad Hoc*

Another choice the parties must make is whether their arbitration is to be administered by an arbitral institution or *ad hoc*. Arbitral institutions offer administrative services for a fee. Usually their procedural rules assume their administrative services will be used. Those services usually include acting as a registry for the filing of “pleadings”, assisting in the appointment of arbitrators if necessary, preliminary consideration of challenges to the independence or impartiality of arbitrators, arranging for the deposit of money to secure the payment of the arbitrator’s fees, receiving and formally issuing the arbitrator’s award, and the like. Some require that all communications between the parties and the arbitrator flow through them.

The parties will have to consider whether these services are worth their cost. For a factually or legally complex dispute, or one involving large amounts of money, they may well be. For simpler disputes, they may not. The economics of a dispute involving a relatively small amount of money may simply make them unaffordable. However, the parties should also remember that if the arbitration is to be *ad hoc*, the arbitrator (whom they must pay) will have to do whatever administrative work is necessary themselves.

The parties must also remember that, even if their arbitration is to be *ad hoc*, they must still specify a set of procedural rules. There are sets of arbitration rules suitable to *ad hoc* arbitrations. Another option is to amend the rules of an arbitral institution to dispense with references to the institution administering the arbitration.

If the arbitration is to be administered, the arbitration agreement should identify the administering institution and clearly state that it will have that responsibility.

Confidentiality

If preservation of the parties' confidentiality is an important potential benefit of the arbitration, the parties should carefully consider how to realize that benefit. The applicable arbitral legislation and rules may deal with confidentiality to some extent. The parties should consider whether their arbitration agreement should incorporate a confidentiality agreement to deal with the issue further.

Seat of Arbitration

In the commercial context choosing the place, or "seat", of arbitration is important. This is because, if it is necessary for the parties to seek recourse to the courts during the arbitration, then they will almost certainly have to do so in the courts of that place, and because the laws of that place will govern the arbitration. Issues like the circumstances under which the parties can go to court and the procedures for doing so will be governed by the law of that place. Depending on where the parties' counsel are authorized to practice, they may have to retain local counsel to exercise those rights.

Sample Arbitration Provision

Perhaps surprisingly, it is possible to address all of these design considerations in relatively few carefully chosen words. Here is one example:

All disputes arising out of, or in connection with, this agreement, or in respect of any legal relationship associated with it or derived from it, shall be finally resolved by arbitration administered by the ADR Institute of Canada

Inc. pursuant to its National Arbitration Rules. The place of arbitration shall be Vancouver, British Columbia, Canada. The language of the arbitration shall be English.

This clause deals with all the design issues set out above:

Scope – broad language.

Number of arbitrators – the ADR Institute of Canada's National Arbitration Rules provide for the default of a single arbitrator.

Qualifications – the Rules require that arbitrators be independent and impartial. No further qualifications are required in this case.

Procedural rules – the ADR Institute of Canada National Arbitration Rules are specified.

Administered v. *Ad Hoc* – the arbitration will be administered by the ADR Institute of Canada.

Confidentiality – The Rules require confidentiality.

Seat of arbitration – Vancouver is specified.

Conclusion

The commercial litigation experience has been that arbitration can indeed be an effective alternative to litigation, if proper care is taken to design and implement process which is more than just compressed litigation. This paper sets out the factors to be considered in that design process.

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