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So You Think You Want To Arbitrate? Think Again, Maybe

Law360, New York (June 04, 2015, 12:02 PM ET) -- You are revising the first draft of a potentially lucrative sales contract. Just as you are about to send your changes to the other side, you realize there is no dispute resolution provision in the agreement. Surely you want to add an arbitration clause, don't you? Isn't that what companies are supposed to do?

Matthew P. Whitley

Maybe. Arbitrating disputes rather than litigating in court certainly has some benefits. The most significant benefit is privacy — if the parties do not want to make a public record of their dispute, arbitration offers a layer of confidentiality that is typically unavailable in the court system. But arbitration is not a one-size-fits-all solution. Before placing an arbitration clause in a contract, consider the implications and potential pitfalls of arbitration.

Cost

The cost of initiating an arbitration is almost always higher than the cost of initiating a suit in court. The American Arbitration Association charges $1,700 to file a consumer arbitration before a single arbitrator and $2,200 before a tribunal.[1] Compared to the cost of filing a civil suit in Harris County, Texas, a mere $252, filing a suit in court is a steal.[2]

In addition, arbitration often includes extra fees that are not charged in court, such as fees for issuing a subpoena, requesting discovery, asking for a continuance, renting a hearing room or conducting a pre-trial conference.[3] And don't forget that parties must pay for each arbitrator. These fees can add up — AAA arbitrators serving on a consumer case charge $1,500 per day for a hearing.[4] Private arbitrators can be even more expensive. It is important to consider these extra, often unforeseen costs before assuming that arbitration is the cheaper way to go.

Discovery

Any litigator knows that discovery can make or break a case. However, the discovery tools used in litigation (e.g., interrogatories, requests for admission, depositions, etc.,) are often not available in arbitration.[5] The AAA construction industry rules, for example, provide that interrogatories may be ordered or depositions taken only: (1) at the discretion of the arbitrator, (2) upon good cause shown and (3) if doing so would be consistent with the expedited nature of arbitration.[6] Moreover, it is often difficult, if not impossible, to obtain discovery from third parties for use in an arbitration.[7] And if an arbitrating party finds

itself on the short end of the discovery stick, courts rarely intervene. Only in "extraordinary circumstances," such as when discovery will be lost, will courts provide relief to a party unhappy with an arbitrator's discovery decision.[8]

Sometimes limited discovery is beneficial. But before committing to arbitration, consider what future disputes might occur under your contract. Are you more likely to be the plaintiff or defendant? Are you more likely going to need extensive discovery of the other side's documents and witnesses, or will you probably be more concerned about restricting the scope of the other side's discovery efforts? How you answer these questions will help you decide whether an arbitration clause should be in your contract.

Right to Appeal

There is no right to appeal an arbitrator's award like there is for a judgment rendered in court. Under the Federal Arbitration Act, for example, a court must confirm an arbitration award except in certain limited circumstances.[9] The FAA provides only four grounds for vacating an arbitration award,[10] which the U.S. Supreme Court has confirmed are the exclusive grounds for vacating an award under the FAA.[11] These grounds are generally limited to procedural irregularities and are difficult to prove, except in the most obvious of cases. Some courts have expanded their review to vacate awards based on the arbitrator's "manifest disregard of the law," but federal circuits are split as to whether this is a valid independent ground for review.[12]

In short, persuading a court to vacate an arbitration award is extremely difficult. You will probably be stuck with the results of an arbitration even if the arbitrator's opinion is flat wrong. Before insisting on an arbitration clause, therefore, consider whether you would prefer having the safety net of appellate review.

Arbitrators

If you think arbitration avoids the hazards often associated with juries, think again. While parties may select an arbitrator who is better educated than an average juror on the particular issues in dispute, an arbitrator's interpretation of the case and the appropriate outcome can be just as unpredictable. This is particularly common when an arbitrator is not legally trained.[13] Thus, you need to consider whether the benefit of having an arbitrator with knowledge of your industry outweighs the risks of having one (or three) fact-finders rather than 12.

