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Thinking Critically About Arbitration For Complex Civil Cases


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Conventional wisdom holds that choosing to arbitrate[1] complex civil disputes leads to a cheaper, faster, and possibly better disposition than traditional litigation through the court system. But as noted economist John Kenneth Galbraith once commented: "The conventional view serves to protect us from the painful job of thinking."[2] The truth is that arbitration is simply another arrow in the quiver of in-house counsel and their outside lawyers for dealing with complex commercial disputes. There is no guarantee that a complex dispute will be resolved faster, more inexpensively or more justly through arbitration. Indeed, simply defaulting to arbitration without analyzing the most likely types of claims or how that arbitration would be structured can lead to a runaway arbitration that is just as expensive as "normal" litigation but without the early "off-ramps" and appellate safeguards. For that reason, lawyers (and especially in-house counsel who often are involved in drafting arbitration clauses) must think critically about how to maximize the upside potential of arbitration before deciding to choose that route.

Conventional Wisdom: Arbitration is Faster

Many business people, and even their lawyers, simply assume arbitration is a faster way to resolve disputes as compared to proceeding in court. Whether this is true depends largely on the nature of the dispute, the terms of the arbitration agreement, and the particular court where the dispute would otherwise be filed.

Because arbitrations proceed outside of the judicial system, the schedules are not determined by the courts' procedures and overcrowded dockets. This *potentially* can result in a faster resolution of complex cases. According to the American Arbitration Association (AAA)'s analysis of complex cases, the median time to complete arbitration from filing to award is 13 months.[3] Given that judiciary budget cuts threaten to further delay traditional litigation (such as the San Francisco Superior Court's July 2011 budget cuts that threatened closure of 25 of 63 civil courts and a five-year wait for getting to trial), the potential speed of arbitration may appear even more attractive to civil litigants.[4]

Arbitration, however, does not guarantee faster resolution of complicated civil cases. First, the potential for a speedy disposition through arbitration can be entirely lost where the arbitrator fails to firmly manage case progress. Neither the AAA nor the JAMS rules include strict rules or deadlines for case progress and instead leave scheduling largely to the discretion of the arbitrator.[5] Moreover, an arbitrator is just as likely as a judge to be required to respond to requests for continuances and to wrangle with the schedules of lawyers, parties and witnesses. The parties can address this issue by agreeing in their arbitration clause to a stipulated maximum duration from filing to award. Indeed, "fast track arbitrations," long prevalent in international arbitration, are becoming more popular in the United States. But these types of agreements can fall by the wayside[6]once a case is underway and the schedules of the parties and the arbitrator get in the way.

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Second, some courts, such as the famed "rocket dockets," quickly dispose of cases through fast track rules and therefore may provide as speedy a resolution as arbitration. For example, a civil case filed in the Western District of Wisconsin takes on average only 5.2 months from filing to disposition and 15.1 months from filing to trial.[7]

Third, courts are more likely than arbitrators to dispose of cases before they reach trial.[8] Recent U.S. Supreme Court rulings in *Ashcroft v. Iqbal*[9] and *Bell Atlantic v. Twombly*[10] have raised the plaintiffs' pleading bar in complex cases. On the other hand, successful motions to dismiss in arbitrations essentially are unheard of. Likewise, courts are much more likely to grant summary judgment motions. Barring specific agreement among the parties, arbitrators may not even be required to hear (much less grant) summary judgment motions. Under the JAMS Rules, for example, an "arbitrator *may* permit" summary judgment motions, but is not required to do so.[11] Therefore, arbitrations do not as a matter of course provide the same early "off-ramps" that are at least potentially available in normal litigation.

Conventional Wisdom: Arbitration is Cheaper

The assumption that arbitration is cheaper is closely related to the assumption that it is faster, but it also rests on the belief that discovery in arbitration is more limited. The truth is more complicated.

