

Protecting the Natural Cost Advantages of Arbitration

By Mitchell L. Marinello

The other day an attorney and friend of mine commented flatly that arbitration was no less expensive than litigation. His comment bothered me, not because it was false, but because it should be. Arbitration has natural cost advantages over litigation. But is it sometimes just as expensive? If so, what factors account for this?

The answer lies in how clients and their counsel use arbitration and whether they take advantage of its natural cost advantages over litigation—or if they instead try to override them. Ultimately, arbitration is just a procedural mechanism for resolving disputes. It can be economical or not, depending on how it is used.

Arbitration: Cost Advantages and Disadvantages

Theoretically, arbitration should have several cost advantages over litigation. It is supposed to and generally does do the following:

- permit less discovery than litigation and, partly as a result, give rise to fewer discovery disputes and motions
- eliminate almost all pretrial motions to dismiss and for summary judgment
- eliminate detailed pretrial orders and move promptly to a final evidentiary hearing
- permit evidence to be presented in a simpler, less technical manner
- act as a final ruling, with very limited bases for appeal

Arbitration also has at least one cost disadvantage compared to litigation. In litigation, a judge and a court system administer the case, and the judge alone or with the aid of a jury determines the facts and decides the final outcome. The judge, jury, and court administrators are paid by the taxpayers, not the litigants,

who generally are charged only nominal filing and jury fees. In arbitration, the parties do not get a free or heavily subsidized administrator or decision maker. Instead, they must pay for those services themselves.

If we accept, for the sake of discussion, that these factors are the primary cost differences between arbitration and litigation, then it is easy to see how the cost advantages of arbitration can be lost.

Exaggerating Claim Values and Using Multiple Arbitrators

One of the most direct ways to increase the cost of arbitration is to maximize its chief economic disadvantage—to increase the cost of administering and deciding the case. Two ways to accomplish this are to exaggerate the monetary size of one's claims and to insist on a panel of three arbitrators when one arbitrator will do.

Arbitration organizations such as the American Arbitration Association (AAA) use a graduated fee schedule for cases: the higher the amount in dispute, the higher the administrative fee. No one should deliberately underestimate the size of a monetary claim, but it is wasteful to exaggerate it. All this would accomplish is to increase the associated administrative charges.

In the same way, each arbitrator selected for a case is entitled to be compensated. To insist on a panel of three arbitrators triples this cost. In actuality, the cost may increase more than three times, because having three arbitrators may lead to more postponements and scheduling problems and may lengthen the proceedings.

Certainly, there are types of disputes or particular cases where three arbitrators may be preferable to one. If that is the situation, then the extra expense may be worthwhile. But choosing to have three arbitrators hear a case instead of one should not be done reflexively. Consider

at the outset whether disputes involving the contract in question are likely to be large or complex enough to justify the expense of three arbitrators. If you want three arbitrators simply on the theory that three heads are better than one, consider whether there is some other less expensive way to obtain the security and confidence in the ultimate decision that you are seeking. One alternative may be to specify in the arbitration agreement the qualifications and/or experience the arbitrator must have. Another method is to carefully screen the arbitration candidates. In many and perhaps most situations, one arbitrator is sufficient as well as more economical.

Conducting Excessive Discovery

Although almost everyone recognizes that arbitration is supposed to involve less discovery than litigation, there is probably no consensus on how much less discovery there should be. The discovery rules of arbitration organizations are often general and do not state what kind or how much discovery is permitted. For example, the commercial arbitration rules of the AAA provide for the exchange of documents but are silent on whether interrogatories or depositions are available. The AAA rules for large and complex commercial cases expressly recognize that depositions may sometimes be appropriate, but they do not contain specific guidelines or limitations. This leaves arbitrators with a lot of discretion.

The discovery rules of the Finance Industry Regulatory Authority (FINRA) are somewhat more detailed and less hospitable to discovery. For example, the FINRA rules for consumer disputes provide that depositions should be allowed only “under very limited circumstances.” One of those “very limited circumstances,” however, is “[t]o expedite large or complex cases.” This too leaves room for argument and gives arbitrators considerable discretion.¹

A reasonable amount of discovery, including depositions, is often necessary or helpful in a case. This is particularly true when one side has sole possession of critical information or when complex fact issues are involved. Another useful guideline is the size of the dispute. When a lot of money is at stake, depositions are easier to justify.

