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Cross-border commercial arbitration clauses come under fire

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Canadian companies have learned the hard way that in contract disputes with U.S. parties, a U.S. jury trial not only has the greatest potential for bias — it also has the potential for unreasonably high damage awards. A carefully drafted arbitration clause is an effective way for Canadian companies to avoid a contract dispute becoming "bet-the-company" litigation.

Navigating state law prohibitions

When negotiating commercial agreements with U.S. parties, Canadian companies do not always have the superior bargaining power necessary to impose a home province forum selection clause. If a Canadian company must agree to litigate disputes in the U.S. party's home state, it should always ask for a jury waiver clause to be included in the agreement.

But jury waiver clauses are not enforceable in every state. Even in circumstances where the Canadian company has the necessary bargaining power, state law may subsequently override a clause that provides for litigation in its home province. An arbitration clause provides much more certainty that the dispute will be heard in a forum with a much lower potential for bias.

A properly drafted arbitration clause will be enforced in most U.S. jurisdictions. The U.S. Supreme Court has consistently held that the *Federal Arbitration Act* pre-empts state law and that an out-of-state choice of venue in an arbitration clause remains valid in the face of a state law prohibition. However, courts in California have fought back against federal pre-emption under the Act, using unconscionability and public policy concerns as a means to invalidate the entire arbitration clause.

It is clear that California courts are willing to use these criteria to strike down arbitration clauses between two U.S. parties. It is not clear whether an arbitration clause in an agreement between international parties will be less susceptible because of the greater respect afforded party autonomy by U.S. courts in the international context.

Careful drafting will ensure that the arbitration clause will not be viewed as unconscionable by a California court.

Judicial review and appeal rights

Once an almost unanimous choice for efficient dispute resolution, arbitration now faces criticism from many commentators, who cite the limited scope for judicial review of arbitral awards as its critical flaw. This is in part because an arbitrator is not always required to follow the law and may substitute his or her own judgment — often leading to some unexpected results.

Section 10 of the *Federal Arbitration Act* sets out a variety of grounds for vacating an arbitral award. However, in practice, it is exceedingly difficult to overturn an arbitral award. One way to correct this flaw is to expand the scope for judicial review within the agreement itself.

Until recently, U.S. courts were split on whether this is permissible. But on March 25, the U.S. Supreme Court shed some light on this issue when it released its decision in *Hall Street Assoc. LLC v. Mattel Inc.*, stating in part that the *Federal Arbitration Act* does not permit the parties to a dispute to expand by contract the scope for judicial review of an arbitration award beyond the grounds provided in the Act.

While the ability to expand the scope of judicial review by contract may now be foreclosed, appeal to another arbitrator or panel of arbitrators is permitted. Most arbitration administrators have established rules for such appeals.

It is becoming more common to see agreements that provide appeal rights where the dollars at issue in the original arbitration reach a material threshold.

Prohibiting class actions

An added benefit of arbitration is that class arbitrations can be expressly excluded. The U.S. Supreme Court provided in *Green Tree Financial Corp. v. Bazzle* that class arbitrations are permitted unless expressly prohibited by contract. This makes it incumbent on the drafter of the arbitration clause to explicitly prohibit class actions.

Rethinking arbitration

Arbitration is now under attack by U.S. legislators. On July 7, 2007, the *Arbitration Fairness Act of 2007* was intro-

See **U.S.** Page 10

Avoid U.S. juries by specifying arbitration when negotiating contracts

U.S.
Continued From Page 9

duced as a bill in both the House of Representatives and the Senate. The bill proposes to amend the *Federal Arbitration Act* to invalidate the enforcement of pre-dispute agreements to arbitrate employment, consumer and franchise disputes, along with any dispute arising under any statute intended to protect civil rights or to regulate contracts or transactions between parties of unequal bargaining power. It also provides that the validity or enforceability of an agreement to arbitrate shall be determined by a court rather than by an arbitrator. If adopted, this legislation would create delay and uncertainty with respect to the enforcement of certain arbitration provisions.

The current rethinking of the benefits of arbitration has led to the increased use of non-binding mediation in commercial agreements. Non-binding mediation is viewed as less confrontational, faster and less costly, and because it is non-binding, the views of a rogue mediator can be ignored. The threat of federal legislation may intensify the shift from arbitration to non-binding mediation.

For the moment, the simplest way for a Canadian company to avoid a runaway U.S. jury is to specify arbitration as opposed to litigation when negotiating contracts with U.S. parties. ■

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