Traditional arbitration rules do not require compliance with strict procedural[12] or evidentiary rules.[13] Therefore, the parties may not be required to submit to traditional discovery procedures or rules of evidence. On the other hand, arbitrators tend to be extremely hesitant to significantly curtail discovery out of fear that such restrictions will create due process arguments for vacating any award.[14] To ensure limited (and perhaps more reasonable) discovery, the parties should seek agreement to discovery limits in the arbitration clause (e.g., limits on electronic discovery, the number of custodians who must be searched, the number of depositions and/or the need to log privileged documents). Attempts to negotiate such limits once a dispute has arisen are difficult. If it were otherwise, parties could easily do the same in cases litigated in the courts. Of course, giving up or limiting discovery rights should not be done lightly. Limiting document or deposition discovery may save time and money during the pre-hearing phase of a litigation, but it also may prevent an aggrieved party from ferreting out key evidence in fraud cases. In contrast, limitations on discovery may not carry the same degree of risk in a breach of contract action turning largely on the interpretation of contractual terms.

Arbitrations also involve a cost not incurred in traditional litigation–arbitration fees (including administrative fees paid to arbitration service providers and hourly fees to the actual arbitrators). Many complex disputes are heard before a panel of arbitrators, each of whom will necessarily be required to spend billable time on the case preparing for and attending hearings. These costs can become substantial especially in complex cases that require a high level of preparation or that are pending for extended periods of time. According to a study of large complex arbitrations conducted by AAA, median arbitration costs amount to over two percent of the claim value.[15] However, more complex disputes involving more active arbitrator involvement in pre-trial proceedings and longer hearings can be significantly more expensive than AAA's statistics suggest.

Other Conventional Wisdom Assumptions

– Subject Matter Experts as Fact Finders

Parties normally have significant control over the selection of at least some of the arbitrators for their case. That process provides more control than the largely random processes used to assign judges or jury pools. Indeed, parties can select fact finders who have advanced training, experience, and credentials in the issues in dispute. This can be especially beneficial in complex disputes involving specialized industries. A construction defect case involving a botched multi-million dollar skyscraper construction, for example, may be best resolved by arbitrators whose experience and training allows them to quickly grasp the facts and claims at issue. On the other hand, an arbitration agreement that requires the use of arbitrators with specialized training, experience, or credentials, may result in a narrow pool of candidates who are excessively costly, unavailable, or have leanings that are disadvantageous to your client. Many lawyers also believe that arbitrators are more likely than judges or juries to "split-the-baby," which may work to the disadvantage of parties with strong legal or factual arguments.[16]

– Arbitration Award Predictability

In an economic environment where juries seem to be increasingly hostile to companies, arbitration awards generally are believed to be relatively conservative. Arbitrators tend to be driven less by emotion than the average juror, and many have legal training and expect more concrete proof of damages. Arbitration simply does not carry the same *ad terrorem* effect that a jury may in a case involving relatively weak proof of causation but terrible injury and a sympathetic plaintiff. Also, because arbitrations are based on contract principals, the parties can further reduce their exposure by agreeing to restrict the type or amount of potential award. Under JAMS Rules 32 and 33, for example, the parties may agree to bracket the arbitration award to a minimum and maximum amount or use "baseball" arbitration to restrict the arbitrator's award to the closest of one the parties' "final" offers.[17] A limitation on the type of award is especially beneficial in cases such as products liability disputes where the risk posed by compensatory damages is many times overshadowed by the risk associated with punitive damages. But, while an arbitration allows a party to ditch the jury and potentially bookend an award, it does not guarantee a more conservative award. For example, iFreedom Communications International was saddled with a

$4.1 *billion* dollar arbitration award (later confirmed by the Los Angeles Superior Court) from a wrongful termination dispute involving a single former employee.[18]

– **Confidentiality**

Arbitration proceedings are not part of the public record and normally are resolved confidentially outside the public eye. This is highly beneficial for disputes involving embarrassing (or, from the plaintiffs' and press' perspectives, "juicy") allegations, testimony, or documents. For example, in an employment dispute involving harassment or discrimination claims, the employer whose employment agreements contain arbitration clauses will likely seek to compel arbitration of the claims (and should seek to get a confidentiality order in place) to prevent the claimant from leveraging bad press for a settlement. At the same time, confidentiality of arbitrations may not be helpful when it prevents a party from publicly vindicating its rights or touting a significant win.

