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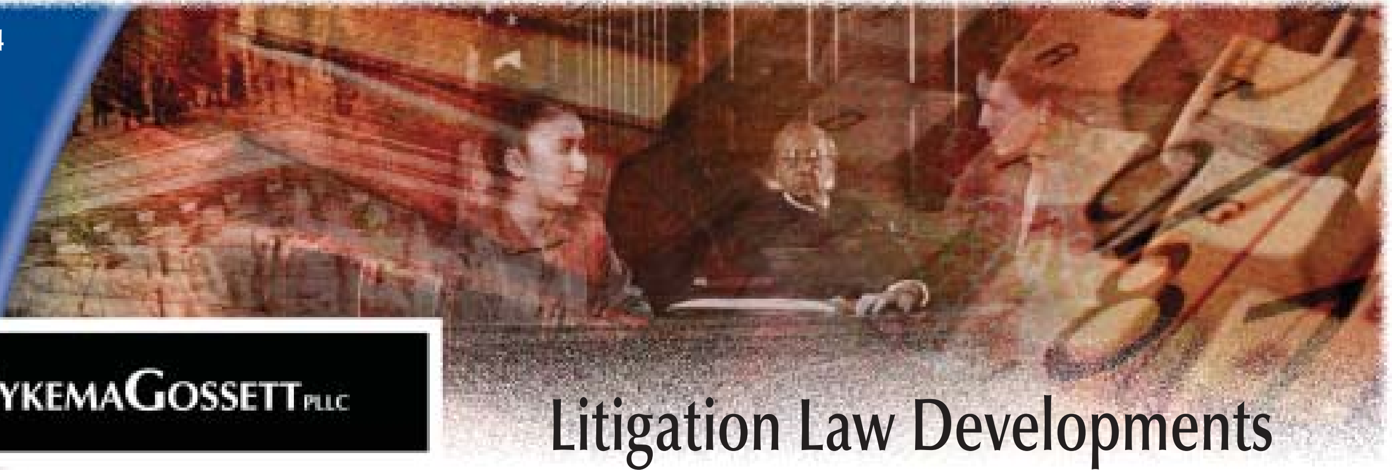

Eight Tips for Drafting Better Arbitration Clauses

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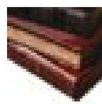

Do you have a typical arbitration clause that you like to use in your contracts? Consider these eight ways of improving the prospective agreement to arbitrate a dispute:

1. How should the question of **enforceability of an arbitration agreement** be resolved? The arbitration clause can so specify, but only if written in clear and unmistakable language. For example: "In the event of any claim that this arbitration agreement is invalid or is not enforceable by the arbitrators, the arbitrators shall determine whether the arbitration agreement is valid and enforceable. The parties agree that this determination, often reserved for the courts, is hereby submitted to the arbitrators."
2. How should **dispositive legal questions** be resolved? The arbitrators could be authorized to determine the equivalent of motions for summary judgment, but the award could be overturned because of the failure of the arbitrators to hear evidence that otherwise would be relevant to the claim or defense. If you believe that the ability to bring a dispositive motion would be useful, despite this risk, include in your arbitration agreement a sentence indicating that, for example, "the arbitrators may hear and determine any preliminary issue of law asserted by a party as dispositive, to the same extent that a court could hear and determine a motion for summary disposition."
3. Should the matter be heard by **one or three arbitrators?** How should they be selected? You should consider this, and specify your ideal in the agreement. Example: "Within ___ days after the commencement of arbitration, each party shall select one person to act as arbitrator and the two selected shall select a third within ten days of their appointment. If the arbitrators selected by the parties are unable or fail to agree upon arbitrator, the third arbitrator shall be selected by the American Arbitration Association."
4. Do you expect **preliminary relief** to be available, before the determination of the full claim? The Commercial Rules of the American Arbitration Association permit preliminary relief. (These are called the "Emergency Interim Relief Procedures" of those Rules.) They permit the holding of monies in escrow, the issuance of an injunction, and other means necessary to preserve the status quo. However, if you anticipate that preliminary relief may be necessary, it will speed the matter if the arbitration agreement explicitly permits a party to apply to the arbitrators for that preliminary relief. Example: "Either party may apply to the arbitrator seeking injunctive relief until the arbitration award is rendered or the controversy is otherwise resolved. Either party also, without waiving any remedy under this agreement, may seek from any court having jurisdiction any interim or provisional relief that is necessary to protect the rights or property of that party, pending the establishment of the arbitration tribunal." Remember, too, that arbitrators proceed carefully with great attention to their authority to do anything beyond the typical award. If you want the flexibility to ask the panel to modify preliminary relief after deciding the whole claim, include that in the arbitration agreement. For example: "Either party may apply to the arbitrator to modify a ruling for preliminary relief before or concurrently with the arbitration hearing."
5. Does the **choice of law** matter to you? If so, provide that "This agreement shall be governed and interpreted in accordance with the laws of [jurisdiction]."
6. What **remedies** are available to the arbitrators for determining the full claims and defenses? For example, the parties may agree that the