Sometimes, however, counsel for the parties act as if the amount of discovery available in arbitration is and should be no different than in the typical lawsuit. If both sides agree to engage in extensive

Specify in the arbitration agreement the qualifications or experience the arbitrator must have and carefully screen the candidates.

discovery, then the arbitrator is likely to go along with it. After all, the attorneys are the agents of their clients and are presumed to be carrying out their client's wishes. If the parties, acting through counsel, want more discovery than is typical in arbitration, the arbitrator has little reason to object and probably will not do so. As a result, one of the chief cost savings of arbitration over litigation will be diminished if not lost.

There are at least two ways to prevent discovery expenses from getting out of hand. One way is to place limitations on discovery in the arbitration agreement itself. For example, the arbitration clause can state specifically whether depositions will be permitted and, if so, how many depositions may be taken and how long they may last. Another way is for clients to stay involved in the arbitration process after a case has been filed and to provide their counsel with guidance on how much discovery they should seek. When the parties disagree on the scope of discovery, arbitrators are more likely to impose restraints on it.

Filing Dispositive Motions with a Low Probability of Success

The fundamental difference between litigation and arbitration arguably is not that litigation is public whereas arbitration is private or that litigation permits broad appellate review whereas arbitration does not. Instead, the difference is much more basic and general. Litigation is all about pretrial proceedings; only a small portion of business cases is actually tried. In fact, if one out of every ten or even fifteen commercial lawsuits that were filed went to trial, the courts probably would become so crowded that they would cease to function. Litigation is a process of discovery and motion practice designed to eliminate claims that clearly have no merit and to reveal extensive factual information about the claims that survive so that the parties can make sound judgments about their value and settle them. It is probably true that about the same percentage of arbitrations settle as lawsuits, but the mechanism is different. Arbitration does not work through a process of extensive discovery and motion practice; rather, it achieves settlements through a credible threat of a prompt trial on the merits.

Partly as a result, dispositive motions usually do not play much of a role in arbitration. For example, the rules of the AAA and FINRA do not even provide for dispositive motions on substantive issues and instead require that the parties be given a fair opportunity to present evidence on the merits of their positions. Careful arbitrators are wary of motions to dismiss or for summary judgment and often will discourage or even forbid them. Indeed, except in the most clear-cut situations (e.g., claims filed after the statute of limitations has expired or claims that are nonsensical or devoid of any legal basis), granting a motion to dismiss or for summary judgment can result in a successful judicial challenge to the arbitrator's decision and wind up wasting everyone's time and money. One of the few bases on which an arbitral decision can be overturned under both the Federal Arbitration Act and the Uniform Arbitration Act is the arbitrator's failure to hear relevant evidence.² Thus, the prudent course is usually to let the case be heard

at an evidentiary hearing and then to decide the merits of the parties' respective legal and factual positions.³

From a practical standpoint, dispositive motions are also less important in arbitration than in litigation. In arbitration, there is no pretrial order and no set of jury instructions to worry about. There is also no risk of jury confusion. As a result, there is less need to reduce the number of claims presented at trial.

Although dispositive motions are disfavored in arbitration, the parties sometimes insist on presenting them. And, when both parties agree that dispositive motions should be heard, the arbitrator is more likely to permit them. The expense of briefing and arguing such motions eliminates another cost advantage of arbitration over litigation. Clients and attorneys should keep this in mind and resist the temptation to file dispositive motions in all but the most clear-cut situations.

Postponing Deadlines and Hearing Dates

One of the chief goals of arbitration is to move cases to the hearing quickly. This may result in indirect economic savings, but its primary function is to resolve disputes promptly so that they do not hang over the parties' heads. A good arbitrator will allow the parties to have enough time to prepare their positions and respect legitimate scheduling problems, but will also push for a prompt hearing date and, once a hearing date is set, will not postpone it unless there is a good reason to do so.

The rules of the AAA and FINRA allow (and in some cases, require) the arbitrator to grant postponements of the hearing when the parties jointly request it or when either party shows good cause. Postponements can increase costs if they occur after one or both parties have spent time preparing for the hearing and have to repeat part or all of that preparatory work. Postponements also can create indirect costs when witnesses arrange their schedule to be available for the hearing only to find that the hearing date has been moved.

Both sides can avoid these issues by selecting a realistic hearing date at the outset, committing to complete their

work on time, communicating regularly with their witnesses, and protecting the hearing date from other scheduling conflicts.

