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TO ARBITRATE OR NOT TO ARBITRATE

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Congress enacted the Federal Arbitration Act in 1925 to address the "costliness and delays of litigation." A majority of the states, including Virginia, has adopted the Uniform Arbitration Act, endorsing arbitration as an effective alternative dispute resolution process. *See* Va. Code § 8.01-581 *et seq*. The National Arbitration Forum claims that arbitration is easier, cheaper and faster than traditional litigation and that the outcome is essentially the same. Surveys and Ballots, Inc., ADR Preference and Usage Report (2006). But are the benefits of arbitration real? If so, do they outweigh the disadvantages? The purpose of this article is to explore the advantages and disadvantages of arbitration in the context of choosing arbitration as an ADR over traditional litigation.

Any decision to arbitrate must be mutual. The decision can be made before a claim arises when an arbitration provision is included in the contract governing the relationship of the parties. This decision is mutual in the sense that both parties must agree to the contract, notwithstanding that the contract typically is one of adhesion, as in the case of an employment contract or franchise agreement. The parties also can agree to arbitration after a claim arises. In either case, once the parties decide on binding arbitration, either party can enforce the decision just as they could any other agreement. *See* Va. Code § 8.01-581.01 (governing the validity of arbitration agreements); *see also TM Delmarva Power, LLC v. NCP of VA, LLC*, 263 Va. 116, 557 S.E.2d 199, 120-21 (2002).

Arbitration traditionally is viewed as a less expensive alternative to traditional litigation. This may or may not be true. The primary (and perhaps only) area in which arbitration may save

the client money is in the form of attorney's fees due to reduced discovery, fewer pretrial hearings and a more streamlined evidentiary hearing instead of a full trial. These savings can be illusory if the applicable arbitration procedures mirror the procedural rules governing traditional litigation. Moreover, the amount of savings in the form of attorney's fees depends largely on whether both parties are interested in taking advantage of streamlined arbitration procedures. Indeed, arbitrators may be more reluctant than judges to "rein in" an attorney who drives up legal fees with overreaching discovery and aggressive litigation tactics.

Even in circumstances when the arbitration rules limit discovery, a lawyer may appeal to the panel to "deviate" from the rules, arguing exceptional circumstances. Most arbitration rules give a great deal of discretion to the arbitrators. For example, the American Arbitration Association's ("AAA's") Commercial Rules address discovery in a single rule (Rule 21) that gives the arbitrator discretion "consistent with the expedited nature of arbitration" to direct the production of documents and other information and to identify witnesses to be called. The rule gives the arbitrator authority "to resolve any disputes concerning the exchange of information." While the rule does not provide for depositions of witnesses, an appeal to an arbitrator may result in depositions if a party makes a compelling case. Again, this falls under the "exchange of information" which is left to the discretion of the arbitrator. John A. Sherrill, a senior litigator with the firm of Seyfarth Shaw, noted that "one of the complaints about arbitrations these days is that it has become pretty expensive" explaining that "if you allow full-blown discovery in an arbitration… it can end up costing as much as litigation." *Arbitration v. Litigation: Which is More Effective*, Atlantic Business Chronicle (January 27, 2006).

Regardless of how the panel resolves various discovery issues, the dispute itself represents an additional arbitration cost. Of course, if one party is successful in expanding the

discovery available, the other party will follow suit. Indeed, the discretion of the arbitrators seems to be governed by one simple rule--treat everyone equally. For example, Rule 30 of the AAA's Commercial Rules provides that, with regard to the "conduct of proceedings," the arbitrator "has the discretion to vary this procedure, provided that the parties are treated with equality and that each party has the right to be heard and is given a fair opportunity to present its case." In short, these "streamlined procedures" can vary, depending on the arbitrator. To truly secure the advantage of a streamlined discovery process in arbitration, the streamlined procedural rules must be set in stone, or the parties must be in agreement that they will take advantage of the streamlined process, something they just as easily could do in the traditional litigation setting.

One area in which the client *will not* save through arbitration is in the cost of the arbitration itself. Unlike courts, arbitration associations that administer cases as well as arbitrators who decide them are paid by the parties. This means that the client not only will pay the administrative fees associated with the arbitration (fees that fund the association), but the client also will pay the hourly rate of the arbitrator. The charges of the arbitrator can be significant and difficult to control, particularly with regards to the arbitrator's review of material and preparation for a hearing. In essence, every arbitrator assigned to the case is one more lawyer that the parties have to pay to prepare for and participate in the presentation of the case. By contrast, judges (and even juries) are free.