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arbitrators can award equitable relief, attorney fees, punitive damages, compensatory damages only, pre-award interest, liquidated damages, a high/low determination, etc. They may agree to place a dollar limit on the award, or to specify a certain rate of pre-award interest (so long as it does not duplicate any pre-judgment interest awarded when the judgment is rendered by a court). Examples: "Any award in an arbitration initiated under this clause shall be limited to monetary damages and shall include no injunction or direction to any party other than the direction to pay a monetary amount." "The arbitrators will have no authority to award punitive or other damages not measured by the prevailing party's actual damages, except as may be required by statute."

7. Are there issues of **confidentiality** that will arise during arbitration? If so, provide for the protection of trade secrets by means of a non-disclosure agreement, the imposition of liquidated damages, or other protection.
8. Are you concerned that the other party may **run out of funds** during the arbitration? Some clients have been in the frustrating position of having an opponent stop paying its share of the arbitration fees. That failure can result in a paralysis of the dispute: it stops dead in its tracks; there is no further arbitration and no award is entered. Consider including in the agreement a provision that states that "the failure by one party to pay its share of arbitration fees constitutes a waiver of the claim or defense in the arbitration," or some similar language.

For more language, and more considerations in drafting your arbitration clauses, consult "Drafting Dispute Resolution Clauses—A Practical Guide" published by the American Arbitration Association.

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United States Supreme Court Prohibits Employers from Amending Pension Plans Retroactively to Decrease Benefits for Young Retirees Who Go Back to Work, but Also Leaves Open the Possibility of Relief through Federal Regulations

In *Central Laborers' Pension Fund v Heinz,* the United States Supreme Court unanimously held that the Employee Retirement Income Security Act of 1974 (ERISA) bars employers from imposing new conditions on already accrued benefits under multi-employer pension plans. Multi-employer benefit plans are common in the construction, mining, retail and manufacturing industries. Approximately 9.5 million people are covered by such plans.

The case involved two Illinois employees who retired from the construction industry after accruing enough pension credits to qualify for early retirement payments under a defined benefit "service only" pension. At the time of their retirement in 1996, the multi-employer pension plan (Plan) prohibited beneficiaries from engaging in certain "disqualifying employment" after they retired. The Plan defined "disqualifying employment" as any job as "a union or non-union construction worker," but did not include supervisory employment positions. The two retirees took supervisory jobs in the construction industry and continued to receive their monthly pension payments.

In 1998, the Plan was amended by expanding the definition of "disqualifying employment" to include any job "in any capacity in the construction industry (either as a union or non-union construction worker)." Because the Plan now covered supervisory work, the two retirees were told that their monthly pension payments would be suspended if they continued in their jobs.

