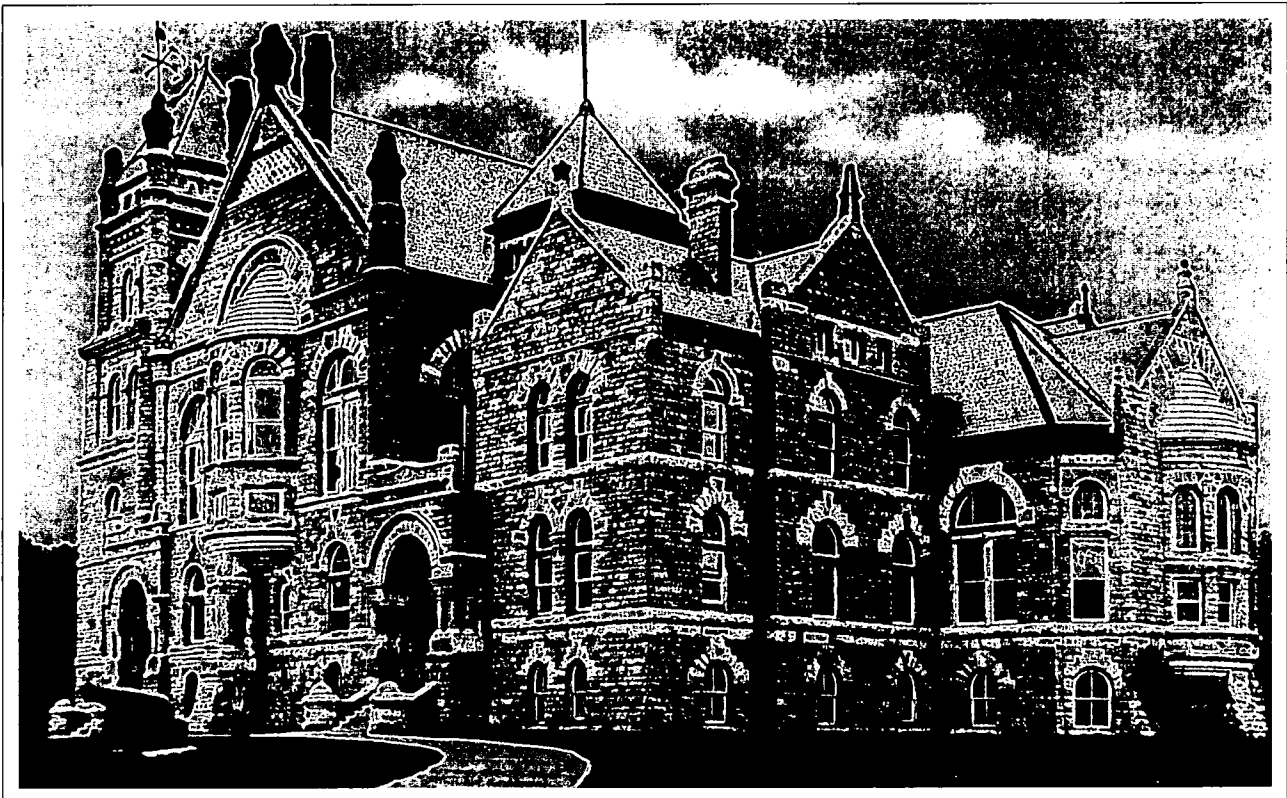




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Arbitration clauses

Arbitration clauses: Points to ponder

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Few clauses in a commercial agreement receive less attention than the arbitration clause. The parties usually want to focus on the positive business aspects of the transaction and do not want to contemplate what will happen if a dispute arises. Just raising the possibility of a dispute may upset the delicate balance of the negotiations and give the parties one more set of issues to have to work through. It is not surprising, therefore, that the arbitration clause, if it is included at all, receives scant attention. This is unfortunate, because a reasonably well thought out arbitration clause can actually help preserve the business advantages of the transaction and preserve a valuable commercial relationship if a dispute arises.

