To Be or Not to Be (in Arbitration)

By Steven Phillips

Many contracts contain a provision requiring the parties to arbitrate any disputes that may arise between them relative to the performance of the contract. Often, arbitration provisions are inserted in a contract as part of the boilerplate provisions in a form used by the drafter, with little thought given to whether arbitration makes sense in the context of disputes that could arise under the contract. What follows are some (but certainly not all) of the considerations relevant to a determination of whether it may make sense to include an arbitration provision in a contract (or otherwise agree to arbitrate a dispute) as opposed to the traditional process of resolution of disputes in court.

Selection of the Decision-Maker/ Factfinder

Parties to an arbitration agreement have, in effect, waived their right to have a jury decide the matter and/or to have a judge preside over the dispute. That said, in an arbitration proceeding, the parties typically have some input into the selection of the arbitrator or arbitrators. The arbitration forum (e.g., FINRA) may have a procedure for selection of the arbitrators, the arbitration agreement may specify how the arbitrator is selected, or the parties may agree upon an arbitrator or arbitrators. Further, parties in arbitration may be able to hand pick their arbitrator based not only on qualifications and expertise, but also on other factors such as a reputation for fairness and the arbitrator's temperament.

In contrast, court cases judges are typically randomly assigned and, sometimes, reassigned during the course of a case. And, with arbitration the selection of arbitrators may not be limited to a particular locale – the parties often can select an arbitrator from anywhere, whereas jurisdiction and venue rules will dictate which court (and that court's judges) will be involved. Jury selection typically results in jurors that know little or nothing about the subject matter of a case. In contrast, arbitrators are often selected based on their experience and background in the factual or legal area in dispute.

Cost Considerations

Arbitration is frequently touted as a more cost-effective dispute resolution mechanism than a court case. That is often not the case. Some arbitration agreements or forums limit the types of discovery that may be undertaken (e.g., no depositions or litigation-style interrogatories), which may reduce the cost of the proceeding. However, the administrative fees associated with commencing arbitration are typically far more costly than court filing fees. And, unlike judges who preside at no cost to the litigants, arbitrators typically charge a daily or hourly rate for their time spent reviewing submissions, attending the arbitration and rendering decisions. As such, a lengthy arbitration could result in forum-related fees and costs well into six figures.

Control over Scheduling and Hearing Dates

In most arbitration proceedings, the parties have reasonable control over the dates the arbitration hearing will be held. Arbitrators and counsel typically work cooperatively in the early stages of the matter to select a defined set of hearing dates and other case deadlines. In typical court cases, while the parties may have some input into the case deadlines and trial dates, often those dates are selected by the court or dictated by the judge's calendar. And, it is not uncommon for court cases to be subject to a trial block or period of weeks during which the parties are on call for a potential trial depending on whether other cases settle or get tried.

Procedural and Evidentiary Matters

Arbitrations are generally less formal and not typically subject to the same pre-trial procedures found in a court case. Depending on the arbitration forum or agreement, there may not be mechanisms for a pre-hearing resolution of the controversy (e.g., motions to dismiss or for summary judgment). For example, investment-related arbitrations are typically resolved in the FINRA dispute resolution arbitration forum which provides for the potential pre-hearing dismissal of a case under only very limited circumstances. And, the rules of evidence may not apply in arbitration or be applied by the arbitrators who generally have broad discretion to admit evidence as they see fit. Also, the ability to conduct third-party discovery is potentially more difficult in arbitration given that non-parties are not subject to or bound by the parties' arbitration agreement.

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The relative informality of arbitrations can lead to situations that are not likely to occur in court. For example, sensitive evidentiary matters for which a judge may act as a screen from the jury must be presented to the arbitrators who act as both judge and jury. In those circumstances, it may prove difficult to unring the bell – arbitrators who have viewed potential or disputed evidence that a juror would never see may have difficulty placing what they've seen out of their minds. And, it's extremely unlikely that an arbitrator will declare a mistrial. Instead, the typical arbitrator's refrain to the receipt of questionable evidence is that the arbitrator will give the evidence whatever weight it deserves.

Speed and Convenience

Although there are exceptions, arbitration generally results in a quicker resolution than a typical court case. Some courts suffer from a back log of cases that simply will not allow for a fast resolution. In contrast, most arbitrators have reasonable schedule flexibility and are able to hear the matter in a time frame that makes sense for all and is not artificially influenced by forum-specific considerations, budget cuts, and the like. And, parties to an arbitration proceeding generally have flexibility to determine the location of the hearing (often, a hotel or law firm conference room).

Privacy

Court cases are generally public. Unless the court agrees that parts of the record may be filed under seal, the complaint, answer, motions and other documents filed in court are freely accessible to the general public, competitors and the media. In contrast, most arbitration proceedings are private disputes, where the parties have the ability to keep the proceedings, and sometimes the result, private and confidential. Further, there are fewer precedent setting decisions in arbitration given, among other things, the lack of published or explained decisions and (as discussed below) limited appeal rights.

Finality of Result

In most matters resolved in court, the parties have some appeal rights. In arbitration, there generally is only a very limited right to appeal as provided in the Federal Arbitration Act and/or applicable state arbitration statutes. Mistakes as to calculation can generally be corrected, but not mistakes that are a result of the arbitrators exercising their discretion. In general, even if the arbitration agreement has a clause that requires the arbitrator to follow the law, you have very little practical recourse if he or she doesn't. As a result, most arbitrations end with the arbitrator's decision. While this generally helps to control the costs involved in a lengthy appeal process, a harsh arbitration result or one that appears to be the product of a tendency to "split the baby" will more than likely stand. On the other hand, arbitration is less likely to result in a runaway jury, an important consideration for defendants.

The takeaway from the foregoing is that parties and attorneys should give careful consideration as to whether agreeing to arbitrate a dispute makes sense given these and other factors.