The consumer advocacy group Public Citizen issued a report in 2002 challenging the notion that arbitration is less expensive than traditional litigation, concluding that (1) filing fees are higher, (2) legal fees are equal as the same professionals handle both arbitration and traditional litigation and (3) an adversary can drive up the cost of dispute resolution just as in traditional litigation by filing motions to dismiss or for summary judgment, the difference being

that the parties *pay* the arbitrator to decide these motions. The report concludes that "in the vast majority of cases, arbitration will necessarily *increase* the transaction costs of litigation." *See* Public Citizen Report, *Cost of Arbitration: Executive Summary* (May 1, 2002) (emphasis in original).

Just as arbitration is perceived to be less expensive, it also is perceived to result in a quicker resolution of claims. This depends on the nature of the traditional judicial forum available. As an example, few arbitrations will result in as quick a resolution as is available in the "rocket docket" of the Eastern District of Virginia. There also are additional factors that may lengthen the arbitration procedure. Many arbitrations involve three panel members. Unlike a judge who theoretically is available on an ongoing basis, arbitrators often maintain a private practice, and coordinating the availability of a panel to hear a case, particularly one that could take several days, may be challenging, pushing back the final hearing.

Arbitration procedures usually are streamlined, with less formal rules and limited discovery. This could result in a quicker resolution, but only if both parties are interested in the benefits available through the more streamlined process. But there is no real reason litigants cannot secure the same benefits by agreeing to a streamlined process in the traditional judicial forum. No judge is going to complain if the partiers agree to an order that limits discovery and sets a quick trial date. Runaway legal fees rarely are the result of state or federal rules of procedure or evidence. The lawyers typically are responsible for prolonging litigation and driving up legal fees when they perceive some sort of advantage for doing so. If a lawyer perceives an advantage to aggressive litigation in the traditional forum, that lawyer likely will take the same aggressive stance in arbitration.

Perhaps the most significant difference between arbitration and traditional litigation is that in arbitrations the parties have more control over exactly who will decide the claim. In

traditional litigation, the claim is decided either by a jury, or by whichever judge is assigned to the case. By contrast, an arbitration is decided by one or more arbitrators usually chosen from a group approved by both parties. Many arbitration procedures provide that the two parties pick their own arbitrator, and the arbitrators choose the third arbitrator to serve on a panel. The arbitrators usually are practicing lawyers or retired judges, and the parties have some control over whether the arbitrators have experience in the issues that may arise in the dispute.

The choice of arbitration over traditional litigation *does not* turn on whether a client wants to avoid a jury. Clients who have control over the manner by which disputes are resolved, such as in a franchise agreement or employment contract, can include a waiver of a jury just as easily as an arbitration provision. *See, e.g.*, *Azalea Drive-In v. Sargoy*, 215 Va. 714, 720-21, 214 S.E.2d 131 (1975). The real question is whether a client is interested in having control over the decision maker, and the ability to choose someone more familiar with the types of issues that may arise in the dispute. If the claim arises out of a failed real estate transaction, the parties may be interested in choosing an arbitrator with a real estate background. If the dispute is over a construction contract, the parties may be interested in an arbitrator who has actually handled construction litigation. Such choice is unavailable in traditional litigation.

While they serve as judges, arbitrators do not always act like judges. For the most part, judges are unbiased, neutral decision makers. While arbitrators may be expected to rule objectively, and "call the claim" exactly as he or she sees it, experience suggests otherwise. In panel arbitrations where each party chooses an arbitrator, the adversary process can extend to the arbitrators themselves. Some arbitrators act as a "quasi advocate" for the party who chooses the arbitrator to serve. After all, repeat business for an arbitrator may depend on the outcome of the claim. For this reason, single arbitrators as well as panels often reach a compromise decision that you would not find in traditional litigation. Even if the arbitration

provisions provide for summary decisions, they are rare. The arbitrators likely will hear the claim and find some "middle ground" resolution. In short, arbitrators do not like "zero sum" outcomes.

Unlike judges, whose decisions may be scrutinized on appeal, arbitrators have a relatively free hand to decide cases as they see fit. This makes compromise decisions, regardless of how one-sided a case may be, even more likely. The arbitrator knows that, absent something extraordinary, the decision will stand. Such a compromise resolution may be good for clients with disputed claims that "could go either way," but it is less appealing for clients with clear claims or defenses.

