Arbitration *v.* Litigation:

You Control the Process *v.* The Process Controls You

BY JOHN ARRASTIA JR. AND CHRISTI L. UNDERWOOD

What trial lawyer would not want to be able to select the judge hearing the case? Arbitration allows the parties to determine the arbitrator's background. Unlike litigation, it gives them choices and flexibity to design a process to fit their needs.

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The advantages of a properly structured and well-managed arbitration are especially valuable today. With clients insisting on more manageable litigation budgets and the courts clogged with the fallout from a struggling economy, efficiency and reduced overall costs are becoming the polestars of healthy client relations.

Arbitration is intended to be quicker, less expensive, and more efficient than litigation. But many litigators complain that the process has become cumbersome and expensive. This happens when trial attorneys treat the arbitration process as they would federal or state court litigation. Why? One explanation is that they are taught to litigate using the court's rules of procedure and evidence, and when faced with the less structured and less familiar arbitration process, they naturally turn to what they know and thus, try to incorporate the rules and procedures of court into the arbitration process. This transforms arbitration into a mirror image of court litigation, with the attendant expense and delay.

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Trial attorneys can satisfy their clients' desires to economize on dispute resolution by understanding the differences between arbitration and litigation, for it is these differences that provide the benefits of arbitration. Only then can counsel maximize those benefits and use the inherent flexibility of arbitration to tailor the process to the needs of the client and the circumstances of the dispute.

Part I of this article discusses the core concept of arbitration and the ways that arbitration differs from litigation. Part II, which will be published in a subsequent issue of this *Journal*, will discuss techniques trial counsel can use to achieve an efficient and cost-effective arbitration.

I. Core Concept of Arbitration

The core concept of arbitration is its flexibility. This means that it is not governed by rigid, detailed rules. The parties have a significant amount of freedom of choice when it comes to designing the process. The concepts of choice and flexibility are recurring themes in this article.

a. Flexible Rules

Institutional arbitration rules are purposely very general and give the arbitrator great discretion in the management of the process. This allows the parties and the arbitrator to consider the most efficient ways to proceed. Thus, the American Arbitration Association's (AAA) Commercial Arbitration Rules provide that the parties may vary the procedures stated in the rules.[1] In addition, nearly all the AAA rules state that they apply "unless the parties otherwise agree." This is a far cry from litigation, which is highly regulated by detailed, step-by-step rules of procedure, supplemented by case law, and subject to the preferences of the presiding judge.

b. Choice

The flexibility of arbitration provides choices on many levels. First, there is choice relating to the selection of the arbitrator. What trial lawyer would not want to be able to select the judge hearing the case? The ability to choose the decision maker in arbitration is one of the primary benefits of the process. There is also choice in matching the speed of the process and the amount of discovery that is allowed to the size of the dispute. Thus, one can fast-track a small case and agree to little or no discovery, and in a large case employ large, complex case procedures and agree to more discovery. In addition, the parties can agree on the form of the award. They can also agree to limit the extent to which the final decision is disclosed to third parties.

Suppose that an existing client comes to you with two new matters that it wants to arbitrate, arising out of the same standard form contract, each raising the same complex issues, but one claim involves $100,000, while the other involves $8 million. Would you approach each dispute the same way? Probably not, and it is fairly certain your client would prefer the resolution of the smaller matter to be resolved faster and cost substantially less. But court rules of procedure generally do not distinguish between cases based on the amount in controversy (except for jurisdictional purposes and except for claims that qualify

for small claims court). Most institutional arbitration rules automatically provide for different procedures for small, mid-size and large disputes tailoring the time, extent of discovery allowed, and costs accordingly.