– **Finality**

Appellate review of arbitration awards is extremely limited.[19] Therefore, by electing to arbitrate, a party essentially gives up its right to appeal. While the lack of appeal rights may reduce costs and present a benefit in a strong case, a party who is bringing a claim premised on a novel legal theory or shaky facts should carefully consider the lack of appellate review. The lack of meaningful review also counsels in favor of a multi-arbitrator panel, where the whims of any one arbitrator can be reined in by the rest of the panel (although the trade off is increased cost).

In the end, the assumption that arbitrations are faster, cheaper, and better is true . . . but only in some cases. Simply selecting to arbitrate disputes does not guarantee any of these benefits, and a party considering arbitration must assess the type of disputes likely to arise, the terms of the arbitration agreement, and their own business and litigation goals when evaluating whether arbitration is preferable to litigating in the courts. In-house counsel especially need to think critically (even prophetically) about these issues at the time the arbitration clause is drafted and inserted into a contract. By the time a dispute arises–often years later–it may be too late to obtain agreement on the limitations necessary to ensure arbitration offers more than just litigation without early off-ramps and appellate review.

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The views expressed herein are those of the authors and do not necessarily represent the views of Bloomberg LP, Jones Day or its clients.

[1] Arbitration is a form of contract-based dispute resolution that proceeds outside of the judicial system. In general, assuming that an arbitration agreement is not unconscionable or otherwise unenforceable, courts enforce arbitration agreements regarding them as "valid, enforceable and irrevocable" contracts. 9 U.S.C. § 2. The Supreme Court recently reaffirmed the strong presumption in favor of arbitration in *AT&T Mobility v. Conception*, which found that the Federal Arbitration Act preempted a California rule banning class action waivers in arbitration agreements. *AT&T Mobility LLC v. Conception*, 131 S. Ct. 1740 (2011).

[2] John Kenneth Galbraith, *quoted in* Barnett, Larry D., *The Regulation of Mutual Fund Boards of Directors: Financial Protection or Social Productivity?*, 16 J.L. & Pol'y 489, 490 (2007-2008).

[3] AAA, Commercial Bulletin, Issue 6, http://www.adr.org/sp.asp?id=38793#statistics (last visited Oct. 6, 2011).

[4] Tess Townsend, "Court Gets $2.5 Million Loan to Soften Cuts," *The Bay Citizen*, Sept. 9, 2011, *available at* http://www.baycitizen.org/courts/story/court-25-million-loan-soften-cuts/. A newly approved loan to the San Francisco Superior Court is expected to reduce the planned courtroom closures from 25 to 14. *Id.*

[5] Both the JAMS and AAA Rules afford the arbitrator wide discretion in scheduling the proceedings and setting hearings. *See, e.g.*, JAMS Comprehensive Arbitration Rules and Procedures, Rule 22(a), (Oct. 21, 2010), http://www.jamsadr.com/rules-comprehensive-arbitration/ ("The Arbitrator will ordinarily conduct the Arbitration Hearing in the manner set forth in these Rules. The Arbitrator may vary these procedures if it is determined reasonable and appropriate to do so" (emphasis added)); AAA Commercial Arbitration Rules and Mediation Procedures, R-22 (June 1, 2009), http://www.adr.org/sp.asp?id=22440 ("The arbitrator shall set the date, time, and place for each hearing"). Also, while the AAA Commercial Arbitration Rules set a deadline for issuance of the award following the hearing, those Rules do not provide any deadlines for when the hearing will be held (except under the expedited procedures which do not apply in cases where the claims are greater than $75,000). *See* AAA Commercial Arbitration Rules and Mediation Procedures, R-41 (June 1, 2009) http://www.adr.org/sp.asp?id=22440 (Rule 41 provides that "[t]he award shall be made promptly by the arbitrator . . . no later than 30 days from the date of closing the hearing"). *Compare id.*, E-7 (the AAA's expedited rules state that "the arbitrator shall set the date, time, and place of the hearing, to be scheduled to take place within 30 days of confirmation of the arbitrator's appointment"). *See also* JAMS Comprehensive Arbitration Rules and Procedures, Rule 16.2 (Oct. 21, 2010), http://www.jamsadr.com/rules-comprehensive-arbitration/ (under the JAMS expedited procedures, the "hearing shall commence within 60 calendar days after the [discovery] cutoff" but the arbitrator may alter the expedited procedures and deadlines on a showing of "good cause").

