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The Advantages of Arbitrating High-Stakes Disputes

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A few months ago, Justice Anthony Kennedy commented that the Supreme Court's docket "seems to be changing."[1] The reason? "A lot of big civil cases are going to arbitration."[2]

My experience certainly conforms to Justice Kennedy's insight that companies are opting for arbitration over litigation in big civil cases. Last year, for example, I sat on a panel involving two toy companies that had sued each other over two products. The sales of each of the products were, conservatively, hundreds of millions of dollars.[3] The claims and cross-claims involved copyright and trademark infringement as well as breach of contract by the developers of one of the products who now worked for one of the companies.

If one company won the dispute, the other company might be forced out of business. The press was following the case, and it had the potential to devolve into an acrimonious affair. And, to top it off, the companies needed the dispute resolved promptly in order to maximize the sale of the products for the upcoming year-end holiday season.

Counseled by two of the best law firms in the country, the parties agreed to arbitrate the dispute pursuant to a schedule and protocol that counsel negotiated. The companies picked three arbitrators including one former judge from the district where the lawsuit was filed. The parties also opted to use appeal procedures that allow either party to appeal a final award to a panel of three new arbitrators.[4]

After streamlined and heavily managed discovery, both parties moved for summary judgment. As a result of this motion practice, the issues were narrowed and the parties received a full, written explanation of the panel's view of the law. After a nine-day hearing, while the panel was drafting an award, the parties reached a settlement that allowed both companies to continue to sell the products at issue.

From start to finish, the above-described case took about seven months.

Historically, there have been a number of reasons why lawyers have not chosen to arbitrate their case - some valid, some not. But, over the last decade, fundamental changes in litigation, arbitration and even the business world have caused many lawyers to consider whether arbitration may now be the better course for resolving their case.

Arbitration Can Resolve Disputes Faster Than Litigation

The median time from filing a complaint to completing a trial in federal court is now more than two years, and the average appeal lasts almost a year.[5] And given that civil filings in the federal district courts have grown nine percent since 2006, the time it takes to reach a resolution in court is likely to increase.[6]

Litigation in state courts takes even longer not only because state courts have much larger dockets but also because legislatures are cutting budgets as a result of the recent economic downturn. For instance, this summer, the San Francisco Superior Court announced it would soon lay off 40 percent of its staff and close 25 out of 63 courtrooms, including courts used for complex business litigation, as a result of the California legislature's cut

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of $350 million from court operations.[7] "With a few exceptions, only criminal cases will go to trial," according to the press.[8] While emergency funding has since lowered these estimates to a layoff of just over 20 percent of the staff and courtroom closures to 14, there is little doubt that the budget cuts will continue to affect court systems around the country.[9] The New York State court system has faced similar, albeit less drastic, cuts in funding.

In contrast, the median time from the filing of a demand for arbitration to an award is less than eight months, according to the American Arbitration Association.[10] The International Institute for Conflict Prevention and Resolution (CPR) has stated that more than half of its domestic and international arbitrations result in an award being rendered in less than a year.[11]

Moreover, since arbitrators generally have far fewer disputes to resolve than judges and other judicial officers in civil-side courts, they may issue an award in even quicker fashion if that is what the parties want. In the arbitration I described above, as indicated, the parties fashioned their own discovery and pre-trial deadlines, and picked arbitrators whose schedules allowed them to promptly issue a lengthy opinion.

Arbitration Can Be More Cost-Effective Than Litigation

In the last decade, discovery, and in particular electronic discovery, has dramatically increased the costs of litigation. According to one survey of Fortune 200 companies, the average outside litigation cost per company has risen from $66 million in 2000 to almost $115 million in 2008 - an average increase of 9 percent a year or a total of 73 percent in less than a decade.[12]

The survey also found evidence suggesting broad discovery provides little marginal benefit to the judge or jury when measured against the costs of production. "In 2008, for example, 4,980,441 pages of documents were produced on average in discovery in major cases that went to trial. However, the average number of exhibit pages totaled 4,772, or 0.10 percent of pages produced."[13] Or, as Mark Segall, former Litigation Head of JPMorgan Chase, recently commented, "The fact is important documents in any case are typically contained in a notebook no more than an inch thick."[14]

Although electronic discovery has also increased the costs of arbitration, the latter retains one significant advantage over litigation: the parties can agree ahead of time to limit the scope of discovery. Finding ways to limit discovery so as to best resolve disputes in a cost-effective manner is now a major focus of arbitrators across the world.