The two retirees sued, alleging that the Plan's amended "disqualifying employment" definition imposed new conditions and thus violated ERISA's "anti-cutback" rule, which provides "[t]he accrued benefit of a participant under a plan may not be decreased by an amendment of the plan…." 29 U.S.C. §1054(g)(1). After noting that ERISA's central objective is to protect employees' justified expectations of receiving benefits promised by employers, the Court agreed with the lower appellate court that "as a matter of common sense, a participant's benefits cannot be understood without reference to the conditions imposed on receiving those benefits, and an amendment placing materially greater restrictions on the receipt of the benefit 'reduces' the benefit just as surely as a decrease in the size of the monthly benefit payment." The Court also concluded that its interpretation of the ERISA provision is consistent with Internal Revenue Service's interpretation.

In an apparent attempt to offer some relief to employers, four Justices noted in a concurring opinion that the decision does not foreclose the Labor and Treasury Departments from issuing regulations allowing plan amendments to enlarge the scope of disqualifying employment with respect to benefits attributable to already-performed services.

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Where Have All the Trials Gone?

Despite media publicity about a national litigation explosion, trial lawyers for more than a decade have sensed the steady development of the opposite phenomenon: there seem to be fewer civil trials, both in federal and state courts. "Litigators" are replacing "trial lawyers." Now there is empirical evidence to support the suspicions of the trial bar and debunk the media hype.

The Litigation Section of the American Bar Association sponsored a symposium on "The Vanishing Trial" in December, 2003 to study the apparent decrease in trials. The working paper for the symposium was "The Vanishing Trial: An Examination of Trials and Related Matters in Federal and State Courts," written by Marc Galanter, Law Professor at the University of Wisconsin. Galanter's study documented an alarming decrease in civil trials, both in federal and state courts.

Galanter tracked federal court filing statistics from 1962–2002. He found that, although yearly dispositions had increased

five-fold from 50,000 to 258,000 cases during that time period, the number of civil trials in 2002 was 20% lower than the number in 1962; 4,569 trials in 2002, 5,802 trials in 1962. Even though filings had increased dramatically over 40 years—no doubt reflecting more laws, more lawyers, and more social complexity—dispositions by trial were less than one-sixth of what they had been in 1962. Trial lawyers used to tell clients 1 in 10 cases went to trial, now it is closer to 2 in 100 cases. And most of the fall-off has occurred in the last 15 years.

Data from state courts around the country are more spotty but nevertheless reflect the trend now documented in federal courts. Statistics compiled from 22 states, including Michigan and California (where, among other states, Dykema Gossett has offices) from 1976 to 2001 show trials as a percentage of dispositions declining from 34% in 1976 to 18% in 2001. Yet total dispositions—reflecting an increase in filings—tripled over that same time period.

Why the decrease in trials nationally? Galanter's study has a tougher time ascribing cause than it does tracking the phenomenon itself. Explanations include the departure of cases to other forums, diversion to alternative dispute resolution, the sheer expense of trial, and the discretion of trial judges to effect dispositions short of trial.

Similarly, the effects of the trial implosion are as yet uncertain. A decrease in trials means the system looses it historic benchmark for resolving many disputes: "What would a jury do?" Commentators now see a profusion of legal doctrine developing independent of trials. Indeed, many settlements already seem to have lost their real-world connection, particularly in class actions, which the parties almost never take to trial. And fewer trials means fewer experienced trial lawyers to help clients decide when they should take the risk of trial and how to manage that risk once taken. Inexperienced trial counsel simply may be less likely to advise clients to opt for trial.

In absolute numbers, trials are not yet an endangered species nationally. But the marked decrease in trials over the last 15 years is sure to have an impact on our system of justice in the decade ahead; exactly what impact no one knows with any certainty.

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The Michigan Business Corporation Act:

Does It Adequately Serve the Needs of Michigan's Small, Privately Owned Businesses?