The best time to decide arbitration details is before a dispute arises in the arbitration clause of the parties' contract.[2] However, if the arbitration does not contain such details, the remaining points can be decided at a preliminary conference with the arbitrator.

c. Fair Results

Most decisions rendered by arbitrators will be made after a great deal of thought and time has been given to reviewing the presentation of evidence and they will be based on an underlying knowledge of the subject matter of the dispute and commercial reasonableness where applicable. Unlike jurors, arbitrators are trained in how to give appropriate weight to evidence, how to manage the process to maintain a level playing field, and provide a decision that is just and fair.

d. Self-Determination to a Point

The flexibility of arbitration decreases as the final hearing approaches. For example, once the arbitrator has issued a pre-hearing scheduling order establishing the framework for the arbitration procedures and deadlines, unless the parties agree, it may be as difficult to persuade the arbitrator as it would be to persuade a judge to make any changes to the order. More importantly, after the final award is entered there is little flexibility since the arbitrator will have no authority to change the decision on the merits under the doctrine of *functus officio*. Final arbitration awards are binding, enforceable and almost impossible to challenge in court, since the grounds to appeal such awards are very limited and courts afford them great deference.[3] The lesson is that a party should focus on establishing a procedure early in the process.

II. Differences Between Arbitration and Litigation

Applying the core concepts of flexibility and party choice, arbitration can differ from litigation in almost every way.

a. Decision Maker

We have already pointed out that arbitration differs from litigation in that the parties can participate in the selection of their decision maker. At most, in litigation, trial attorneys can decide whether to file the case in state or federal court and whether to seek a jury or a bench trial. In any event, a judge will likely be assigned to the case by a blind draw of the clerk of the court.

Arbitration does not offer the option of a jury. What it does offer is the ability to have a decision maker with far more expertise than a judge or jury would have in the specific issues presented by the case. Not only that, the parties can decide how many decision makers there will be.

i. Size of Tribunal. The parties can agree on a single arbitrator or a panel of three. Some parties believe that the "collective wisdom" of three decision makers may encourage more accurate results. Though panels raise the cost of arbitration, they make the most sense in large, complex matters.

The parties can state how many arbitrators there should be in their arbitration clause. Or they can agree to follow the rules of an arbitration institution. If they opt to use the AAA Commercial Arbitration Rules, there will be a panel of three if the dispute qualifies for the Large, Complex Case Procedures and the parties have not agreed otherwise.[4] When parties agree to use three arbitrators, they can also decide if all three will be neutral, or if two will be partial to the party that appointed them. The trend is toward a panel of all neutral arbitrators. AAA commercial rule R-12 provides that party-appointed panel members must be impartial unless the parties have specifically agreed otherwise.[5]

Arbitrations involving three arbitrators may take longer because of scheduling difficulties and the need for the panelists to find time to confer, deliberate and write an award. Even if an arbitration clause calls for three arbitrators, the parties can agree to use one arbitrator if they are concerned about reducing the cost of resolving the dispute.

ii. Qualifications of the Arbitrator. Arbitrators are usually chosen for their ability to efficiently manage an arbitration proceeding and/or their knowledge of a particular field or issue. For example, the parties to a construction dispute may want the arbitrator to be a construction lawyer, a general contractor, an architect, or an engineer, or some combination of these professions. Each skill set brings a different perspective to the arbitration. Having expertise in the subject matter is considered an advantage because the arbitrator should understand the facts and issues more quickly than judges or jurors who are likely unfamiliar with construction. The same is true whether the dispute involves real estate, biotech, telecommunications, international trade, or some other area of specialization.

Parties should want an arbitrator who is a

good manager, who will be proactive in keeping the arbitration moving forward. Some want an arbitrator who asks questions at the final hearing while others prefer minimal or no questioning by the arbitrator.

Then there are practical considerations, such as the arbitrator's availability to serve. If you need the final hearing in October but the arbitrator is scheduled for a three-month trial in the fall, then that arbitrator is not the one for you. To avoid delays, parties with particular scheduling needs should ask the administering institutional case manager to screen prospective arbitrators in advance of their appointment concerning their availability.