Often, an arbitration clause in a commercial agreement will simply say that the parties agree to submit any dispute to arbitration, perhaps adding that the arbitration will be conducted "pursuant to the Ontario *Arbitration Act*." It can easily be argued that the parties are better off without such a provision. It can produce the worst of all possible outcomes. When a dispute arises, the party who wants to arbitrate can be faced with litigation as both an appetizer and dessert to a main course of arbitration. If the parties cannot agree on an arbitrator or on other preliminary issues, those issues will have to be decided by the court before anything else happens. Also, if one of the parties does not like the decision of the arbitrators, there will be considerable scope for that party to attempt to appeal the decision of the arbitrators to the courts.

A carefully thought out arbitration clause will allow the parties to decide a number of issues in advance and to tailor the arbitration process to their business and financial needs.

Should you commit yourself to an institution?

One of the first issues that should be addressed, particularly if the contract is between parties from different countries, is whether any arbitration should be conducted under the supervision of an arbitration institute such as the International Chamber of Commerce (ICC), the London Court of International Arbitration, or the American Arbitration Association. Arbitrations supervised by these bodies can be arranged to take place in Canada or elsewhere.

Such organizations have specific advantages and disadvantages. They provide tremendous support for the arbitration process

if difficulties arise with respect to the appointment or replacement of arbitrators and a framework of rules and procedures within which the arbitration will proceed if the parties do not agree on such matters. Such support is also available from the courts in non-institutional arbitration. However, arbitral institutions provide this support in a relatively expeditious and businesslike manner, which is not always possible in the adversarial court process.

Designating an arbitration institution as a supervising body does add a layer of costs and administration to an arbitration. In the case of some bodies, such as the ICC, the costs can be very substantial and are based on the amounts claimed to be in dispute and not on the amount of time actually spent by the arbitrator(s) or the amounts awarded to the winning party. The institution itself takes a portion of the fee. The courts, by contrast, provide their services virtually free of charge.

The institution's rules may provide for a degree of administrative review by the institution of the final decision of the arbitrator(s) without input from the parties or their counsel. This review is normally aimed at ensuring that the decision is rendered in compliance with all of the formal requirements of the institution.

If it is anticipated that the disputes which are likely to arise will be substantial and that cost will not be a major consideration in the conduct of the arbitration, an institutional arbitration would likely be a wise choice. In addition, in contracts involving parties from more than one jurisdiction, one or more of the parties may not want to have the arbitration supervised by the courts of the other party's country or province. In this case, supervision by an international arbitration institute may be the only solution.

If it is decided that institutional arbitration will be used, the particular institution should be contacted for current information as to how it should be named in the arbitration provision and for guidance as to any other matters that should be specifically provided for in the clause.

Arbitrations not supervised by an arbitral institution are known as ad hoc arbitrations. They proceed in accordance with the provisions of the arbitration clause and are supervised by the courts of the place where the arbitration takes place.



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Are three heads better than one?

Some arbitration clauses include a provision that there will be three arbitrators, without any consideration having been given to whether arbitration by a single arbitrator would suffice. The three-arbitrator model does allow each party to have complete control over the selection of one of the arbitrators. The two arbitrators selected in this manner can then choose the third to chair the arbitration panel. However, this is an expensive mechanism if the sole benefit is to provide a process for the selection of the third arbitrator, who is expected by the parties to “really make the decision.” The parties will have to pay for the fees of all three arbitrators throughout the arbitration process.

The idea that you will be able to count on at least one of the three arbitrators being “on your side” has a number of flaws. First, all three arbitrators are bound by law to be independent and to act impartially. If one of the party-appointed arbitrators fails to disclose a possible ground for suspecting bias or fails to act impartially, this could provide grounds for the entire decision of the panel to be attacked in the courts. Second, why pay for two of the arbitrators to be closet advocates for the parties who appointed them, when each party will have their own legal counsel in any case? Third, if the arbitrator you appointed turns out to be against you, you and your lawyer may have an even harder time persuading both of the other two arbitrators to decide in your favour.

