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How Do Mandatory Arbitration Clauses Work? Three Introductory Issues

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In a dispute resolution class during my master's degree, the instructor, a veteran arbitrator and mediator, asked the twenty or so of us:

"How many of you have signed a contract in which you are subject to a mandatory arbitration clause? Put up your hands."

About half of us did, me included.

"If you have a cellphone," the instructor said, "you are."

Mandatory arbitration clauses are becoming increasingly common in commercial contracts, from large-scale purchase and sale agreements, to independent contractor consulting contracts, to consumer contracts (such as cellphone contracts). Some of them involve two powerful parties, such as two large corporations, or a corporation and a labour union. Others involve a David and Goliath situation, in which a large corporation, often a telecommunication, insurance or car rental company, drafts a standard form agreement to be signed by an individual consumer.

Proponents of these clauses often argue that they ensure more efficient dispute resolution, by allowing parties to save time and money versus fighting in court. Similarly, parties to an arbitration are often free to craft their own procedures rather than be fettered by any particular jurisdiction's rules.

Detractors of these clauses often argue that they deprive parties of their constitutionally protected right to seek redress in the court system, they entrench systemic bargaining power imbalances, and they are confusing to unsophisticated parties.

Three of the key aspects of a mandatory arbitration clause are the **scope of the contract**, the **arbitrator selection**, and the **arbitration procedure**.

SCOPE OF THE CONTRACT

Just because two parties are subject to a mandatory arbitration clause does not mean that every dispute between them is subject to arbitration. The example I like to use is, "let's say you've just signed a cellphone agreement. On the way out of the office, you slip and fall, breaking your hip. You want to sue the cellphone company. This absolutely does not go to arbitration."

A typical mandatory arbitration clause might say something like, "Any dispute *arising out of this contract*…" [emphasis mine]

This is where clear, concise contract language is important. Battles over *arbitrability* (i.e. whether a disputed should be arbitrated or tried in a court) often make disputes costlier, slower, and more damaging to any ongoing relationship between the parties. Whether a dispute should be resolved at arbitration or in the court system is often not as clear-cut as the personal injury example I gave above. Disputes involving third parties, insurers, or defamation claims, among countless other topics, may be the subject of arbitrability battles as well. When the scope of the contract is unclear, this is a crucial point for a party and counsel to review.

ARBITRATOR SELECTION

In a court system, a judge is assigned to a case with no input from the parties. In an arbitration, to quote the aforementioned instructor, "the only criterion to be an arbitrator is that the parties agree on you."

What does it mean to agree, though?

The arbitrator can be named in the mandatory arbitration clause. This is the simplest method. However, if a dispute arises out of the contract, and the arbitrator is booked, it can result in frustrating delay. It also benefits the more powerful party, who will typically be the one listing the named arbitrator. When one party unilaterally selects an arbitrator, the *repeat-player problem* arises: if one party is consistently appearing before that arbitrator, but the other party is appearing on a one-off basis, the arbitrator may feel financial pressure to make decisions favourable to the repeat player. Even if no financial pressure is present, the perception that there may be financial pressure may make the one-off player feel like it is not receiving a fair and just decision.

An institute or roster can be named in the mandatory arbitration clause. This is the approach that most mimics a court proceeding, as any arbitrator from that institute or roster can be named. (Examples are ADR Chambers in Ontario or Judicial Arbitration and Mediation Services in the United States.) The repeat-player problem is a non-issue here. However, the institute or roster process does not guarantee that the arbitrator will be familiar with either the parties' needs or the nature of the dispute. Similarly to how a wrongful dismissal lawsuit might end up in front of a judge whose experience is in insurance litigation, the random approach, although arguably the fairest, may result in the wrong arbitrator.

The parties can use "elimination" or "slash" selection. This is uncommon, but if it appears in your arbitration clause, take note: it requires counsel to know the names of some qualified arbitrators. Here is an example:

Each party nominates a certain number of arbitrators for a combined list. Then the parties alternate "eliminating" or "slashing" names off the list. Eventually, only one name remains. That person is selected as the arbitrator. The upside is that it is transparent and that it forces the parties to agree on the creation of the list. Often, getting parties to agree on a small, procedural matter can help build the type of trust it takes to resolve a dispute in full. The downside is that it is usually only available between two sophisticated parties, each with substantial (if not necessarily equal) bargaining power. You will *not* see elimination/slash arbitration selection in a cellphone contract.

ARBITRATION PROCEDURE

Arbitration procedure is flexible. Arbitration is not subject to court timelines, production of documents, or rules of evidence.

This flexibility is beneficial to resolving a dispute in an efficient manner: whereas lawsuits can take years to resolve, arbitrations can occur within weeks, or even days, of the arising of a dispute. Affidavits or books of documents can be shorter in length. An arbitrator can consider evidence that would not normally be admissible in court, such as hearsay, for its weight; unlike a judge, or especially a jury, an arbitrator with subject-matter expertise will know which evidence to rely on and which evidence to discount.

However, flexibility can also be ambiguous. For example, if a party files a statement of claim in the Superior Court of Justice here in Ontario, Rule 14 of the *Rules of Civil Procedure* dictates how and when that filing should occur. There is no unified set of rules for an arbitration, so if the parties have a process dispute, there is not necessarily an underlying law that prevails. If parties want to enjoy some of the flexibility of arbitration while still maintaining a semblance of certainty, they can rely on model rules such as those provided by UNCITRAL, the World Trade Organization, or whichever model rules are most applicable to the contract at hand.

CONCLUSION

Mandatory arbitration clauses are everywhere. Most Canadians are now subject to a mandatory arbitration clause of some sort, whether they read it or not. There is too much material to discuss in one short article, but the above three points should be considered by any party entering into a contract with a mandatory arbitration clause, or any lawyer either drafting or reviewing one.

ABOUT THE AUTHOR

Matthew Gordon has experience in a variety of areas of litigation, including general civil, constitutional, labour and employment, family and administrative law. Since his call to the bar in 2017, he has practised as an associate for two boutique downtown Toronto firms. He also holds a Master of Industrial and Labor Relations from Cornell University and has experience in oilfield services and border security. Matthew has been a member of the Ontario Bar Association's Alternative Dispute Resolution executive committee since 2018.