In 2009, the College of Commercial Arbitrators (CCA), an international professional association, held a "summit" with both arbitrators and users of arbitration –- litigators and corporate general counsel –- in attendance. The goal of the conference was to identify practical steps to make arbitration more efficient and cost-effective in business-to-business arbitration. The CCA then issued specific suggestions for the management of the arbitration process, including "managing electronic records and handling electronic discovery much more efficiently than is currently done in federal and state courts."[15] For example, the protocols state that "at a minimum, the description of custodians from whom electronic discovery can be collected should be narrowly tailored to include only those individuals whose electronic data may reasonably be expected to contain evidence that is material to the dispute and cannot be obtained from other sources."[15] Likewise, the CCA also suggests that arbitrators reject requests for backup data, deleted files, and metadata unless the requesting party can demonstrate a reasonable likelihood that files were deliberately destroyed or altered in anticipation of arbitration or litigation or outside of usual document retention policies.[16]

JAMS[17] has also striven to curb the cost of arbitration generally, including the cost of electronic discovery. In 2010, JAMS amended its Comprehensive Arbitration Rules and Procedures to include two new sections: "Application of Expedited Procedures" and "Where Expedited Procedures are Applicable."[18] The rules on electronic discovery are similar to those suggested by the CCA. Moreover, the rules give the arbitrator discretion to further limit electronic discovery or shift the costs of production if "the costs and burdens of e-discovery are disproportionate to the nature of the dispute or to the amount in controversy...."[19]

Likewise, the CPR has issued guidelines with various levels of disclosure that parties may select.[20] The most restrictive provision provides for no pre-hearing disclosure other than copies of printouts of electronic documents that the parties will present in support of their cases. The broadest choice as to scope of discovery is akin to discovery allowed under the federal rules.

In short, as the costs of electronic discovery have risen dramatically over the last decade, arbitration providers have responded with approaches seeking to maintain arbitration as a cost effective alternative to litigation. Savvy counsel can select, or even design, a level of discovery that helps resolve the dispute without engaging in costly discovery.

The Confidential Nature of Arbitration Can Keep Companies Out of the Limelight

Traditionally, confidentiality has proven valuable to companies that do not want trade secrets disclosed. Moreover, today, in an era where blogs may cover every public detail of a messy dispute, keeping allegations confidential can also prove valuable. My sense is that the confidentiality of the toy companies benefited from keeping the dispute private not only because the parties and witness knew each other, but also because it made it easier to settle the case.

The proliferation of document-sharing websites such as Scribd.com and niche blogs that follow litigation (e.g., the Wall Street Journal's Law Blog) gives an incentive for general counsel of any company to consider whether to include an arbitration clause in their business or employment contracts.

Parties May Select Arbitrators with Particular Expertise

Parties may appoint experts in an industry – either with respect to the technical aspects of a dispute or regarding the relevant law – to resolve their disputes. As the business world has become increasingly complex, this feature of arbitration has become increasingly attractive. Arbitrators with a particular expertise do not need to be educated about certain background information, which not only results in a more efficient hearing but also reduces the likelihood of receiving an arbitrary judicial decision or jury verdict. International banks may, for instance, include arbitration clauses in their contracts that specify the arbitrator must be familiar with international banking practices or certain trade rules.

Parties may also appoint a lawyer or former judge with reputations of being even-handed, strong-willed or willing to render a large award if that is what the evidence and law support. For instance, the two toy companies may have selected a former federal judge and an arbitrator known for running of tight ship when presiding over large, complex arbitrations. The hearings were held on time and in an efficient manner. The confidence with which my co-arbitrator managed the hearing also, in my opinion, helped facilitate discussions between the parties and the eventual settlement. The parties certain knew that if the panel said it would issue an award by a certain date, it would happen on that day.

Parties May Design Their Own Appeal Procedures in High-Stakes Arbitration

All of these advantages raise the question of why lawyers do not recommend that every big case go to arbitration? The primary reason is the perception that arbitration is too risky for bet-the-company or even large litigation because of the limited judicial review of arbitration awards. Parties fear the so-called "knucklehead awards."[21]

Moreover, in 2008, the U.S. Supreme Court held in *Hall Street v. Mattel*[22] that parties cannot agree to expand the grounds of judicial review under the Federal Arbitration Act (FAA). Accordingly, in cases in which the FAA governs, the parties may not agree to have a court review the factual findings or legal holdings of arbitrators as an appeals court might review the conclusions of a trial court.

But there is a solution to this problem as well: as the example I began with demonstrated, the parties may agree to have the award reviewed by another arbitrator or a panel of arbitrators, a procedure that every major provider of arbitration currently allows.[23]

For instance, the parties may require a three-neutral panel to apply the same review standard that the first-level appellate court in the jurisdiction would apply to an appeal from a trial court decision. And, like an appellate court, the arbitration appellate panel will not consider new evidence unless the appellate panel determines there is good cause to re-open the record.

Counsel who wish to use an appeal procedure in arbitration should answer several questions. First, when should the parties be allowed to appeal? In federal court, appeals are typically limited to final judgments. However, in some state courts, including New York courts, parties may appeal prior to the final award. Counsel in an arbitration might, for example, want the option to appeal the denial of a motion to dismiss the demand or a motion for summary judgment, which are often critical points in the arbitration. They may, however, forego the option to appeal every discovery-related decision of the trial arbitrator, which can happen in certain state court systems.

