U.S.: Drafting An Arbitration Or Mediation Clause

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Parties who wish to arbitrate a maritime claim in the United States have many options, both as to the location of the arbitration and the rules which will govern. Of course, whether a claim will be subject to arbitration, and, if so, where and under what rules, will ordinarily be determined long before such claim arises, in the arbitration clause in the governing contract. The time to consider where and how disputes should be resolved, therefore, is during contract negotiations.

Care in crafting the arbitration clause will invariably save the parties time and money down the line if disputes arise. Above all, clarity and precision are key to avoiding costly and unnecessary litigation over the question of what exactly the parties meant in their arbitration clause. At a minimum, an arbitration clause should specify (1) the nature and scope of what disputes are to be subject to arbitration, (2) where the arbitration is to take place, and (3) what law and arbitration rules, if any, will govern. If not already specified in the rules which are to be incorporated, then the clause should further specify (4) how arbitration is to be commenced, (5) how arbitrators shall be appointed, and on what timetable, (6) who may (or may not) be an arbitrator, and (7) any other special rules which the parties want to include, such as establishing a time bar period for claims or stipulating whether the prevailing party shall be entitled to recover its attorneys' fees and costs.

Finally, the arbitration clause should specify that a judgment of the court may be entered upon any arbitration award made pursuant to arbitration under the agreement. Although not necessary in cases governed by the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (also commonly referred to as the New York Convention), this last point can be critical where enforcement is sought under the Federal Arbitration Act which governs in respect of "non-Convention" maritime arbitration cases in the United States - as a failure to stipulate that an arbitration award may be enforced by the courts may complicate a party's right to obtain a judgment on an arbitration award under that statute.

1. Broad vs. Narrow Arbitration Clauses

In specifying exactly what claims are to be subject to arbitration, one should consider two related questions: (1) upon whom shall the clause be binding, and (2) in respect of what kind of claims. Taking the latter point first, consideration should be given to whether all claims "arising under, or in connection with, the contract" should be subject to arbitration or whether there is a subset of claims - cargo damage claims as one common example - that the parties wish to preserve for the courts.

The question of who should be bound by an arbitration clause might seem obvious until one considers the situation, for instance, in which a charter party is subsequently incorporated into a bill of lading. Courts in the United States routinely hold that a charter party arbitration clause duly incorporated into a bill of lading will be enforced, even in respect of a claim by or against a third party not a party to the charter, so long as the arbitration clause is worded sufficiently broadly to cover the claim. The quintessential "broad" arbitration clause usually requires arbitration of "all disputes arising under, or in connection with, this charter party." One typical example of a "narrow" arbitration clause, on the other hand, limits arbitration to "all disputes between Owner and Charterer." The courts have construed this latter clause to exclude from the arbitration obligation claims by or against third parties. Perhaps surprisingly, there are nearly as many court decisions considering whether a particular clause is a narrow or broad one as there are variations of the two above examples. In nearly every case, however, it is the wording of the arbitration clause which controls.

2. Appointing Arbitrators

What about the common problem where a party commences arbitration and the other party refuses to appoint an arbitrator? The Federal Arbitration Act specifically allows the parties to stipulate a method for appointment of arbitrators, and most contracts do specify one method or another. Where the contract fails to address this issue, or if a party fails to follow the specified method, Section 5 of the Federal Arbitration Act permits a party to request the court to appoint an arbitrator. 9 U.S.C. § 1 et seq. In such case, unless the contract specifies otherwise, a single arbitrator will be appointed.

Some contracts circumvent the need for a court application by providing that if the second party fails to appoint an arbitrator within a specified period of time, the arbitrator appointed by the first party shall act as sole arbitrator or, where a panel of three arbitrators is called for, the first party may appoint a second arbitrator and the two so chosen shall appoint the chairman. Although courts will closely scrutinize the circumstances surrounding such an appointment, such agreements are typically recognized in the United States.

While such clauses can make the process of initiating arbitration proceedings quicker and easier, however, there is a risk to such clauses which is well worth considering: in the event a dispute arises concerning the validity of the formation of the Panel under such a clause, such dispute will not be resolved until after the arbitration has been concluded, i.e., in the context of an application to confirm the award. Thus, if such a provision is to be used, care should be taken to ensure that it clearly specifies the timing, notice and/or service requirements and that such requirements are honored.