The parties may also have other requirements that in their mind will result in a more fair hearing. For example, in an employment case, the employee might want a more ethnically diverse panel. In AAA arbitrations, the case manager provides a list of arbitrator candidates that match the criteria requested by the parties.

b. Rules

As indicated above, a key difference between the two processes is that litigation is governed by procedural and evidentiary rules that the parties cannot change, while arbitration proceedings are governed by rules selected by the parties, which can be changed if they both agree. Arbitrators are charged with following the rules unless the parties agree otherwise. In addition, an arbitration proceeding may be subject to the Federal Arbitration Act (FAA),[6] a state arbitration act, or an international convention if the dispute is international in nature. These laws and treaties generally do not take away the flexibility of arbitration. Rather, they focus on the enforcement of and challenge to arbitration agreements and awards.

c. Confidentiality

An important benefit of arbitration that is not available in litigation is that it is more private than litigation. Litigation is public and often newsworthy. The Internet has made news of litigation more widely available. Also, anyone has the right to review the court file and attend the court proceedings, absent an order sealing the case or closing the proceedings. Sealing any part of a court record is exceptionally difficult, and typically includes notice to the press so that it may object to any such proposed order.

The public cannot attend arbitration proceedings between private parties. Under AAA commercial rule R-23, only a party with a direct interest in the proceedings is entitled to attend, unless the arbitrator directs otherwise. The privacy of arbitration derives from its contractual nature, not a statute. There is no federal or state law making arbitration confidential. Thus, in order to obtain confidentiality, parties often enter into a confidentiality agreement concerning the arbitration itself. Sometimes a party may also enter into a separate confidentiality agreement with an expert witness. However, a confidentiality agreement is effective only to the extent that the signatories adhere to it. In addition, a confidentiality agreement will not prevent a party from revealing the arbitration if disclosures are required by law or government regulation (such as a security law filing). It should also be noted that arbitration providers may have a legal obligation to disclose information about their cases. For example, administering institutions that do business in California are required by state law to provide detailed information about their national consumer case load. "Consumer" is broadly defined.

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d. Consequences of a Failure to Appear

In court, a failure to appear or file a written response to pleadings can result in a default judgment. The concept of a default judgment is not recognized in arbitration. In arbitration, if the respondent does not appear, the claimant must still sustain its burden of proof and submit evidence sufficient to sustain the award.[7]

e. Court Scheduling Conference v. Preliminary Conference

The court scheduling conference is usually held to schedule the discovery in the case, rather than to set the trial. Indeed the trial date will not

be set until much later (often years later in large cases) and they are often postponed several times if the court has a backlog of cases. The discovery dates will be set in accordance with rigid court rules. Following the scheduling conference, the judge often orders the parties to participate in a settlement conference.

The preliminary conference in arbitration is far more collaborative and broader in scope. Its main purpose is to identify and organize the steps necessary to prepare for the final hearing (i.e., the pre-hearing procedures), establish the dates for completing these procedures, and set a date certain for the final hearing on the merits.

At the first preliminary conference (there can be more than one), the arbitrator and counsel for the parties (and sometimes party representatives) will discuss a variety of matters. The first conference usually takes place on the telephone 30-45 days after the arbitrator is appointed. The matters discussed include, for example, the parties' needs for discovery, whether the parties expect to retain experts, and the use of cost-saving measures that can be used to control the time and cost of the proceeding. As a result of these discussions, the parties and the arbitrator will agree on the pre-hearing procedures and deadlines, and set the date for the final hearing.