If the matters in dispute are complex and substantial or if a broad range of expertise is required, there may be a need for a three-member arbitration panel. For example, a three-person panel would allow for one or more of the arbitrators to be non-lawyers with relevant expertise. A tripartite panel is also appealing if the consequences of the decision are likely to be very serious for one of the parties to the dispute and the parties have agreed that there will be no appeal of the decision of the arbitration panel. However, in the vast majority of cases, the decision of a single arbitrator with no right to appeal the decision will give the parties the quick, inexpensive (or less expensive), and final decision that businesses usually require.

The problem of parties not being able to agree on a single arbitrator can be addressed by having a mechanism whereby, if the parties cannot agree, the appointment is made by a designated arbitration organization or individual (for example, ADR Chambers, the British Columbia International Commercial Arbitration Centre, or the head of some relevant trade or professional organization). It is preferable for the appointing authority to be an entity of some permanence or the holder of a specified office within such an entity. It is wise to ensure that the appointing authority is properly described in the arbitration clause and would be willing to perform the function if called upon to do so.

If no effective provision is made and the parties cannot agree, the courts may be called upon to appoint the arbitrator.

How long a leash?

The parties may want to give some indication in the arbitration clause as to what procedures they expect will be followed in the arbitration and how long they expect each procedure to take, for

example, in exchange of pleadings, exchange of relevant documents, and pre-trial discovery of the parties. They may do so by simply referring to an established set of arbitration rules, such as the UNCITRAL Model Rules of Arbitration, with or without the modifications they desire. Alternatively, they can leave the entire procedure to be decided by the arbitrator(s) once they have been appointed. In some cases, they may want to set out certain parameters that they wish to define in advance. For example, where the absence of a quick resolution could have disastrous consequences for the transaction or for one of the parties, the arbitration clause should be explicit both as to the length of the entire process and the steps to be taken.

As a general rule, however, it is wise to give the arbitrator(s) some discretion as to how long the various steps in the arbitration will take and what exact procedure will be followed. Although an overall indication of the timing and procedures is desirable, there is a need to allow the arbitrator to tailor the procedure to the actual dispute that arises. A simple or urgent dispute may require shorter time frames and fewer pre-trial procedures. Similarly, a more complex, less urgent dispute may require more time and more extensive pre-trial procedures. If the parties set too rigid a timetable in the original arbitration clause, it may be more difficult to accommodate these exigencies, and the arbitrator's decision may be open to attack in the courts if the strict timetable is not followed.

One of the advantages of arbitration over litigation is that the same procedure does not necessarily have to be followed in every case provided that both sides are treated in an equal manner and given a reasonable chance to present their case.

You show me yours and I'll show you mine!

When negotiating arbitration clauses in international agreements, it should be remembered that many countries do not have the same requirements for full disclosure of documents and examinations for discovery or depositions before trial as exist in Canada and the United States. Indeed, it could be argued that many advanced countries – Germany, France, England – seem to do just fine without some or any of these expensive adjuncts to North American litigation. In arbitration agreements between parties who are both from the same legal system, the assumption will usually be that the same rules that apply in litigation with respect to pre-trial procedures in their common legal system will also apply in the arbitration. However, even in this case, discretion should be given to the arbitrator to order more limited pre-trial procedures (or even the power to conduct the entire arbitration through written submissions only) where that is appropriate.

When the parties are from different legal systems, it is a good idea to provide some indication of the parties' expectations with regard to pre-hearing procedures. However, whether or not this is spelled out in the arbitration clause, it is a good idea to give the arbitrator some discretion so that the procedure can be tailored to the dispute. Remember that the arbitrator is likely to have a preconceived notion of what is fair and necessary by way of pre-trial disclosure, depending on the legal system from which she or he comes.

If either or both parties are sensitive about the matters likely to be disclosed in the arbitration or about the public disclosure of the existence of the dispute, there should be a specific provision regarding the confidentiality of the proceedings.

Who pays the piper?