Second, what law will govern? Generally, the parties will confront this issue at the beginning of the arbitration process -- and frequently there is no dispute as the relevant contract in a commercial dispute may specify the governing law -- but if the contract is not clear or if the parties can not otherwise agree, the trial arbitrator or panel of arbitrators will resolve the issue in the first instance. If there is a disagreement, the choice of law issue may be an issue before the appellate panel. But, agreement will make the process more cost-effective, particularly if there are significant differences in the potentially applicable law. For example, in the arbitration between the two toy companies, one of the claims was for trademark infringement. Because different federal appellate courts apply a different set of factors in determining whether there is infringement, the parties greatly streamlined the amount of work –- and time –- by agreeing on the particular circuit whose law would be controlling.

Third, what standards of review will the appeal panel use? The typical default rule is that panel should apply the same standard of review that the first-level appellate court in the jurisdiction would apply to a trial court decision, but this isn't the only option. In fact, if the evidence is primarily documents, rather than testimony, the parties might prefer to allow the panel to engage in *de novo* review on the trial arbitrator's finding of facts.

Other questions for counsel to answer include how many arbitrators should sit on the appeals panel, how quickly should the appeal be decided and should the panel be required to issue a written opinion explaining its denial or affirmance of the original panel's decision? The last question may be particularly important for lawyers who seek an opinion that is more detailed than the one or two page summary opinions that appellate courts often issue.

Conclusion

Arbitration has long been used by businesses to resolve their disputes; some people date the origins of arbitration to Phoenician merchants over 2,000 years ago.[24] Today, businesses continue to use arbitration for good reason: arbitration is inherently flexible

and allows sophisticated commercial parties and their counsel to design a procedure to resolve disputes in a fair, timely and cost-effective manner and in a way that best suits their needs.

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[1] Pamela A. MacLean, Justice Kennedy on Vanishing Big Civil Suits, Trial Insider (Aug. 16, 2011) *available at* http://www.trialinsider.com/?p=639.

[2] *Id.*

[3] I have changed various facts of this dispute to preserve the confidentiality of the parties.

[4] *See* JAMS, Optional Arbitration Appeal Procedure (2003) available at http://www.jamsadr.com/rules-optional-appeal-procedure/

[5] James C. Duff, Judicial Business of the United States Courts: 2010 Annual Report of the Director at 187 (2010) (Table C-10) (reporting that the median time from the filing to trial for civil cases in which trials were completed during the 12-month period ending September 30, 2010 was 24.3 months); *see id.* at 106 (Table B-4A) (reporting that the median time from the filing of a notice of appeal to final disposition over the same time period was 11.7 months).

[6] *Id.* at 21.

[7] Bob Egelko, Budget woes slow the wheels of justice, S.F. Chron., July 19, 2011, at A1.

[8] *Id.*

[9] Bob Egelko, New state funds ease S.F. layoffs, closures, .F. Chron., September 1, 2011, at A1.

[10] Edna Sussman, Why Arbitrate? The Benefits and Savings, 81 N.Y. St. B.J. 20, 21 (Oct. 2009).

[11] *Id.*

[12] Lawyers for Civil Justice, Civil Justice Reform Grp. & U.S. Chamber Inst. for Legal Reform, Litigation Cost Survey of Major Companies at 15 (2010).

[13] *Id.* at 23.

[14] Chris Poole, Effective Advocacy in Arbitrations, JAMS ADR Blog, Aug. 16, 2011, available at http://jamsadrblog.com/2011/07/27/shaping-e-discovery-within-arbitration/ (quoting Mark E. Segall).

[15] *Id.*

[16] *See id.* at 54 n.173.

[17] JAMS is the largest private alternative dispute resolution provider in the world. *See* http://www.jamsadr.com/

[18] JAMS Rules 16.1-16.2.

[19] *See* JAMS Rules 16.2(c)(iv).

[20] International Institute for Conflict Prevention & Resolution, CPR Protocol on Disclosure of Documents and Presentation Of Witnesses in Commercial Arbitration (2008)

[21] Christopher R. Drahozal & Quentin R. Wittrock, Is There a Flight From Arbitration?, 37 Hofstra L. Rev. 71, 79 (2008).

[22] 552 U.S. 576 (2008).

[23] *E.g.*, JAMS, Optional Arbitration Appeal Procedure (2003), available at http://www.jamsadr.com/files/Uploads/Documents/JAMS-Rules/JAMS_Optional_Appeal_ Procedures-2003.pdf; International Institute for Conflict Prevention & Resolution, Arbitration Appeal Procedure (2007), http:// www.cpradr.org/ClausesRules/ArbitrationAppealProcedure/tabid/79/Default.aspx; *see also* Paul Bennett Marrow, A Practical Approach to Affording Review of Commercial Arbitration Awards: Using an Appellate Arbitrator, 60 Disp. Resol. J. 10 (Oct. 2005).

[24] New York State Bar Association Dispute Resolution Section Arbitration Committee, Report on Arbitration Discovery in Domestic Commercial Cases, at n.1 (2009).