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Civil LITIGATION

Multi-tiered dispute resolution clauses: Pre-arbitration procedure

"Everything in its right place." — Radiohead

Mise en place is a French culinary phrase often used in professional kitchens to refer to preparing and arranging the ingredients a chef will require for a meal before service begins. In short, it means to "set in place." If we applied this concept to the drafting and enforcement of contracts, a lawyer may look to a well-drafted escalation clause to ensure the parties to an agreement — and their expectations with respect to future risk — are organized appropriately. A multi-tiered dispute resolution clause, providing for multiple level conflict mitigation procedures, can help parties who are operating a business or engaged in a joint venture to resolve conflicts as efficiently as possible, with an appropriate forum utilized for the specific type of dispute, before turning to an arbitration panel or the courts.

The purpose of the escalation clause is to enhance the parties' chances for finding a prompt solution, filtering out certain disputes as effectively as possible, and avoiding further proceedings, which are likely costly and time-consuming. A multi-step or "waterfall" clause can provide a two- or three-step procedure, usually consisting of good faith negotiations, then mediation, and finally arbitration or litigation in state or federal court.

Our firm often represents stakeholders in conflicts involving the interests or control of a closely held entity. One recent case involved a business which had operated successfully for many years, but the partners had grown increasingly distrustful of each other, engaged in repeated clashes about expenses, customer relationships and transfers of assets. Years ago, when the entity was first formed, the partnership's lawyer at the time inserted a simple dispute resolution clause setting out a mechanism for addressing future conflicts. The subject provision did not include an escalation clause but instead called for "all disputes to be resolved before the American Arbitration Association."

By DAVID M. TANG
Daily Record Columnist

When things came to a head, the parties participated in the alternative dispute resolution process: Both engaged and paid attorneys, they paid fees relating to the ADR process, and both were afforded an informal proceeding where the dispute was submitted to an impartial panel. The benefits of the arbitration (versus a court proceeding) were several — discovery disputes were minimized, resource-consuming motion practice was avoided, and the parties secured a decision from the arbitration panel within 18 months from the filing date of the arbitration claim. The entire proceeding was conducted and resolved privately.

Clients should be advised that binding arbitration for certain types of disputes can present unique challenges — and these should be considered by the client and by the attorney tasked with drafting a dispute resolution clause. I was recently asked to advise a party who was embroiled in a shareholders' dispute. The dispute resolution clause in the shareholders' agreement was similar to the one in the above-described partnership agreement, as it did not incorporate a multiple-tiered procedure but instead called for all disputes to be resolved in binding arbitration.

In this latter case, the shareholders participated in the arbitration process: The arbitrator was selected, each party asserted multiple claims against the other, all issues were briefed (pre- and post-hearing), and an award was issued within a year of the first filing of the arbitration claims. However, from the time of the filing, the matter had escalated into a "bet the company" dispute and the non-prevailing party was left with very limited options in the face of a sizeable damages award. There is no appeal right in arbitration and the grounds for vacating an award are very limited.

Although the non-prevailing party in the shareholder matter sought to vacate the award, the standard in New York for a party seeking to set aside an arbitration award requires a showing that the award or the arbitrator's decision is "totally irrational" — a difficult standard for any litigant to overcome. A federal court's review of an arbitration award is similarly narrow and well-established.

Last year, the U.S. Court of Appeals for the Second Circuit confirmed that "even if an arbitrator makes mistakes of fact or law, [the court] may not disturb an award so long as he acted within the bounds of his bargained-for authority." *National Football League v. NFL Players Association*, 820 F.3d 527 (2d Cir. 2016) (a court's review of arbitration awards is "narrowly

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circumscribed and highly deferential — indeed, among the most deferential in the law").

If the contracting parties can agree in advance to: (1) participate in discussions among principals (or senior officers) to resolve a dispute and, should that fail; (2) contribute in good faith to a mediation process, before turning to a tribunal or seeking court intervention, the chances of saving time, money and business relationships are improved, as is the likelihood of reducing the impact of confrontation on a business, when positions polarize in litigation. Some conflicts cannot and should not be avoided, but frequently the better result for the business client is preservation of relationships and assets.

Like the skilled, professional chef, who dedicates time each day to set things in place in anticipation of the situations that could logically occur during a service period, counsel who is advising a party about to engage in a business transaction should discuss incorporating an escalation clause into the agreement. Having the parties agree to a multi-step dispute resolution procedure will help clients in the variety of situations which may arise under the contract, and will encourage the application of resources to the right place.

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