The Michigan Business Corporation Act provides an indispensable framework within which Michigan businesses, operating in the corporate form, conduct their affairs. Michigan's legislature is to be applauded for periodically updating the Act to address changes that occur within the business environment from time to time. Nonetheless, important issues occasionally fall between the cracks and do not receive the degree of attention they may deserve. This is understandable given that the Act addresses issues affecting a broad range of businesses with very different needs, organizational structures, and management issues. The Act applies equally to Fortune 500 corporations, professional practices (e.g., medical, dental), and family-owned enterprises with only a few employees. Many of its provisions do not translate well into the practical day-to-day issues that often face small and family-owned businesses. As a result, when privately-owned or closely-held businesses have disputes that are not readily addressed by the Act, owners of such businesses may be forced to pursue costly and time-consuming litigation to obtain a satisfactory resolution.

There has been progress in the last several years, with the adoption of Michigan's Limited Liability Company Act. Many new enterprises are adopting this form of business organization because of the beneficial flexibility it provides. In addition, the Michigan Business Corporation Act was amended in July 2001 to allow shareholders to opt out of some provisions of the Act and to provide alternative methods and procedures for managing a company and ascribing shareholders' rights within the company's articles, bylaws, or shareholder agreements. These are welcome changes that provide needed flexibility for new companies and existing companies that can generate the necessary shareholder support to enact them. The fact remains, however, that the vast majority of Michigan's existing privately-owned businesses have not been converted to LLCs and they cannot obtain the necessary votes among the shareholders to do so. Thus, they cannot make the changes necessarily to overcome the "holes" in the provision of the Michigan Business Corporation Act. Accordingly, a more comprehensive solution may be needed.

Possibly the most pressing need for change involves the current difficulties encountered by a 50% shareholder who seeks to exit a Michigan business corporation. Without a shareholder agreement providing for a withdrawal, such a shareholder is left with two poor options in the event the shareholder no longer wishes to invest capital or otherwise participate in an enterprise in which he or she lacks a controlling interest. The shareholder can sue to have the corporation dissolved pursuant to MBCA § 1823 or bring suit alleging oppression pursuant to MBCA § 1489. But the burden of proof in each case is very heavy, and often presents an insurmountable hurdle to exiting the enterprise. The shareholder thus is forced either to sell out for whatever others will pay or to remain a shareholder.

In order to dissolve a corporation, the shareholder must establish that a deadlock exists and that as a result the corporation no longer can function effectively in the best interests of its shareholders and creditors. While it is relatively easy for shareholders owning 50% of a company to establish that a deadlock exists, meeting the second part of the dissolution test is more difficult. Often, the shareholders of the other 50% interest are entrenched in management and able to operate the company to their satisfaction. They may assure that the customers are satisfied and that the creditors are paid, while also enjoying significant perks not shared with the other shareholders. In extreme cases, they may limit or completely eliminate shareholder distributions. While some courts around the country have found dissolution to be appropriate where a deadlock exists, even when the corporation is not in danger of failing, the results are by no means uniform. There is

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currently no authoritative case law in Michigan on the subject. In many cases, the result is determined more by the judge randomly assigned to the case than by any established legal principles.

Minority shareholders (those owning less than a 50% interest) have even fewer options. Because they usually cannot establish a deadlock, the remedy of judicial dissolution is unavailable to them unless they can prove shareholder oppression. Section 489 of the Michigan Business Corporation Act provides for equitable remedies, including dissolution, if the oppressed shareholder can show that the acts of those in control of the company are illegal, fraudulent, or willfully unfair and oppressive. While Section 489 provides a strong remedy for the wronged shareholder, in the most extreme cases a savvy majority group usually can take adequate precautions to assure that its minority shareholders will have a difficult time establishing such oppressive conduct.

Michigan's Business Corporation Act would be strengthened and its relevance to small business owners increased if it were amended to address these dilemmas. In a future article, I will review approaches adopted in other states and discuss changes that may be worth considering in Michigan.

For more information, contact Mark Hauck at (313) 568-6754 or mhauck@dykema.com.

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