Some arbitrators will ask the attorneys if they have raised the subject of mediation with their clients. However, in arbitration the parties will not be forced to mediate or to participate in a settlement conference as a condition to a final hearing.

f. Paperwork

i. Pleadings. From a work standpoint, arbitration requires less paperwork than litigation. The pleadings are simpler than in court and not highly regulated. The first pleading is the demand, the purpose of which is to give the adversary notice of the intention to arbitrate. The AAA commercial rules require the demand (as well as a counterclaim) to contain a "statement of the nature of the dispute, the names and addresses of all parties, any claims and counterclaims, the amount involved, if any, the remedy sought and the hearing locale requested."[8]

The adversary is not required to file an answering statement but has the option of doing so. The rules also encourage the parties to describe their claims "in sufficient detail to make the circumstances of the dispute clear to the arbitrator." Often, the parties are given an opportunity to better define their positions after the first preliminary conference.

ii. Motions Generally. Arbitration contemplates fewer motions than litigation. The only motions specifically contemplated by the AAA rules are those seeking interim relief, resolution of a discovery dispute, or challenging the arbitrator's jurisdiction or the arbitrability of a claim.

There are no formal requirements in the AAA rules for motions or applications (except for emergency interim relief prior to the appointment of the arbitrator). Therefore, in the an arbitration of any agreement or order of the arbitrator, a party may file a motion or application in the form of a letter or an e-mail. There are no briefing requirements in the rules, and no need to prepare proposed orders. The arbitrator normally informs the parties what kind of supporting materials should be submitted with their letter or e-mail. The arbitrator will also set a date for the other side to submit its written comments.

iii. Dispositive Motions. Motions that decide all or part of a case in arbitration are called dispositive motions; in litigation they are summary judgment (SJ) motions. SJ motions are standard practice in litigation. This is not the case in arbitration where parties have a strong expectation of being able to present their case at the final hearing. Nevertheless, dispositive motions are sometimes very carefully used in arbitration. This is possible because arbitrators are required to manage the arbitration proceedings with an eye toward efficiently resolving the case and this includes focusing the parties on dispositive issues. At the same time, they have the duty to treat the parties equally and give each a fair opportunity to be heard.[9] The efficient management obligation can include the authority to hear and decide a dispositive motion in an appropriate situation, as long as all parties have been given a fair opportunity to be heard. The case law on this issue is not extensive, but several cases that exist have upheld arbitral rulings granting such motions.[10] For example, the opportunity to be heard does not necessarily mean an oral hearing on the merits.[11]

However, the authority to grant a dispositive motion should not be used cavalierly or misused because the award may be subject to challenge under Section 10 of the FAA on the ground that the arbitrators exceeded their authority or refused to hear evidence, or both.[12] To protect the award and afford appropriate process rights of the parties, many arbitrators believe it is prudent to obtain the agreement of the parties to the dispositive motion procedure before agreeing to hear and decide a dispositive motion.

The arbitrator can ask the parties at the first preliminary conference if anyone has a dispositive issue (such as one based on the statute of limitations, or an alleged waiver of consequential dam-

ages) that could be resolved by a summary judgment motion. If the answer is yes and the opposing parties agree to allow the arbitrator to rule on the issue in order to narrow issues or dispose of the case altogether without the necessity of a full hearing, the parties can agree on the procedure to be followed. Such flexible procedures can save time and money while giving the parties a full opportunity to have the pertinent issues heard.

g. Discovery

In litigation, discovery can generate the largest single expense. Depositions are standard in court cases. Each deposition requires counsel to spend time to prepare the witness to testify (or to question the witness), review relevant documents and attend the deposition itself. This is followed by summarizing the deposition and paying for a copy of the transcript.

There is almost no restriction on the amount of documents that may be requested from the adversary or third parties, all of which need to be reviewed and analyzed after they are produced. These often result in objections.

Interrogatories and requests for admission are standard in litigation. They invariably generate written objections and few substantive responses. As a result, discovery disputes often arise. They require the parties to file with the court motions and supporting memoranda of law seeking a protective order or to compel a witness to answer particular questions at a deposition or to compel a party to produce withheld documents or to answer certain interrogatories. The court may require oral argument on the motion. This means that before appearing in court, the attorneys will have to spend time preparing an argument and anticipating the other side's arguments and the judge's questions.