Another problem unique to arbitration is a repeat-player bias. At least one statistical study has found that companies consistently get better results when they have more cases in front of the same arbitrator, and individual arbitrators who favor companies over consumers receive more cases in the future.[14] While this may prove favorable to you in some cases, a party in arbitration always risks ending up on the wrong side of that bias.

Without question, arbitration offers benefits that are attractive in some circumstances. But arbitration is far from perfect, and its drawbacks could dramatically affect your chances of success. So consider carefully whether an arbitration clause is the right choice for your agreement. You don't want to discover too late that you didn't really want to arbitrate after all.

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[1] Costs of Arbitration (including AAA Administrative Fees) (Jan. 1, 2015), available at www.adr.org.

[2] Civil & Family Cases: Filing & Service Fees (Feb. 4, 2015), available at www.hcdistrictclerk.com.

[3] See supra note 1.

[4] Id.

[5] Martha Nimmer, The High Cost of Mandatory Arbitration, 12 Cardozo J. Conflict Resol. 183, 207 (2010).

[6] Construction: Arbitration Rules & Mediation Procedures (Oct. 1, 2009), available at www.adr.org/construction.

[7] George E. Lieberman, Discovery in an Arbitration Proceeding Appealing an Award Under the FAA: It's Not That Simple (And What You Do Not Know Can Hurt You), The Federal Lawyer 55 (May 2009).

[8] Joseph L. Forstadt, Discovery in Arbitration, ADR & The Law 52, 4 (20th ed. 2006).

[9] 9 U.S.C. § 9. An arbitration award may be modified or corrected only where: (1) the award miscalculates figures or mistakenly describes a person, thing or property, (2) the arbitrators award on a matter not submitted in the arbitration or (3) the award is "imperfect" in form and the imperfection does not affect the merits of the controversy. Id. at § 11.

[10] Id. at § 10 (permitting vacatur of an arbitration award where: (1) the award was procured by corruption, fraud or undue means, (2) there was evident partiality or corruption in the arbitrators, (3) the arbitrators were guilty of misconduct in refusing to postpone the hearing or to hear evidence pertinent and material to the controversy or (4) the arbitrators exceeded their powers).

[11] Hall St. Assocs. LLC v. Mattel, 552 U.S. 576, 578 (2008).

[12] Compare Stolt-Nielsen SA v. Animal-Feeds Int'l, 548 F.3d 85, 94 (2d Cir. 2008) ("manifest disregard" is a "judicial gloss" on the grounds enumerated in 9 U.S.C. § 10), rev'd on other grounds, 559 U.S. 662 (2010), & Comedy Club Inc. v. Improv W. Assocs., 553 F.3d 1277, 1290 (9th Cir. 2009) ("[M]anifest disregard of the law remains a valid ground for vacatur because it is a part of § 10(a)(4).") with Frazier v. Citifinancial LLC, 604 F.3d 1313, 1323 (11th Cir. 2010) (holding that the Supreme Court's categorical language in Hall Street prohibited all extra-statutory grounds for vacatur) & Citigroup Global Mkts. Inc. v. Bacon, 562 F.3d 349, 355 (5th Cir. 2009) (same). See also Stolt-Nielsen S.A. v. Animal Feeds Int'l Corp., 559 U.S. 662, 672 n.3 (2010) ("We do not decide whether 'manifest disregard' survives our decision in Hall Street Associates, LLC v. Mattel Inc., 552 U.S. 576, 585, 128 S.Ct. 1396, 170 L.Ed.2d 254 (2008) as an independent ground for review or as a judicial gloss on the enumerated grounds for vacatur set forth at 9 U.S.C. § 10.").

[13] Joseph L. Daly & Suzanne M. Scheller, Strengthening Arbitration by Facing Its Challenges, 28 Quinnipiac L. Rev. 67, 104 (2009).

[14] Miles B. Farmer, Note, Mandatory & Fair? A Better System of Mandatory Arbitration, 121 Yale L.J. 2346, 2356, 2358 (2012) ("In the most extreme cases, this bias has

manifested itself in arbitration providers directly marketing themselves as friendly to businesses, and in the removal of individual arbitrators who rule against the companies in subsequent cases where the same arbitration provider is used.").