3. Incorporating Arbitration Rules

If the parties do not specify the rules that shall govern their arbitration, then the arbitrators will be required to develop rules on an "ad hoc" basis - subject to any agreement between the parties-by which the arbitration shall proceed. This may in fact suit the parties to an agreement in some cases, as where they anticipate that any arbitration under the agreement will be "unique" in some way which will require particularized arbitration rules. On the other hand, it can be an expensive expenditure of time and good will between the parties to attempt to negotiate detailed dispute resolution rules in a contract before a dispute arises, and leaving such issues unspecified until after a dispute already has arisen can be very risky. For this reason, many parties prefer instead to incorporate existing arbitration rules into their contract. Two of the more common examples in the United States maritime context are the rules of the Society of Maritime Arbitrators, Inc. (the "SMA") and of the American Arbitration Association (the "AAA").

a. The SMA

Formed in 1969, this non-profit organization has published arbitration rules and maintains a roster of qualified arbitrators. Members of the SMA are...
The SMA proposes the following model arbitration clause:

Should any dispute arise out of this Charter, the matter in dispute shall be referred to three persons at New York, one to be appointed by each of the parties hereto, and the third by the two so chosen, their decision or that of any two of them shall be final, and for the purpose of enforcing any award, this agreement may be made a rule of the Court. This contract shall be governed by the Federal Maritime Law of the United States. The proceedings shall be conducted in accordance with the Rules of the Society of Maritime Arbitrators, Inc. (including Section 2 - consolidation). The arbitrators shall be members of the Society of Maritime Arbitrators, Inc.  

i. Consolidation and Appointment of Arbitrators: The SMA Rules provide for consolidation of proceedings where two or more arbitrations involve common questions of fact or law (such as, for instance, where a dispute involves a head charter and one or more sub-charters). The Rules provide that arbitration is to be commenced by giving written notice to the other party demanding arbitration, and any such arbitration shall take place in New York City unless the parties specify otherwise. The Rules further provide that, unless the parties specify otherwise in their agreement, the party demanding arbitration must resort to Section 5 of the Federal Arbitration Act to obtain an order from the court appointing an arbitrator if the other party fails to appoint an arbitrator.

ii. Hearings: The parties are entitled to legal representation at arbitration hearings conducted under the SMA Rules, and unless the parties agree otherwise, a stenographic record shall be made of any hearing. Hearings ordinarily are conducted in a conference room at the counsel's office of one or the other of the parties (often, the parties will alternate depending on whose witness is being presented) or at some other mutually agreed place.

iii. Evidence: The parties may submit documentary evidence and may submit witness evidence by affidavit or through oral testimony at a hearing. The Panel is specifically empowered to issue subpoenas for witnesses and documents, although this power is not unlimited. The parties may also agree to proceed on documentary evidence alone.

iv. The Award and Provisional Relief: The SMA Rules provide that the Panel has the "collective duty" to issue an award within 120 days of the close of the proceedings. If stipulated by the parties, or where it deems it necessary or appropriate, the Panel is empowered to issue a partial final award deciding certain of the disputes while remaining constituted to resolve other issues at a later date. The arbitrators are also empowered to compel the posting of security in appropriate circumstances. Alternatively, the parties may seek security through the courts, such as by means of maritime attachment or arrest, as may be appropriate.

v. Arbitrators' and Attorneys' Fees: Section 30 of the SMA Rules provides that the Panel "shall assess arbitration expenses and fees" and: shall address the issue of attorneys' fees and costs incurred by the party. The Panel is empowered to award reasonable attorneys' fees and expenses or costs incurred by a party or parties in the prosecution or defense of the case. The arbitrators charge fees for their services, but the SMA does not charge administrative fees. The arbitrators are empowered to and frequently do, direct the parties to put funds in escrow to secure the arbitrators' fees and expenses.

vi. Shortened Procedures: The SMA also provides rules for a shortened arbitration procedure, which the parties may incorporate in their contract. The Rules contemplate that the parties will stipulate the claim amount threshold below which the shortened procedure will be used. The Shortened Arbitration Rules set a procedure for selection of a sole arbitrator and set a short schedule by which the claim is to be presented. The shortened arbitration proceeds on documents alone, and no discovery is allowed except as deemed necessary by the arbitrator. An award must be issued within 30 days of the final submission, and the arbitrator's fees may not exceed $1,500. The arbitrator may award attorneys' fees and costs, but only up to $2,500.

vii. Publication: A feature of the SMA which many of its users consider valuable is that it publishes its awards in a periodical reporter and on the LEXIS document service. Indeed, Section 1 of the SMA Rules provides that "unless stipulated in advance to the contrary," by incorporating the SMA Rules the parties expressly consent to publication by the SMA of any award. While arbitration awards do not establish binding precedent for future cases, many commentators argue that the publication of reasoned awards provides the maritime community with a better opportunity to understand what kinds of disputes are arising and to predict how such disputes are likely to be resolved. This allows parties to determine in the first place whether they should change their behavior or modify their contracts before a dispute arises and, once a dispute has arisen, whether and on what terms it should be settled.

b. The AAA

Another well known arbitration organization in the United States is the American Arbitration Association. That organization, which was formed over 75 years ago, reports that it handled more than 230,000 cases in 2002, including arbitrations, mediations, fact-finding hearings and mini-trials.

