DRAFTING AN ARBITRATION AGREEMENT—IT'S NOT AS EASY AS IT LOOKS

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INTRODUCTION

The first and essential step towards successful dispute risk management is agreeing to go to arbitration. While this might seem easy enough, getting the drafting right for an arbitration agreement can be surprisingly difficult.

That is because there are underlying complexities which must be understood. If they are not, a small drafting mistake can lead to unnecessary expense and delay before an arbitration; or even a court battle over the validity or existence of an arbitration agreement.

In this article we look at some of the common pitfalls of drafting, and why expert advice is often needed to avoid them.

One of the most common mistakes when drafting an arbitration agreement is including provisions that are inconsistent with the arbitrator's own rules. For example, in *Sumitomo Heavy Industries v Oil & Natural Gas Corporation* [1994] 1 Lloyd's Rep 45, the arbitration agreement referred the dispute to the ICC, but also allowed for the appointment of an umpire. As this was inconsistent with the ICC procedure, the ICC refused to administer the arbitration.

Your arbitration agreement should refer to an established set of arbitration rules to govern the arbitral procedure and you should be cautious when making alterations to those arbitration rules. Any alterations should be for a good reason and thought through properly, because alterations which are inconsistent with the rules themselves may invalidate the arbitration agreement.

IS YOUR DISPUTE CAPTURED BY THE ARBITRATION CLAUSE?

The scope of the arbitration agreement is a matter of interpretation and as such the parties may believe that their agreement will capture all potential disputes, when in fact it will not. In the past many disputes re the validity and scope of the arbitration agreement arose from wording such as disputes 'arising from' or 'out of' a contract.

Since the decisions in *Comandate Marine Corp v Pan Australia Shipping Pty Limited* [2006] FCAFC 192 and *Hi-fert Pty Ltd. v Kiukiang Maritime Carriers Inc* (1999) 159 ALR 142, Australian courts have been more willing to widen the scope of arbitration agreements in order to give them commercial effect. This is also the case in England but the same cannot be said for other important jurisdictions such as India. It can be costly down the track when the parties are unsure if their dispute is covered by the arbitration agreement.

Parties should be aware that careful, unambiguous wording of the arbitration agreement is required to ensure that all relevant dispute are captured by the agreement.

CONFLICTING PROVISIONS

Commonly parties try to keep all avenues open by including arbitration clauses in the same contract with forum selection clauses (or jurisdiction clauses), or combining arbitration and litigation procedures (for example, 'the parties shall proceed to litigate before the arbitration court').

They might however be shooting themselves in the foot as they can lead to ambiguity as to the parties' intent to refer their disputes to arbitration, an ambiguity which can make their

arbitration clauses ineffective and unenforceable.

Be very cautious about including a court jurisdiction clause together with an arbitration clause; there is a risk that it renders the arbitration clauses ineffective and ambiguous.

CASE STUDY—THE HELPFUL CLAUSE THAT BACKFIRED

The recent case of *Seeley International Pty Ltd v Electra Air Conditioning BV* [2008] FCA 29 is a good example of how badly drafted arbitration agreements can cause trouble and harm (and be unenforceable).

The parties agreed that if the senior management couldn't resolve a dispute it would be referred to arbitration.

20 Dispute Resolution

...

20.1 (b) if senior management of each party are unable to resolve the Dispute under Section 20.1(a), it shall be referred to arbitration in accordance with the Rules for the Conduct of Commercial Arbitrations of the Institute of Arbitrators and Mediators Australia. The number of arbitrators shall be 1. The place of arbitration shall be Melbourne, Australia. The language of arbitration shall be English. The arbitral award shall be final and binding upon both parties.'

Presumably to clarify that an arbitrator may grant injunctive or declaratory relief without requiring the parties to satisfy time–consuming procedural steps, the parties then added one sentence:

20.3 Nothing in this Section 20 prevents a party seeking injunctive or declaratory relief in the case of a material breach or threatened breach of this Agreement.

The court, however, took a different view. Owing to the fact that an arbitrator already has the power to grant injunctive or declaratory relief under section 23 of the *International Arbitration Act 1974* (Cth), the court instead interpreted clause 20.3 as preserving a party's right to seek injunctive or declaratory relief before a court. The court was assisted in this interpretation by clause 25 which says that the contract is governed by the laws of Victoria, and that:

Subject to s 20, the parties irrevocably submit to the courts of Victoria, and any courts of appeal from such courts, in relation to the subject matter of this Agreement.

As a result of these contradictory and overlapping provisions, it was held that the parties had not agreed to submit the relevant dispute to arbitration. The unnecessary inclusion of clauses 20.3 and 25 ultimately caused the arbitration agreement to fail.

CONCLUSION

Most failed arbitration clauses can be associated with a lack of precision in drafting the clause. A number of the common pitfalls to avoid have been highlighted above; however, if you are required to include special terms or procedures in these types of clause you should seek expert advice as small drafting mistakes can be costly and ultimately lead to the failure of an arbitration.

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