[6] *See supra* note 5. *See also* AAA Commercial Arbitration Rules and Mediation Procedures, R-28 (June 1, 2009), http://www.adr.org/sp.asp?id=22440 ("[t]he arbitrator may postpone any hearing . . . upon the arbitrator's own initiative").

[7] Federal Judiciary Report, March 2011, http://www.uscourts.gov/viewer.aspx?doc=/cgi-bin/cmsd2011Mar.pl (last visited Oct. 6, 2011).

[8] JAMS, *Arbitrators Less Prone to Grant Dispositive Motions Than Courts*, (June 26, 2009), http://www.jamsadr.com/arbitrators-less-prone-to-grant-dispositive-motions-than-courts-06-26-2009/ (acknowledging that "arbitrators are generally much more reluctant than courts to grant dispositive motions–whether they are motions to dismiss a complaint or arbitration demand, or motions for summary judgment").

[9] 129 S. Ct. 1937, 173 L. Ed. 2d 868 (2009).

[10] 550 U.S. 544 (2007).

[11] JAMS Comprehensive Arbitration Rules and Procedures, Rule 18, (Oct. 21,

2010), http://www.jamsadr.com/rules-comprehensive-arbitration/.

[12] While both the AAA and JAMS have some limited procedural rules, many of those rules may be modified at the discretion of the arbitrator or on a showing of cause.

[13] *See, e.g.*, AAA Commercial Arbitration Rules and Mediation Procedures, R-31 (June 1, 2009), http://www.adr.org/sp.asp?id=22440 ("Conformity to legal rules of evidence shall not be necessary. . . . The arbitrator shall determine the admissibility, relevance, and materiality of the evidence offered and may exclude evidence deemed by the arbitrator to be cumulative or irrelevant."); JAMS Comprehensive Arbitration Rules and Procedures, Rule 22 (Oct. 21, 2010), http://www.jamsadr.com/rules-comprehensive-arbitration/ ("Strict conformity to the rules of evidence is not required, except that the Arbitrator shall apply applicable law relating to privileges and work product.").

[14] *See, e.g., Arnold v. Arnold Corp.*, 920 F.2d 1269, 1279 (6th Cir. 1990) (stating that "[i]f the arbitrator were to deny Arnold access to the necessary records or persons to prove his claim and he were to lose, the judgment in favor of Arnold Corp. could be vacated . . ."); *Cotter v. Shearson Lehman Hutton, Inc.*, 126 F.R.D. 19, 21-22 (S.D.N.Y. 1989) (explaining that if a claimant's "opportunity to present proof is too narrowly circumscribed by the arbitrators" such that it denies a fair hearing, "that of course would be a basis for not confirming any award rendered"); *Hyman v. Pottberg's Ex'rs*, 101 F.2d 262, 265 (2d Cir. 1939) ("the documents were in the hands of the claimant, and if they were in fact of any importance, the [arbitrator] committee should have called for them . . .").

[15] AAA, Commercial Bulletin, Issue 6, http://www.adr.org/sp.asp?id=38793#statistics (last visited Oct. 6, 2011).

[16] This point is hotly disputed by the arbitration service providers. *See* AAA, "Splitting the Baby: A New AAA Study" (Mar. 9, 2007), http://www.adr.org/sp.asp?id=32004 (noting the myth that arbitrators "split the baby" in rendering arbitration awards).

[17] JAMS Comprehensive Arbitration Rules and Procedures, Rules 32 & 33 (Oct. 21, 2010), http://www.jamsadr.com/rules-comprehensive-arbitration.

[18] Judgment Confirming Final Arbitration Award, Chester v. iFreedom Communications Inc., No. BC 353567 (L.A. Sup. Ct. May 28, 2009).

[19] While there are some statutory bases to vacate an arbitrator's award, in general, judicial review of arbitration awards is extremely limited, and the merits of the arbitrator's decision will not be reviewed. *See Major League Baseball Players Ass'n v. Garvey*, 532 U.S. 504, 509 (2001). Cal Civ. Code § 1286.2 (a); 9 U.S.C. § 10(a).