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5 Things Every M&A Lawyer Should Consider When Drafting Arbitration Provisions

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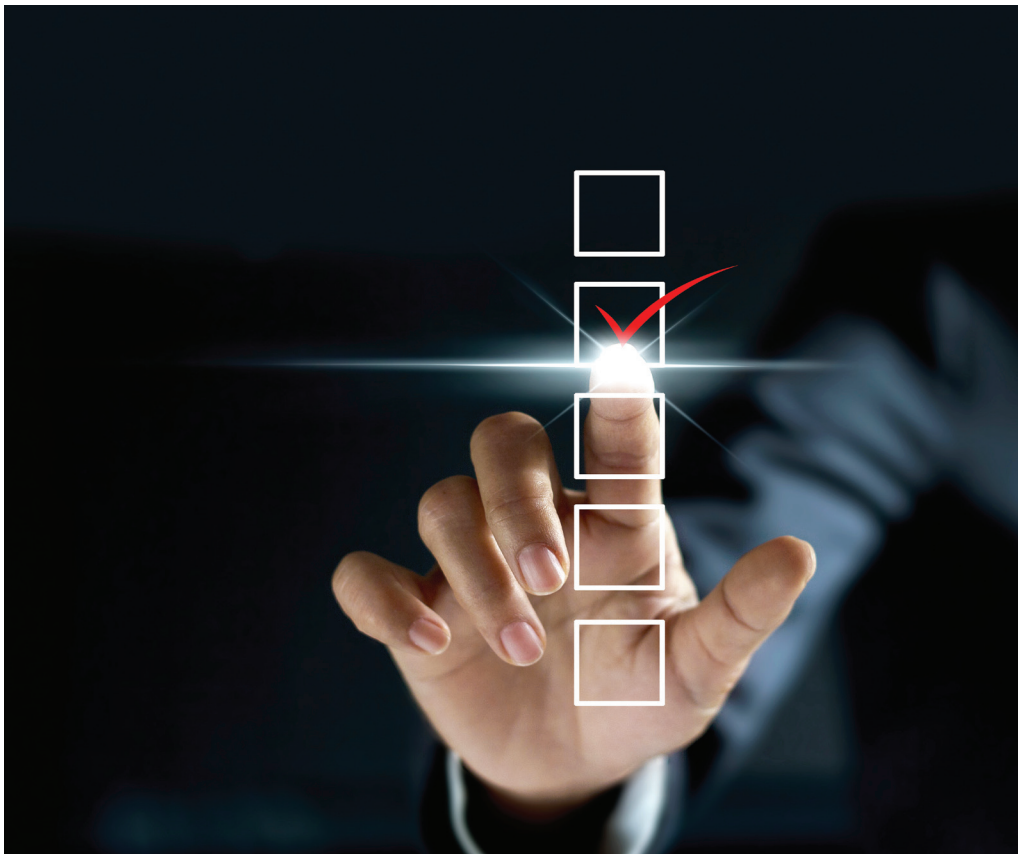

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Alternative dispute resolution provisions are frequent inhabitants of all sorts of contracts. In the M&A world, they might govern the means of resolving a purchase price adjustment, a representation breach, or an escrow dispute.

Arbitration provisions also are frequently included in representations and warranties insurance policies, which are increasingly used to insure the risk of loss caused by a representation breach. It is crucial that M&A practitioners understand the implications of an agreement's arbitration provision and how to draft an arbitration provision that serves their clients' needs. This article will discuss five issues that counsel should consider when drafting an arbitration provision and provide insights on how to effectively craft an arbitration clause to enable the efficient and cost-effective resolution of M&A disputes in domestic arbitration.

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1. Confirm That Arbitration Is Best For Your Client

There are many advantages to arbitration. Arbitration permits parties to control the dispute resolution process. Parties can agree to abide by procedural rules that are different from those that would apply in court. Parties can select who will hear their dispute so as to ensure that the arbitrator will have the skills and experience necessary to resolve a dispute involving complex accounting issues, for example, or other specialized

areas of knowledge. However, parties are required to pay the fees of their arbitrators, which can be substantial.

Arbitration is generally confidential. For organizations concerned with protecting trade secrets or other proprietary information, the option to resolve disputes in private is appealing. Parties should consider, however, that, in any dispute, there may be benefits to having access to the court of public opinion, particularly in a David vs. Goliath dispute, in which "David" may want a public record and to be before a judge who is bound by precedent. Unlike a court, arbitrators are not bound by decisional law and may award any decision that is equitable. *Sprinzen v. Nomberg*, 46 N.Y.2d 623, 629 (1979); *Transparent Value, L.L.C. v. Johnson*, 93 A.D.3d 599, 601 (1st Dept. 2012).

