Should You Include an Arbitration Clause in Your Engagement Agreement?

By Houston Putnam Lowry

Introduction

With Connecticut's recent adoption of the Revised Uniform Arbitration Act,[1] it is time to consider whether you should insert an arbitration clause into your engagement agreement. It does not matter if your terms of engagement are contained in a countersigned letter or in a formal, signed 30-page contract. You should consider whether or not to include an arbitration clause.

The law has changed and you should take that as an opportunity to review your procedures. Why shouldn't you consider arbitration now?

What is arbitration?

Arbitration is a contractual agreement to submit a dispute to a neutral third party to decide. The arbitration award is binding on all parties and can be enforced by a court (who will issue a judgment to enforce the arbitration award, which can be enforced by any other judgment through an execution).

The concept of "advisory arbitration" is an oxymoron. Arbitration reaches a binding conclusion. If the result isn't binding, it isn't really arbitration.

Arbitration is different from mediation because a mediator does not have the power to resolve the dispute. The mediator can only convince and cajole the parties to resolve their dispute. If the parties refuse to agree, the mediator cannot force them to agree. The arbitrator resolves the dispute, even though one or more of the parties do not agree with the arbitrator's decision.

Arbitration is different from litigation because the dispute is determined by an arbitrator selected by the parties (or at least the process for selecting the arbitrator). In litigation, a judge from a court will decide the case. Any judge's decision is subject to appeal. While arbitrator's awards can be overturned, the grounds for vacating an arbitrator's award are very limited. Virtually all arbitration awards are confirmed.

Why should I arbitrate?

There are a number of reasons to prefer arbitration over litigation:

Faster

A well-managed arbitration will be over faster than the standard court case. Court cases can take up to five years, especially once appeals are taken into consideration. Most arbitrations are done within a year (assuming the parties are skilled in managing arbitrations, which is a different skill than managing litigation).

Cheaper

An arbitration will be cheaper because it is over faster. One of the biggest costs in litigation is the costs for attorneys. While the parties must pay the arbitrator for the arbitrator's time (as opposed to a judge, who is paid by the government), the less time the arbitrator spends on the case, the less the arbitrator will charge.

Some arbitrators charge by the hour. Some arbitrators charge by the day. Some arbitrators have cancellation fees and some do not. The arbitration costs multiply by five times if the parties select a three person arbitrator panel instead of a single arbitrator!

Scalable

Arbitrations are scalable. A small dispute should have a simple and inexpensive process to resolve the dispute. A large dispute might well warrant a more expansive (and expensive) process to resolve the dispute.

For example, most arbitral institutions will not administer claims within the small claims $5,000 jurisdictional limit. It is just easier (and less expensive) to go to small claims court for claims $5,000 and under.

You may want to have a simple case resolved by using a documents only submission rather than having an oral hearing. The arbitration agreement can allow for telephonic hearings for the right sized cases. For small cases, you might prefer to avoid a requirement to mediate before you arbitrate. For larger cases, you would want to require mediation before the arbitration. You can scale how the arbitration will work and most arbitral rules take this into account.

Expertise

The parties get to pick their arbitrator (or at least the process to pick the arbitrator). When the parties select an arbitral institution, one of the things they get is that institution's list of arbitrators. Unless you arbitrate a lot, you won't know who is a good arbitrator or who is working on their very first case. Arbitral institutions make sure the arbitrators on their list are trained and reliable.

Confidentiality

An arbitration is confidential. There is no court clerk's office to go to see if there is an arbitration pending (or was pending). There is no central repository of arbitral awards. As long as the losing party pays, there is no reason to file the arbitration award in the courts to enforce it.

There is no public record of the dispute unless the power of the court is required to make the losing party pay. If the losing party wants to keep the matter confidential, they will pay the award. If the losing party does not care about confidentiality and will not pay, then the winning party will have to resort to the court to enforce the award.

Once you have considered these factors, you will likely conclude that it makes sense to arbitrate disputes with your clients.

Should the arbitration be administered?

There are two different kinds of arbitrations: administered and *ad hoc*. The kind of arbitration will be specified in the arbitration clause.

An *ad hoc* arbitration is not administered by an arbitral institution. The parties must have a fair bit of experience to handle an *ad hoc* case well. While optimists think there will be no dispute in administering their case, the parties may not agree how the

case should proceed. If the parties do not agree, they must resort to the courts.