In arbitration, discovery is not so broad. Indeed, the amount of discovery used in litigation was never contemplated to be a part of arbitration. The AAA rules provide for the exchange of information (i.e., documents) and don't refer to discovery or depositions (except for the Large, Complex Case Procedures). The rules leave it to the parties and the arbitrator to fashion the amount of discovery appropriate for the dispute.

Thus, arbitrators expect the parties to agree to very limited discovery and where they disagree, the arbitrator can and should streamline the process. This is necessary to curtail costs.

When discovery disputes arise in arbitration, and they do, they are handled more informally than in litigation, so resolving the dispute costs much less. They are usually resolved in telephone conference with the arbitrator or by a written order from the panel chair.

i. Absence of Third-Party Discovery. An important distinction between litigation and arbitration concerns discovery of information in the hands of third parties. Article 7 of the FAA authorizes arbitrators to issue subpoenas for witnesses to appear at the final hearing, and bring documents along with them.[13] Some jurisdictions have interpreted this provision to permit third-party discovery.[14] However, some federal appeals courts have not authorized pre-hearing document discovery from third parties.[15] They have interpreted Article 7 to mean that the witness can only be required to bring documents when he or she testifies as a witness before the arbitrators.[16] This area is constantly evolving, so arbitration advocates should determine the law on third party discovery in the locale where arbitration is contemplated or pending.

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b. Final Hearing

We have alluded to the expertise of the arbitrators (as opposed to jurors and some judges) and the confidentiality of the hearing versus the public nature of a trial. We have discussed the fact that rules of civil procedure do not apply in arbitration, making arbitration a process of choice and more informal. There are, however, other differences between a trial and an arbitration hearing.

i. Venue. In litigation, venue is determined by the facts and rules of procedure. When it is contested, the resolution of the dispute can be tied up in controversy, including appeals, for years at a time.

Venue is determined differently in arbitration. The parties to the arbitration can agree on venue in their arbitration agreement or during the arbitration at an early preliminary conference. If not predetermined in the contract, venue normally will be based on the convenience of the parties. In an arbitration under the AAA Commercial Arbitration Rules, if the parties cannot agree on the

locale of the hearing, the AAA will make that decision.[17] In a construction dispute, under Rule R-12 of the recently amended AAA Construction Industry Arbitration Rules, if the parties cannot agree on venue, the hearing will be held in the city nearest the project in dispute, subject to the arbitrator's approval.

As for the location of the hearing, it usually takes place in a conference room, the arbitrator's office, or a hearing room specifically provided by the service provider, almost never a courtroom.

ii. Presentation of Evidence in Arbitration. Since arbitrators are not bound by specific rules of evidence, the parties have greater flexibility with regard to the presentation of evidence. This means that hearsay can be introduced, as well as copies of business records. In addition, efficiency techniques can be used to introduce evidence, techniques that would not be permitted in a courtroom but which are very effective.

Most arbitrators are open to new ideas to make the arbitration process more efficient. And AAA arbitrators are trained to give affidavit evidence the weight it deserves in light of the adversary's objections.[18]

Conclusion

There has always been a need to have disputes addressed fairly but in a faster, less costly way than the court system allows. That need is even greater in the current economic downturn as companies seek to make the dollars allocated to dispute resolution more productive. Counsel can achieve client goals by using arbitration. To make good use of arbitration, counsel must understand the core concepts that distinguish it from litigation.

Arbitration is flexible. It allows the parties to determine most procedural aspects of the process, including the scope of discovery. Litigation does not. Arbitration allows the parties to select an experienced decision maker or panel and to enter into a private agreement to keep the arbitration and its outcome confidential. Litigation does not. In addition, arbitration allows the parties to set a hearing date that is months (not years) away and to agree on steps that should make the process more efficient. These are just a few advantages that arbitration has over litigation. How to make the most of these advantages to make arbitration more efficient and cost effective is the subject of Part II of this article. ■

ENDNOTES

[1] R-21 "Exchange of Information," AAA Commercial Arbitration Rules, available online at www.adr.org.

