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Arbitration: The Good, the Bad and the Ugly

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Arbitration is supposed to save us all money, time and from the evils of litigation, right? Of course, as it turns out, arbitration does not always work this way. Before a company decides to put an arbitration clause into its credit application or other applicable contracts, or before it otherwise agrees to arbitrate a dispute, the company should think through the benefits and risks of arbitration. There are certain advantages to pursuing or defending claims in arbitration versus litigation and a trial before a court. However, there are also disadvantages that should be considered. If a company's contract already has an arbitration clause, it is beneficial to understand the arbitration process and how it differs from proceeding before a judge or jury in a court at law. By understanding what is involved in arbitration, the arbitration process may be better managed.

What is Arbitration?

Arbitration is a form of alternative dispute resolution where the parties, usually to a contract, agree to have a dispute heard before a private arbitration forum and finally decided by a single arbitrator or panel of arbitrators instead of going to court to have their dispute heard publicly and decided by a judge and/or jury.

> If a party wants to ensure that any disputes under an agreement will be arbitrated, then it is also important to have a solid, well-written, enforceable arbitration clause.

Arbitration Agreements Are Highly Favored

Parties to a contract may have an arbitration clause that states all disputes related to or arising under the contract will be decided in arbitration. Such clauses typically (and should) specify the arbitration forum the parties to the contract are agreeing to use. Popular arbitration forums include the American Arbitration Association (AAA) and the International Chamber of Commerce (ICC).

Arbitration clauses are often seen in international contracts, but they are also commonly found in construction agreements and other commercial contracts between domestic parties. Parties to a dispute may agree to arbitrate even if their contract does not contain an arbitration clause, but often an arbitration clause in a contract will dictate whether a dispute is arbitrated.

Contractual arbitration clauses are highly favored by most courts in the United States. As such, if a party seeks to litigate a claim in court under a contract that contains a strong arbitration clause, such a claim may be compelled to arbitration by the court upon motion by the other party to the dispute and/or contract. Public policy in most states favors arbitration over litigation, but only when the parties have agreed to arbitrate their disputes pursuant to a valid and enforceable arbitration agreement.

Thus, if a party changes its mind later about going to arbitration, it may be stuck unless the other side also wants to waive its right to arbitrate under the agreement. If a party wants to ensure that any disputes under an agreement will be arbitrated, then it is also important to have a solid, well-written, enforceable arbitration clause.

Clear Arbitration Clauses Help Set the Stage for Success

A clear arbitration clause will help set the stage for a successful arbitration and will serve to eliminate disputes about whether a particular claim should be arbitrated in the first place. A well-crafted arbitration clause may include the following:

- Definition of what is subject to arbitration (*e.g.*, "Any dispute arising from or related to this contract or the breach thereof…");

- A commitment to the dispute being finally decided by binding arbitration;
- A selection of an arbitration forum and applicable rules (*e.g.*, AAA Commercial Arbitration Rules);
- A statement that a judgment on the arbitration award may be entered in a court of law having appropriate jurisdiction;
- Especially applicable to international transactions and contracts, the language the arbitration will be conducted in (*e.g.*, English);
- The location of the final arbitration hearing (*e.g.*, Dallas, TX);
- The number of arbitrators, which could be one arbitrator for simpler domestic transactions or a panel of three or more arbitrators for international or more complex transactions.

Other terms, or additional customized provisions, may be appropriate for a particular arbitration clause in any given contract and transaction. The most important take away is that the parties should consider what they are agreeing to in an arbitration clause and not assume that it will be "fine" based on the belief that the parties "will never" have a problem. If or when there is a problem, it is best to be completely comfortable with, and fully understand, the chosen arbitration process and procedure that will ultimately decide the company's fate in a particular dispute.

Arbitration, the Positives and the Negatives

Whether arbitration will truly fit a dispute and work for the parties will depend on the particulars of any given case. Many of the pros of arbitration are also cons, depending on the parties, their objectives and the situation. The following discussion outlines various positives and negatives associated with the arbitration process to help with the assessment of whether arbitration is right for you and your company.

1. Privacy

Arbitration is conducted in a private forum and the proceedings are typically confidential. The private nature of arbitration is in contrast to a very public lawsuit filed before a court, typically an open, accessible state or federal forum—although it is possible to file a motion to seal the case, prohibiting general public access to the proceedings. Overall, the privacy of an arbitration proceeding largely wins out as a positive, especially where privacy and confidentiality are priorities for a party in a particular dispute.

2. Arbitrator(s) Selection

A neutral arbitrator or a panel of arbitrators will decide instead of a judge or jury in arbitration. Thus, agreeing to arbitration means giving up the right to a jury trial, which can serve as a positive or a negative depending on a party's objectives in a case. Unlike in litigation, the parties have the ability to participate in deciding who the arbitrators will be in a typical arbitration proceeding. In a lawsuit, the parties do not pick their presiding judge—cases are normally randomly assigned by the clerk of the court to a judge without party input. The parties may be able to participate in jury selection to some degree in litigation in the *voir dire* process, but the parties are normally powerless to control any part of the selection of the jury pool from which a jury is derived.

In arbitration, the parties, along with their counsel, may be able to suggest arbitrators, investigate qualifications and backgrounds of proposed arbitrators, and may strike proposed arbitrators they do not want on the case. The parties may even have the ability to select party-appointed arbitrators if a panel of multiple arbitrators is provided for, and the parties may even be able to communicate directly with their respective party-appointed arbitrators about the case. The party-appointed arbitrators often (but not always) serve as extended party-advocates who may advocate with a neutral arbitrator that is typically selected to preside over the arbitration.