The court will appoint an arbitrator if the parties do not agree. This obviously detracts from the confidentially because the application must be filed in the court. It is entered on the docket and becomes a matter of public record. Then the court will ask the parties who they would like as the arbitrator. Surely the parties will not agree, otherwise they would have jointly appointed the arbitrator without applying to the court.

The question will be who will the court appoint? While the court might appoint an arbitrator recommended by one of the parties, that isn't very likely if both parties are before the court and make differing recommendations. The court will select an arbitrator.

However, courts do not appoint arbitrators every day or even every year. The court will have to find someone it considers qualified based upon the judge's experience (or from a list maintained by the Judicial Branch, which might not be up-to-date).

The situation is different for administered arbitrations. There are a variety of arbitral institutions, such as the American Arbitration Association,[2] the American Dispute Resolution Center,[3] the International Chamber of Commerce,[4] and many others. The arbitral institution is responsible for ensuring the arbitrations filed with it proceed smoothly and charges a filing fee whenever a case is filed.

Each arbitral institution has full time case administrators. These people handle arbitration cases all day, every day. They know the "ins and outs" of their rules (and each arbitral institution has their own rules). They have access to a panel of trained and experienced arbitrators. They may even have attorneys on staff to answer the case manager's questions.

Whatever the situation, the case manager has likely seen it before. The case manager helps both parties as needed and is a "handmaiden" to the process. Having an arbitral institution administer an arbitration will almost certainly eliminate the need to apply to the courts for assistance during the arbitration.

The pathological arbitration clause

The parties must have agreed in writing to have an arbitration.[5] If there is no agreement, there is no arbitration (unless the parties agree after the dispute has arisen, which is very hard to do). The most effective agreement refers to future disputes, not existing disputes.

It is surprisingly easy to draft a defective arbitration clause. This makes the clause unenforceable and requires the parties to go to court to straighten out the mess. Sometimes there is a small problem. Sometimes there is a big problem. Sometimes there isn't even a problem.

For example, the parties may have picked standards for selecting an arbitrator that just cannot be met in the real world. There are just not that many trained arbitrators who are lawyers, have a certified public accountant qualification, and a PhD in astrophysics. Under the circumstances, the court will pick that arbitrator for you and the arbitrator is not likely to have all of the qualifications the parties agreed to.

Each arbitral institution has a recommended arbitration clause. Their recommended arbitration clause will not be pathological, so you should consider using their standard arbitration clause unless there is a good reason to deviate.

The American Arbitration Association Consumer Due Process Protocol

The American Arbitration Association developed a Consumer Due Process Protocol in 1998. This will apply to cases where a party is a consumer, meaning the transaction involves a sale or service primary for personal family or household purposes. This protocol does not apply to business transactions.

If you provide services primarily for personal, family, and household purposes and you want to have the American Arbitration Association administer your arbitration, you must adhere to their Due Process Protocol. This will include subsidizing the costs of the arbitration to ensure the consumer's cost is reasonable.[6] The use of mediation is strongly encouraged.[7] The protocol assumes there will be a hearing and the matter will not proceed on a documents only basis.[8]

The American Arbitration Association will decline to administer cases where the arbitration clause violates their Consumer Due Process Protocol. Towards this end, the American Arbitration Association will review your clause before a dispute arises to determine if it meets with their requirements. If it doesn't, they will tell you in advance so you can fix it.

If you don't have your arbitration clause reviewed in advance, you will only find out there is a problem after a case has been filed and the American Arbitration Association declines to administer the case. Once they decline to administer the case, your arbitration clause becomes instantly pathological and will require court intervention to fix it.

Conclusion

An arbitration clause will provide all of the benefits of arbitration if it is drafted carefully and is administered by a skilled user. If done right, arbitration is faster, cheaper, and more flexible than litigation. However, without advanced planning, an arbitration clause will not deliver the desired benefits. ■

Houston Putnam Lowry is a member of Polivy Taschner Lowry & Clayton of Hartford.

Notes

1. HB-5258 became PA 18-94, to be effective October 1, 2018.
2. Adr.org
3. http://www.adrcenter.net
4. https://iccwbo.org/dispute-resolution-services/arbitration/
5. PA 18-94, §6(a).
6. Principal 6.
7. Principal 10.
8 *See* Principal 12(1).