[2] For a complete discussion of the options available to parties when drafting alternative dispute resolution clauses, see "Drafting Dispute Resolution Clauses: A Practical Guide," available online at www.aaauonline.org/referencecenter.aspx?cid=1.

[3] See *Hall Street Assoc. v. Mattel, Inc.*, 128 S. Ct. 1396 (2008) (holding that the grounds stated in Section 10 of the FAA are the exclusive grounds on which a party may seek to vacate an award under the FAA). Nevertheless, parties may agree to a private appellate arbitration process if an appeal right is important to the clients.

[4] See, e.g., AAA Large, Complex Case Procedures, L-2, which provides that in disputes over $1,000,000, "three arbitrator(s) shall hear and determine the case" if the parties are unable to agree on the number of arbitrators.

[5] See also Canons IX and X of the AAA-ABA Code of Ethics for Arbitrators in Commercial Disputes, available at www.adr.org and www.abanet.org/dispute/commercial_disputes.pdf. They provide that party-appointed arbitrators shall be presumed neutral. If they are not neutral, they must inform the parties and other arbitrators.

[6] 9 U.S.C. § 1, *et seq*.

[7] For example, Rule R-23 of the AAA Commercial Arbitration Rules states that "[a]n award shall not be made solely on the default of a party."

[8] See R-4(a)(1). See also R-5 (initiation under a Submission).

[9] See R-30(a).

[10] *Sherrock Bros. Inc. v. Daimler Chrysler Motors Co., LLC*, No. 06-4767, 2008 WL 63300 (3rd Cir. Jan. 7, 2008) (confirming award granting summary judgment motion under AAA commercial rules); see also *Schlessinger v. Rosenfeld, Meyer & Susman*, 47 Cal. Rptr. 2d 650 (Cal. Ct. App. 1995); *Intercarbon Bermuda, Ltd. v. Caltex Trading & Transport Corp.*, 146 F.R.D. 64 (S.D.N.Y. 1993); *Stifler v. Seymour Weiner*, 488 A.2d 192 (Md. Ct. App. 1985); *Campbell v. American Family Life Assurance Co. of Columbus, Inc.*, 613 F. Supp. 2d 1114 (D. Minn. 2009).

[11] See the *Sherrock Bros.* and *Intercarbon* cases, *supra*, n. 10.

[12] See *Campbell*, *supra*, n. 10

[13] Article 7 of the FAA provides that the arbitrator "may summon in writing any person to attend before them or any of them as a witness in the proper case to bring with him or them any book, record, document, or paper which may be deemed material as evidence in the case."

[14] Third-party discovery in arbitration has been upheld in *Security Life Ins. Co*, 228 F. 3d 865 (8th Cir. 2000); *Illinois, in Amgen, Inc. v. Kidney Ctr. of Del. County, Ltd.*, 879 F. Supp. 878 (N.D. Ill. 1995); *Meadows Indemnity Co. v. Nutmeg Ins. Co.*, 157 F.R.D. 42 (M.D. Tenn. 1993); *Stanton v. Paine Webber Jackson & Curtis, Inc.*, 685 F. Supp. 1241 (S.D. Fla. 1988). But see *Kennedy v. American Express Travel Related Serv. Co., Inc.*, No. 09-61157, 2009 WL 2488298 (S.D. Fla. Aug. 12, 2009).

[15] See, e.g., *Hay Group, Inc. v. E.B.S., Acquisition Corp.*, 360 F.3d 404 (3d Cir. 2004).

[16] *Life Receivables Trust v. Syndicate 102 at Lloyd's of London*, 549 F. 3d 210 (2d Cir. 2008) (barring document discovery from entities that are not parties to the arbitration proceeding).

[17] Rule R-10.

[18] R-32(a) of the AAA Commercial Arbitration Rules.