I. Applicable Rules: Unlike the SMA, the AAA has published several different sets of rules designed to accommodate many specific kinds of cases. These include rules relating to commercial disputes, real estate disputes, wills and trusts, and employee benefit issues. The AAA has not, however, published specific maritime arbitration rules, nor does it have a roster of specially qualified maritime arbitrators.

The rules with the most relevance for present purposes are the Commercial Arbitration Rules and the International Arbitration Rules. The parties may expressly incorporate any set of Rules into their agreement. If no rules are specified, then the Commercial Arbitration Rules shall apply by default whenever the parties have called for arbitration by the AAA of a domestic commercial dispute and the International Arbitration Rules shall apply by default when the parties have called for arbitration by the AAA of an international commercial dispute.

The AAA offers the following model arbitration clause:

Any controversy or claim arising out of or relating to this contract, or the breach thereof, shall be settled by arbitration administered by the American Arbitration Association under its Commercial Arbitration Rules, and judgment on the award rendered by the arbitrator(s) may be entered in any court having jurisdiction thereof.

II. Appointment of Arbitrators: Both the Commercial and the International Rules allow the parties to specify the manner in which the arbitrator(s) shall be appointed. Unlike the SMA Rules, however, both sets of AAA rules provide a default procedure and timetable in the event that one or the other party does not comply with the method chosen or if no method is specified in the agreement.

III. Proceedings: Arbitration is commenced by written demand to the other party, coupled with filing of the demand and a copy of the arbitration provision with the AAA. Under both sets of Rules, unless the parties specify to the contrary, there shall be only one arbitrator. Neither set of rules provides for consolidation of related proceedings.

As with the SMA Rules, the parties are permitted to offer evidence by way of documents, affidavits and oral testimony. A stenographic record of hearings is taken only if one of the parties so requests. Under the International Rules, the tribunal may appoint its own independent expert to report to it in writing on specific issues. Where such an expert is used, any party so desiring may thereafter examine the expert about its conclusions.
iv. AAA, Arbitrators' and Attorneys' Fees: Both the Commercial and International Rules require the payment of a filing fee and a case service fee to the AAA, the amounts of which are pegged to the quantum of the claim. The filing fee, which is due upon the filing of a claim or counterclaim, is $500 for claims up to $10,000, $750 for claims up to $75,000, $1,250 for claims up to $150,000, and increases gradually to $8,500 for claims over $1 million. Where no amount is stated or where the claim or counterclaim is not for a monetary amount, the initial filing fee is $3,250. When the first hearing is scheduled, an additional case service fee is assessed for claims over $75,000. This fee ranges from $750 to $2,500 for claims over $1 million. These costs are in addition to the arbitrators' fees. The AAA may require the parties to put funds in escrow to cover anticipated arbitrators' fees.

The Commercial Rules empower the arbitrators to award the costs of arbitration, and they may also award attorneys' fees, but only “if all parties have requested such an award or if it is authorized by law or their arbitration agreement.” The International Rules provide that the tribunal may apportion arbitration expenses and attorneys' fees among the parties if it determines that such apportionment is reasonable.

v. Award and Interim Relief: Both sets of rules specifically empower the tribunal to issue interim relief, including injunctive relief and measures for the protection or conservation of property. The rules also permit a request for interim relief to a judicial authority, such as seeking an attachment or arrest of property.

The Commercial Rules provide that an award shall be issued within 30 days of the close of the proceedings; the International Rules contain no time limit. Under the Commercial Rules, the award must be in writing, but the arbitrators need not render a reasoned award unless the parties request such an award in writing prior to appointing the arbitrator or unless the arbitrator deems it necessary. Under the International Rules, the tribunal must render a reasoned award unless the parties agree that no reasons need be given. Unless the parties consent, AAA awards shall not be made public.

vi. Expedited Procedures: The Commercial Rules contain provisions for expedited procedures where the claim amount is less than $75,000 (this threshold can be altered by the parties). These rules limit the availability of extensions, streamline the procedures for appointment of an arbitrator and encourage the parties to proceed on documents alone (this is required for claims under $10,000). Where a hearing is required, it ordinarily may not exceed one day. An award shall be issued within 14 days of the closing of the proceedings. The International Rules do not contain similar provisions for expedited hearings.

