Dos and don'ts for drafting alternative dispute resolution causes[1]

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In our experience there are a number of matters commonly overlooked when parties draft alternative dispute resolution (ADR) clauses. The following piece does not purport to be a complete guide to drafting such clauses, but rather we have highlighted what we see as five key issues to address.

Scope: defining 'dispute'

It is surprising how often one sees ADR clauses that refer to determining a 'dispute', but nowhere in the contract do the parties identify or define the scope of disputes that may be submitted to ADR. It is important to identify this and to ensure that the scope covers precisely what the parties intend. In most cases, this will be all disputes 'arising out of or in connection with' the contract. The phrases 'arising out of or in connection with' and 'arising out of or relating to' have become the model for many of the arbitration clauses published by the major arbitral institutions around the world (for example, the standard arbitration clause under the International Chamber of Commerce (**ICC**) Rules of Arbitration and the recommended arbitration clause under the London Court of International Arbitration (**LCIA**) Rules). By using a more-limited description, for example one which covers only disputes 'arising out of' the contract, the parties risk a Court finding that the parties did not intend a certain fact pattern to be the subject of ADR (see, for example, the United States Federal Appeal Court decision of *Vetco Sales, Inc v Vinar*, 98 F. App'x 264, 266-67 (5th Cir. 2004), where the Court held that 'arising out of' language in an arbitration clause indicated that 'the parties intended to limit the applicability of this clause', and holding that claims for breach of a related agreement were outside the scope of the arbitration clause).

The issue is highlighted by considering the two alternative formations of the definition of 'dispute' below:

Example 1

'Dispute' means any dispute, difference or question which may arise at any time hereafter between X and Y with respect to this agreement.

Example 2

'Dispute' means any dispute, difference or question arising out of or in connection with this agreement or its formation.

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The clause in example 1 would cover disputes as to the interpretation or application of certain contractual provisions. However, it is unlikely to cover claims in tort, statute, or related equitable claims. By contrast, in example 2, the words 'in connection with' are wide enough that pre-contractual misrepresentations and related statutory and tort claims would comfortably fit within the ambit of the clause. The use of the word 'formation' makes this doubly clear (in relation to pre-contractual conduct) and includes disputes as to whether there is a contract.

Multi-tier clauses: a clear process and boundaries

It is increasingly common in complex commercial contracts to see 'multi-tier' ADR clauses: clauses that set out a number of escalating steps in the ADR process. These often start with compulsory negotiation and end with binding arbitration. It is important that these clauses are carefully considered. Clauses that simply say, for example, that the parties are to engage in 'good faith negotiations' before proceeding to arbitration leave a number of issues open. How is it clear that the parties are in the contractually mandated negotiation process? How long can the parties take in the negotiating process? If negotiations are futile, how does a party escalate the matter to the next level of ADR? When has a party not acted in 'good faith' in a negotiation process? Generally in drafting these clauses it is preferable to remember the following rules.

- Specify how the ADR process is initiated. For example, it may be initiated by one party serving the other party with a notice setting out brief details of the dispute.
- Set time limits on the various stages of the ADR process. For example, the clause could provide that in the negotiation stage of ADR the parties must make representatives with authority to settle the dispute available for the purpose of meeting in an effort to resolve the dispute and that such meeting must take place within 30 days of service of a notice of dispute. If the negotiation turns out to be fruitful and not enough time has been allocated, the parties can always agree to extend the time period. By setting a time limit the parties eliminate the risk that either party will cause undue delay by declining to participate in the negotiation.
- Spell out how a dispute is moved from one stage of the ADR process to the next. This should be triggered by an indisputable event, for example expiry of a time period. In the example above, if the dispute is not settled by the authorised representatives in the 30 days, make it clear that the dispute shall proceed to be determined in accordance with the remainder of the ADR clause.
- Avoid the use of terms which may cause a dispute in themselves. For example, a requirement that negotiations be conducted in good faith adds nothing, other than an invitation to a dispute about whether one party acted in good faith.

Arbitration: making key choices

Place of hearing (domestic) / place of arbitration (international)

Among the key issues that parties to an arbitration clause should consider is the place of the hearing for domestic contracts, and the place of arbitration for international contracts (i.e. contracts where the parties reside in different jurisdictions). Where the contract is a wholly domestic one, the location for the hearing may not be an issue if both parties reside in, say, Auckland (the parties would invariably designate

Auckland as the place for the hearing). However, if the parties reside in different cities and the contract does not designate a hearing location, unless the parties can agree, this will be up to the arbitrator to decide (adding time and cost to the process while this issue is being determined). The issue is very simply avoided by a clause specifying the place of the arbitration, for example 'The arbitration will be held in Auckland, New Zealand.'

In an international contract parties should designate a 'place' or 'seat' of arbitration (for example 'The place of the arbitration shall be Paris, France.'). This is more than simply a place of hearing, and in fact can be different from where the hearing physically takes place. The choice of a place of international arbitration determines the governing arbitration law (i.e. the law that will determine such matters as the conditions for validity of the arbitration agreement, the scope of the arbitration agreement, the appointment and removal and replacement of arbitrators, challenge of arbitrators, power of arbitrators and courts to grant interim measures, power to consolidate proceedings, the form and validity of the award and the finality of the award/rights of appeal). This is to be distinguished from the law governing the parties' contract (i.e. the law identified by the governing law clause in the contract or determined by applying conflicts of law principles). The governing law or law of the contract is the law under which the arbitrator decides the substance of the parties' dispute, and this may be different from the law of the place of arbitration.