The arbitration clause should specifically provide for determining how the costs of the arbitration will be met. Usually each party will bear its own costs of preparing and presenting the case to the arbitrators. However, other costs (institutional fees, if any, arbitrators' fees and expenses, costs of meeting facilities, and so on) should usually be borne equally by both parties until the arbitrator(s) decide the case and reallocate the costs between the parties. The consequences of one party not meeting its share of the costs as the matter proceeds should be spelled out. Usually a party who has not put up its share of the costs should be precluded from further participation in the arbitration. If it is possible that this might result in an inequality between the parties, the arbitrator could be given the discretion to make a different order. However, it is unrealistic to expect that the arbitration will proceed if the arbitrator(s) are not satisfied that the fees and expenses of the arbitration will be met.

Your place or mine?

If the parties are from different countries, cities, or linguistic backgrounds, the place and language of the arbitration should always be specified. A failure to do so could give rise to serious disagreement and litigation, which could undermine the effectiveness of the arbitration procedure. The place of arbitration does not have to be a place where either of the parties is physically located or does business. A neutral third location is often preferred so that both parties are equally inconvenienced by travel and other logistical considerations. However, the location should be one in which the basic resources needed to conduct the arbitration (accommodations, telecommunications and business support) are readily available. It is also desirable to conduct the arbitration in a jurisdiction that has laws that are highly supportive of the arbitration process itself.

Generally, the arbitration should be governed by the law of the place where it occurs, regardless of the law that governs the substance of the contracts between the parties, since any applications to the court in connection with the arbitration will have to be made to the court of the jurisdiction where the arbitration is being conducted. The lawyer drafting the arbitration clause should therefore be generally familiar with the arbitration statutes of the proposed jurisdiction. This is one of the reasons why arbitrations of international contracts tend to be held in a relatively few cities with well-known arbitration laws.

It is not necessary, and often is not desirable, for a party to be represented by a lawyer from the city in which the arbitration takes place. It is usually more important for a party to choose a lawyer in whom he or she has confidence and who has expertise in the particular type of dispute and law that is applicable to the contract. If the law governing the contract (as opposed to the law governing the arbitration procedure) and the language in which

the arbitration is to be conducted are not the local law and language, it is usually more effective to retain a lawyer qualified in the former rather than the latter.

The final award: Unappealing but unappealable?

The arbitration clause should specifically address whether or not the parties wish to provide for or exclude appeals to the courts. If they wish to provide for an appeal, the clause should set out any restrictions: for example, whether the appeal can be on any grounds, or only on questions of law. If the arbitration is international (because the parties are from different countries) it will be governed in Ontario by the *International Commercial Arbitration Act*, and there will be no right of appeal unless the parties specifically provide for this. If the arbitration is governed by the Ontario *Arbitration Act*, a party will be entitled to seek permission from the court to appeal from the final award on a point of law unless the arbitration agreement specifically excludes this right. In any case, an unsuccessful party will be able to challenge an award on certain other grounds, for example if the arbitrator(s) did not give one of the parties a chance to present its case or decided an issue that was not within the arbitration agreement.

Obviously, if all rights of appeal are excluded, the arbitrator(s) have a very broad mandate to decide the dispute and may do so on a basis that is not strictly in accordance with legal principles. This may or may not be a bad thing from a business standpoint. In fact, some arbitration agreements specifically provide that the arbitrator(s) are free to decide the case on the basis of what is fair and just in the circumstances and not necessarily in accordance with strict legal principles. As a practical matter, if such an approach to the resolution of the dispute is not likely to be in your interest because your contractual rights are ones that require strict interpretation and enforcement, you should probably consider whether arbitration really is your preferred vehicle for the resolution of the dispute. If you conclude that you do wish to take advantage of some of the benefits of arbitration (such as confidentiality and tailoring of pre-hearing procedures) but still want to have the dispute determined on a fairly strict legal basis, you can specify in the arbitration clause that the arbitrator will be a retired judge and/or provide for an appeal to a panel of retired judges within the arbitration process itself, a technique recently pioneered by ADR Chambers in Toronto. This has the advantage of providing a level of review while preserving the confidentiality of the proceedings, which would be lost on an appeal to the courts.

Conclusion

Arbitration is a flexible dispute resolution mechanism that can be adapted to meet specific business needs. In order to obtain and maximize the benefits of arbitration, specific provision for arbitration should be made in commercial agreements, and some thought should be given in advance to the various options available to best serve the business needs of the parties.