2. Select Your Arbitration Forum and Venue Carefully

For deals closing in 2018, nearly half selected the American Arbitration Association (AAA) as the forum for arbitration. SRS Acquiom 2019 M&A Deal Terms Study at 85. There are several organizations providing dispute resolution services in the United States, including AAA, JAMS, and the International Institute for Conflict Prevention & Resolution (CPR). There are differences between the rules of these different fora, so counsel should review the rules of each organization carefully before agreeing to arbitrate in any particular forum. For example, JAMS Rule 17 permits each party to take one deposition of the opposing party, but AAA Rule L-3 permits depositions only in the arbitrators' discretion.

Another key consideration is venue (the seat of the arbitration). Unless otherwise specified in the arbitration provision, under the principal of lex loci arbitri, arbitrators typically will refer to the procedural law of the jurisdiction where the arbitration is being held to fill gaps in the arbitration rules. The parties can control which procedural and substantive law will apply by specifying which laws will apply in the arbitration clause.

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Parties should select a venue that is convenient to the parties and permits the parties to subpoena witnesses and documents as necessary. Generally, arbitrators cannot subpoena witnesses and documents unless it is in connection with a hearing. See, e.g., AAA R-34(d)*; Life Receivables Trust v. Syndicate 102 at Lloyd's of London*, 549 F.3d 210, 212 (2d Cir. 2008); *Odfjell ASA v. Celanese AG*, 328 F. Supp. 2d 505, 507 (S.D.N.Y. 2004); *De Sapio v. Kohlmeyer*, 35 N.Y.2d 402, 406 (1974). Even where a subpoena is issued in connection with a hearing, the subpoena will need to be enforced in court, where jurisdictional limits to enforcement will apply. See *Wash. Nat'l Ins. Co. v. Obex Grp. LLC*, No. 18 CV 9693 (VB), 2019 U.S. Dist. LEXIS 9300, at *12 (S.D.N.Y. Jan. 18, 2019); *Lin v. Horan Capital Mgmt.*, No. 14 Civ. 5202 (LLS), 2014 U.S. Dist. LEXIS 114631, at *2 (S.D.N.Y. Aug. 13, 2014). Parties should choose an arbitration venue that will permit them to subpoena third party witnesses as necessary.

3. Control Costs At the Outset

Arbitration is expensive. Filing an arbitration demand in AAA may exceed $10,000 for claims above $10 million. Each arbitrator also charges an hourly rate. In the event there are three arbitrators, generally, each party will pay the fees of its party-appointed arbitrator and share the costs of the panel chair. The parties can save costs by specifying that the dispute will be heard by a single arbitrator instead of a panel. Even if the arbitration provision requires a panel of three arbitrators, parties can control costs by specifying that certain issues,

such as discovery disputes, will be determined by a single arbitrator, as opposed to the panel.

Permitting mediation prior to arbitration at one party's option may save costs and lead to a faster resolution. Parties can also control costs by setting out parameters for discovery in the arbitration provision, as discussed below.

4. Control the Discovery Process

AAA Rules provide that the arbitrator "shall manage any necessary exchange of information among the parties with a view toward achieving the efficient and economical resolution of the dispute, while at the same time promoting equality of treatment and safeguarding each party's opportunity to fairly present its claims and defenses." AAA R-22(a). In effect, arbitrators operating under this rule have wide discretion with respect to permitting parties to engage in discovery, which can be extensive, if not circumscribed in the parties' contract.

Parties can mitigate the time and expense of protracted litigation with a thoughtfully-drafted arbitration provision that serves their clients' needs.

Parties can control costs and save time by outlining rules for discovery in their arbitration provision. The provision should specify limits for electronic discovery (e.g., that the parties need not produce documents from back up tapes) and that depositions with not be permitted or will be limited in number. Parties can also specify that discovery motions will have page limits and be heard by a single arbitrator. These are all cost and time saving measures.

AAA Rules permit arbitrators to "allocat[e] costs of producing documentation, including electronically stored documentation," but they rarely do so. AAA R-23(c). The parties should provide for cost-shifting in their arbitration provision to ensure that the costs of discovery are shared between the parties. Addressing these issues at the time of drafting can save time and expense in the event discovery disputes arise.

5. Control the Timing of the Resolution

It is often thought that arbitration produces results faster than litigation. But with the rise of extensive, litigation-style discovery in arbitrations, the arbitration process may take much longer than expected.

Delay can be avoided by circumscribing the discovery process as discussed above and may also be limited by setting forth time limits for the arbitrator selection process. The arbitration clause should specify that parties are to select their party-appointed arbitrator within 15 days of initiating proceedings and that the party-appointed arbitrators will select a chair within 15 days of their appointment.

AAA Rules require that an award be rendered "no later than 30 calendar days from the date of closing the hearing," but do not specify a time frame by which the hearing must commence. AAA R-45. To avoid extended proceedings, the arbitration clause should specify that the dispute will be submitted to the panel within a certain time period, for example, six months after the preliminary hearing.

Parties can mitigate the time and expense of protracted litigation with a thoughtfully-drafted arbitration provision that serves their clients' needs. Following the above guidelines will assist the parties in creating an arbitration provision that does so.