3. Costs

Arbitration is touted as less expensive than litigation. Cost may be reduced, depending upon the parties and how they chose to conduct the arbitration. As noted below, summary disposition of an arbitration may not be available and the parties may be forced into a final hearing, which is like a trial with submission of written evidence as well as testimonial evidence. Summary disposition may be more streamlined and less expensive than effectively going to "trial" in a final hearing, but arbitrators, who bill by the hour, typically prefer to have a final hearing as opposed to summary disposition of the case.

The chosen arbitration forum typically charges a fairly hefty filing fee for an arbitration, depending upon the type of dispute and the amount in controversy, including other factors. For example, the AAA charges the following filing fees based upon the amounts in controversy for cases under the AAA Commercial Arbitration Rules:[1]

AMOUNT OF CLAIM	INITIAL FILING FEE	FINAL FEE
Up to $75,000	$750	$800
Above $75,000 to $150,000	$1,750	$1,250
Above $150,000 to $300,000	$2,650	$2,000
Above $300,000 to $500,000	$4,000	$3,500
Above $500,000 to $1 million	$5,000	$6,200
Above $1,000,000 to $10 million	$7,000	$7,700
Above $10 million	Base fee of $10,000 plus .01% of the amount above $10 million up to $65,000	$12,500
Nonmonetary Claims	$3,250	$2,500
Three or more arbitrators	Min. $4,000	Min. $3,500

The arbitrator will also typically charge the parties for his or her time on an hourly basis. Arbitrator expenses are multiplied when a panel of three or more arbitrators is required. Add the parties' respective attorneys' fees and expenses to the mix, and arbitration costs can quickly soar.

In litigation, typically the parties pay to the court clerk a minimal filing fee of a couple of hundred dollars to kick off the litigation, depending on the state and county where the case is filed. It is a pittance compared with arbitration filing fees and arbitrator fees, especially when the amount in controversy is significant. A judge in a lawsuit is not paid by the parties, but rather is paid a salary by the applicable federal, state or county government. Of course, picking a judge and presenting a case at a jury trial is more involved, resulting in more fees and expenses.

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4. Time

Courts are often overflowing with case backlogs, especially in larger metropolitan areas. Hearings are available when the court is, and a trial is also only available when the court has time and an opening for a setting. A case may be set for trial on a particular date six or nine months or even a year (or more) out, and that initial setting will often not be the date of the trial, due to other cases bumping the setting or the parties seeking continuance for discovery purposes or otherwise. In arbitration, parties do not have to necessarily worry about a docket or a backlog of cases before the arbitrator(s). Parties have much more say regarding when the final hearing in arbitration will be conducted. They can communicate with the arbitrator at the beginning of the case concerning the arbitration timeline and participate more directly in when the final hearing is scheduled.

5. Finality

A final arbitration award is final and cannot be appealed, barring exceptional circumstances usually involving fraud. Such finality is great when you are the winner, but less than wonderful if you are on the losing side. In litigation, the loser at least has the right to file an appeal to raise points of error made by the trial court to the court of appeals. In arbitration, what the arbitrator decides is typically the final decision. In recent years, arbitral forums have started to address the lack of appellate rights by building in the ability of the parties to choose an appellate remedy to another panel. For example, effective in 2013, the AAA instituted its Optional Appellate Rules that parties may adopt in their agreed to arbitration clause.[2]

6. Limited discovery

Discovery is typically more limited in arbitration. If a party needs more information from the opposition to prove its claims or defenses, this limitation can be a big disadvantage. However, the parties ultimately control the amount of discovery that is taken in arbitration and, if the parties agree, they can customize a discovery plan that fits the needs of the parties and the case. In litigation, the amount and extent of discovery is governed by the applicable rules of civil procedure, which allow for written discovery and depositions concerning facts relevant to the claims.

7. Informality

Arbitration is less formal than litigation. For example, summary disposition (*e.g.*, summary judgment) is not favored in most arbitrations. Arbitrators typically prefer to proceed to the final hearing to hear and then decide the case. So, a quick disposition on the pleadings may not be an option in arbitration. Additionally, the rules of evidence may not be applicable in arbitration. Thus, the final hearing can sometimes feel like the "Wild West" with the arbitrator making unpredictable decisions concerning the evidence. Typically, the arbitrator in these instances will lean toward allowing the presentation of evidence, despite its origins or despite the technical evidentiary objections (*e.g.*, hearsay, irrelevant, prejudicial, etc.) that might normally apply to exclude such evidence at trial in a court at law before a jury. Arbitrators are supposed to follow the law, but they may not always follow it exactly. Thus, arbitration decisions may end up being inconsistent and unpredictable because each case and circumstances are not necessarily driven by binding precedent in the body of applicable law.

Conclusion

Arbitration may be an excellent route to resolving a dispute. However, go in with eyes wide open to the benefits as well as to the potential pitfalls of arbitration. Arbitration may or may not be the best decision for every company or every situation. It is important to evaluate the options, risks, advantages and disadvantages to make an informed and wise decision about arbitration.

1. https://www.adr.org/aaa/ShowPDF?doc=ADRSTAGE2025290.
2. https://www.adr.org/aaa/ShowProperty?nodeId=/UCM/ADRSTAGE2016218.

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