The chosen forum (or place of arbitration) will also determine the degree of risk that local courts might interfere in an arbitration and the risk of an unenforceable arbitral award. If the parties unwisely choose a place of arbitration where the legal regime is hostile to arbitration or to foreign parties, they expose themselves to the risk of interference by a local court and to the risk of an unenforceable award. The United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (**New York Convention**) is a key consideration in this respect. The New York Convention facilitates recognition and enforcement in each signatory state of international arbitral awards rendered in other signatory states (of which there are currently around 140). It also restricts the grounds for refusing to enforce awards. However, one of the grounds for refusing to enforce an international arbitral award under the New York Convention is that the award has been set aside at the place of arbitration. This makes the selection of the place of arbitration important. Moreover, the pro-enforcement regime of the New York Convention is in most instances available only with respect to awards rendered in nations that are party to the Convention (making it advisable not only that the country designated as the place of arbitration has an arbitration-friendly regime, but that it is a signatory to the New York Convention).

Administered or ad hoc arbitration (international)

In an international contract, parties should consider whether or not to have the arbitration administered by an arbitral institution, for example the ICC, LCIA, New Zealand Dispute Resolution Centre or Singapore International Arbitration Centre, to name a few. By selecting an institution in their arbitration clause, the parties then pay the institution to assist, in accordance with its rules, in the initiation of the arbitration and in the constitution of the arbitral tribunal, to intervene as appropriate before the arbitrators are selected (and occasionally after), and to assist throughout the process with matters such as payments, notice, mailings, and arranging for hearing facilities. Recommended clauses for the selection of the various institutions are available on their websites.

By contrast, non-administered or 'ad hoc' international arbitrations are arbitrations conducted by the parties and the arbitrators (once appointed) without the assistance of an administering institution. The parties may also choose a designated set of rules even without an administering institution (such as the United Nations Commission on International Trade Law Arbitration Rules).

Arbitrators

A further issue to consider, both in a domestic and in an international contract, is the method of selection and number of arbitrators. If the place of arbitration is New Zealand, the default position under the Arbitration Act 1996 (NZ) is that there is one arbitrator for a domestic arbitration and three arbitrators for an international arbitration (Article 10, Schedule 1). The parties are free to agree otherwise and free to agree on a procedure for the appointments of arbitrators. Failing agreement on arbitrator appointment, in an arbitration with a sole arbitrator, the arbitrator may be appointed by the High Court (Article 11(3)(b), Schedule 1). In an arbitration with three arbitrators, the fall back position is that each party appoints one arbitrator and those two arbitrators appoint a third (again, if the parties cannot agree, this reverts to the High Court for determination) (Article 11(3)(b), Schedule 1, Arbitration Act 1996). If the parties desire something different, this must be specified in the contract. The parties may indeed want something different where, for example, it is a domestic contract with a large monetary value attached to it and a multi-tier dispute resolution clause. A dispute that reaches arbitration (the last step) is likely to be a dispute of some commercial and financial significance to the parties. Accordingly, the parties may wish to provide for a panel (i.e. three arbitrators) rather than leaving the matter in the hands of a sole arbitrator (i.e. the default position under the Arbitration Act). Of course, the parties are free to agree this procedure at any time, but often these issues are most easily dealt with at the contract drafting stage, before a dispute has arisen.

Language

Language may also be an issue. Where parties share a language and their contract is in that language, there is no need to specify the language of the arbitration. However, if the parties use different languages, the arbitration clause should specify which language will be used in the arbitration (for example 'The language to be used in the arbitral proceedings shall be English.'). Without this, the arbitrator(s) will determine this, and it is likely that they will decide that the language of the contract will be the language of the arbitration.

Making the process exclusive

Effective ADR clauses mandate ADR (whether it is negotiation, mediation, expert determination, arbitration or a combination of all of them (i.e. a multi-tier clause)). Ineffective ADR clauses unintentionally provide an *option* of ADR or litigation, for example providing that any disputes which cannot be settled by negotiation 'may' be submitted to arbitration (not 'must' or 'shall'). Another error is for a contract to contain, in successive clauses, a consent to the jurisdiction of certain courts and a consent to arbitration, leaving it uncertain whether the parties intended arbitration to be the exclusive dispute resolution process. These errors are avoided by careful drafting and word choice.

Addressing ongoing performance obligations

Finally, it is worth clarifying that the parties must continue to perform their obligations under the contract while the ADR process is underway. This answers any party who, while engaged in the ADR process, effectively 'downs tools' and refuses to perform obligations unrelated to those which may be the subject of the dispute. A clause to the following effect deals with that situation:

> *'Each party must continue to perform its obligations under this agreement as far as possible as if no dispute had arisen pending the final resolution of any dispute.'*

Conclusion

An ADR clause might still be workable despite the fact it fails to address the issues we have discussed above. However, these issues will need to be dealt with at some point and it is much easier to do so at the contract drafting stage than when a dispute is afoot and relations between the parties have deteriorated.