Generally, arbitration hearings are less formal (and in many instances much less formal) than a traditional trial. Arbitrators are less likely to strictly apply the rules of evidence, and typically give attorneys a good deal of latitude in leading witnesses. Whether this is an advantage depends on the circumstances. For example, a party attempting to enforce a relatively clear contract provision may prefer traditional litigation where a judge is likely to enforce the parole evidence rule. An arbitrator more likely would give a party the opportunity to present evidence that might alter the meaning of a provision, such as prior negotiations or industry standards.

The streamlined arbitration proceedings are less conducive to extensive discovery. For example, the AAA's Commercial Rules do not provide for depositions. While arbitrators have the authority to issue subpoena, not all states have adopted the Uniform Arbitration Act and the procedures for enforcing an arbitration subpoena in those states vary. In light of the significant discretion typically given to arbitrators with regard to controlling discovery, there is an inherent risk that the arbitration forum will not provide the tools to develop the evidence necessary to present a complex claim. The relaxed rules on the presentation of evidence means little if you do

not have the tools to discover the evidence. Nevertheless, there is empirical evidence to suggest that the discovery limitations have no real impact on the outcome of a claim. *See* Barkai and Kassebaum, *The Impact of Discovery Limitations on Pace, Cost and Satisfaction in Court and Arbitration*, 11 U. Haw. L. Rev. 81 (1988).

Because arbitration decisions essentially are final, the client should avoid arbitration if the client would be interested in appealing an adverse ruling. Assuming an award is the result of a valid, enforceable arbitration agreement and that the arbitrators acted pursuant to the agreement, an award will be set aside only if it is procured by something akin to fraud or a party is effectively denied a hearing. Virginia Code Section 8.01-581.010 governs the grounds for vacating an arbitration award. The court is required to vacate an award that was "procured by corruption, fraud or other undue means" or if "there was evident partiality by an arbitrator appointed as a neutral, corruption of any of the arbitrators, or misconduct prejudicing the rights of any party." Notably, the Code makes clear that an award would not be set aside merely because the relief would not be available at law or equity. Improper conduct does not include mistakes. It does not matter if the arbitrator misinterprets a contract or commits errors of law. *See Farkas v. Receivable Fin. Corp.*, 806 F.Supp. 84, 87 (E.D. Va. 1992).

Aside from fraud or misconduct, courts will set aside an arbitration award if either party is deprived of an opportunity to be heard. Virginia Code Section 8.01-581.010 specifically states that an award shall be vacated if "the arbitrators refuse to postpone the hearing upon sufficient cause" or "refuse to hear evidence material to the controversy or otherwise so conducted the hearing, contrary to the provisions of § 8.01-581.04, in such a way as to substantially prejudice the rights of a party." In essence, the parties get a hearing, and not necessarily one free from errors, as the resulting decision governs notwithstanding that the arbitrators make mistakes such as admitting hearsay evidence. *See Farkas v. Receivable Fin. Corp.*, 806 F.Supp. at 87. As long

as the arbitrators are honest, give the parties a hearing which is free from corruption and fraud, the ultimate decision will be binding.

Arbitration is probably best suited for specialized claims that may require a particular expertise, or custom procedural and evidentiary rules. While essentially the same evidentiary and procedural rules govern all civil claims filed in the Commonwealth, the AAA offers more than fifteen separate sets of rules tailored to specific types of complaints. These "custom" rules have become popular for resolving certain claims such as construction and securities disputes. This is particularly true when the arbitration is included in a contract of adhesion where one party is likely to have extensive experience with the unique arbitration rules that apply to the industry.

Arbitration can be beneficial. It gives the parties the opportunity to choose a decision maker that may be more familiar with the issues that can arise in the case. Further, arbitrations usually allow a party greater latitude in presenting evidence, including documents that might otherwise be inadmissible, and testimony that might be difficult to introduce in the traditional litigation forum. While the streamlined procedures of arbitration are designed for a quicker, less expensive resolution, these benefits depend on cooperation of the parties. The same level of cooperation can result in a quick, and maybe even less expensive resolution in a traditional forum. Absent extraordinary circumstances, arbitration decisions are final, and for this reason are ideal for parties interested in a simple resolution that ends the controversy regardless of the outcome.

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