4. Mediation Clauses

Mediation has long been a useful tool in dispute resolution in the United States; however, the idea of including a mediation clause in the contract seems to be of more recent vintage. Both the SMA and the AAA offer form mediation clauses for inclusion in contracts. Both have also published mediation rules (although the SMA calls theirs Conciliation Rules). The SMA's model conciliation clause is as follows:

Where, in the event of a dispute arising out of or relating to this contract, the parties wish to seek an amicable settlement of that dispute by conciliation, the conciliation shall take place in accordance with the Rules for Conciliation of the Society of Maritime Arbitrators, Inc. of New York then in force.

The AAA's mediation clause is somewhat different, providing as follows:

If a dispute arises out of or relates to this contract, or the breach thereof, and if the dispute cannot be settled through negotiation, the parties agree first to try in good faith to settle the dispute by mediation administered by the American Arbitration Association under its Commercial Mediation Rules before resorting to arbitration, litigation or some other dispute resolution procedure.

The SMA model clause thus only designates the method in which mediation will take place in the event that the parties, after a dispute arises, determine that mediation would be useful. The AAA clause, on the other hand, goes much further to require a good faith effort at mediation before a party may even commence litigation or arbitration.

The goal of mediation, of course, is to resolve disputes as quickly and inexpensively as possible on a commercial basis, and mediation has proved over the years to be an effective tool in dispute resolution. On the other hand, mediation, by its very nature, is non-binding unless a settlement is actually reached, and it therefore can only assist the parties in resolving their dispute where they are both interested in reaching a commercial compromise. There are some kinds of disputes, however, in which one or the other party - acting entirely in good faith - would prefer a clarification of its rights or obligations under an agreement. This is particularly true, for instance, where the same issue is likely to arise again and again under one or more contracts. In such cases, it would seem at least open to debate whether requiring the parties to mediate a dispute before they will be permitted to arbitrate or litigate will succeed in facilitating dispute resolution or whether it will merely insert another layer of expense before the dispute can be resolved.

On a more technical level, the AAA clause raises the important question of whether a party to such an agreement may seek security for a claim through an attachment or arrest notwithstanding that mediation has not yet taken place. One way or the other, the answer to this question probably should be expressly addressed in the agreement.

5. Conclusion

The lesson to be drawn from all the foregoing is simple and straightforward. If proper consideration of these issues is given at the time the arbitration clause is drafted, the parties will have a much better chance of ensuring that their expectations as to how disputes should be resolved will be fully met in the event such a dispute arises, and they will also stand a much better chance of saving themselves valuable time and money by minimizing the risk of an unexpected court battle over what the arbitration clause was supposed to mean.

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1. 19 U.S.C. § 9. See Varley v. Tarrytown Associates, Inc., 477 F.2d 208 (2d Cir. 1973) (holding that Section 9 of the Federal Arbitration Act provides that confirmation of an award under the Act is only permitted where the parties in their agreement have specifically that a judgment of the court shall be entered upon the award); The Home Ins. Co. v. RHA/Pennsylvania Nursing Homes, Inc., 113 F. Supp. 2d 633 (S.D.N.Y. 2000) (noting that, although criticized, Varley remains valid in the Second Circuit).

2. The parties may omit this last sentence if they do not wish to be restricted to selecting arbitrators from the SMA roster. Many contracts merely specify that the arbitrators shall be “commercial persons.” Others provide that the party-appointed arbitrators shall be commercial persons and the chairman shall be a maritime lawyer.


4. Unless either the incorporated rules or the arbitration clause itself provides for it, consolidation of arbitration proceedings is ordinarily not permitted in the United States. If the parties do not wish to allow for consolidation, they may alter this provision of the SMA Rules in their
agreement. Also, as a practical matter, consolidation may only be possible where both contracts call for New York arbitration and either specify application of the SMA Rules or otherwise provide for consolidation.
5. This issue of what discovery may be obtained in connection with arbitration is a subject unto itself and is outside the scope of this article.
6. These and the other AAA rules are available on their website at www.adr.org.
7. Or, if the parties prefer, under the International Arbitration Rules.
8. Where a counterclaim is filed, a separate filing fee is due by the counterclaimant.