Failing to Stipulate to Evidence

To shorten the time and expense of trial, courts often encourage the parties to stipulate to the admissibility of documents and other evidence and to reduce the number of witnesses as well as the length of their testimony. The same time-saving practices are often used in arbitration. In addition, an arbitration hearing can be structured in ways that save time and resources and that are not possible in a court of law. For example, sometimes direct testimony can be presented in narrative fashion or through affidavits or other sworn writings, distant witnesses can testify by telephone, or opposing experts can testify at the same time, taking turns answering the same questions or responding to each other's positions.

Of course, these mechanisms do not always save time nor are they always appropriate. It is almost never a good idea to present important contested testimony in writing or by telephone. Having the witness tell his or her story in person and letting the arbitrator observe the witness's demeanor are usually essential in such circumstances. In addition, if the testimony is complex or lengthy, putting it in writing may take more time than presenting it orally.

In my experience, the parties usually will agree to reasonable suggestions for streamlining a case and take the hint when arbitrators indicate that they have heard enough evidence on a given topic. There are times, however, when one party or the other insists on a protracted presentation of its case or when the parties are very antagonistic and simply will not cooperate with one another. In these instances, the personality and style of the individual arbitrator come into play. Some arbitrators will insist on moving the hearing along in an expeditious fashion; others will be more deferential to the parties' wishes. Counsel and their clients must recognize that they share responsibility for the efficiency of arbitration proceedings. If you are uncooperative or drag out the proceedings, you cannot

rightly complain that arbitration is not as fast and inexpensive as it is cracked up to be.

Filing Meritless Appeals

After an award has been rendered by the arbitrator, the victorious party generally is required to confirm the award in a court of law so that the award has the same effect and can be enforced through the same legal means as a judgment. The losing party has the opportunity to challenge the award, but the bases for doing so are extremely limited.

Under the Federal Arbitration Act, an award may be vacated:

- where the award was procured by corruption, fraud, or undue means;
- where there was evident partiality or corruption in the arbitrators;
- where the arbitrators were guilty of misconduct in refusing to postpone the hearing upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy, or of any other misbehavior by which the rights of any party have been prejudiced; or
- where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.⁴

The Uniform Arbitration Act, which has been adopted by most states, provides essentially the same grounds for challenging an arbitration award.⁵ The reported case law makes it clear that the courts take these limitations seriously and confirm arbitration awards in all but the rarest of circumstances.⁶ Despite this, however, losing parties sometimes vigorously oppose the confirmation of an award and even take an appeal if the award is confirmed by the trial court. This introduction of litigation into the arbitration process can reduce the cost advantages of arbitration.

There is probably no way to prevent one's opponent from challenging an award or appealing if the award is confirmed, but such behavior can be discouraged. One way to accomplish this is to provide in the arbitration agreement that

if the appeal is taken and if the award is confirmed, the losing party will pay the other side's legal fees and expenses for the appeal.

Conclusion

Arbitration has natural cost advantages over litigation because it generally involves less discovery, less motion practice, quicker and more streamlined evidentiary hearings on the merits, and fewer bases for appeal. These natural cost advantages can be lost, however, if the parties do not protect them. ■

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Endnotes

1. NASD CODE OF ARBITRATION PROCEDURE FOR CUSTOMER DISPUTES, R. 12510.
2. See 9 U.S.C.A. § 10(a)(3) (West 2008); UNIF. ARBITRATION ACT § 12(a)(4) (2008).
3. The arbitrator's obligation to hear relevant evidence does not mean the arbitrator is at the parties' mercy and must hear evidence that is redundant, unnecessary, or unhelpful. Arbitrators have substantial discretion in structuring the hearing and making evidentiary rulings. *Generica Ltd. v. Pharm. Basics, Inc.*, 125 F.3d 1123, 1130-31 (7th Cir. 1997).
4. 9 U.S.C.A. § 10(a) (West 2008); see *Hall Street Assoc., L.L.C. v. Mattel, Inc.*, 128 S. Ct. 1396, 1403 (2008) (discussing the limited grounds for challenging an arbitration award).
5. See UNIF. ARBITRATION ACT § 23.
6. See, e.g., *Cook County v. Am. Fed. of State, County & Mun. Employees*, Dist. Counsel 31, 294 Ill. App. 3d 985, 988 (1st Dist. 1998) (describing standards for vacating an award and deference to arbitrator).