Has Arbitration Failed Its Essential Purpose?

By Joe Anthony

Arbitration was touted as a fast, efficient, economical method for dispute resolution. In the business litigation context it may have failed on all three fronts. Arbitration takes as long or longer than a lawsuit, is no more efficient, and can be astronomically more expensive. It is an alternative system of justice where the arbitrators need not be lawyers, the law need not be understood nor properly applied and there is virtually no right of appeal. In the commercial context, why do so many transactional lawyers agree to arbitration provisions in contracts?

Purchase, employment and intellectual property agreements almost always contain a provision compelling arbitration. The terms of arbitration clauses are limited only by the creativity of the transactional lawyer who represents the client with the greater economic power in the transaction.

While it may have made sense to include an arbitration clause at the time the contract was drafted, the client's view may change when the time comes to use that clause to resolve a dispute. The typical FINRA arbitration, according to the most recent 2012 statistics, takes 16.6 months from start to finish. We could not find AAA published information more current than 2003, before the advent of e-discovery, so there is no meaningful comparison. Anecdotal experience indicates that business litigation under AAA auspices takes 12 to 18 months from start to finish. The average length of time for all trials in Minnesota state courts for 2012 was 11.7 months and for a court trial was 9.5 months. In 2011, the average was 10 months for court trials and 12 months for all trials. So much for the notion that arbitration is faster.

Arbitration in the business litigation context is slower and less efficient because of scheduling, rules relating to discovery and the economic incentive to delay. Arbitrators typically have other full-time jobs. That makes scheduling a challenge. Having to utilize the arbitration agency to coordinate the scheduling and hearing of motions adds to the delay. Non-FINRA arbitrations in business disputes are usually governed by the rules of civil procedure and are subject to the same time consuming discovery and motion procedures that exist in court. The AAA discovery rules are available but rarely used in any significant business dispute. Arbitrators have little incentive to resolve cases

quickly. Arbitrators, unlike judges, make money as long as the dispute continues. There is a reverse economic incentive at play. Combine that reality with the fact that some lawyers and clients are not interested in quick or inexpensive dispensation of justice and delay is inevitable.

Another source of arbitration delay is, ironically, the courts. If a party to a contract persuades a trial court that an arbitration clause is invalid, the trial court's decision is immediately appealable. That adds delay of anywhere from 9 to 16 months. On the other hand, if the trial court grants the motion to compel arbitration, the losing party cannot typically appeal that decision until after the arbitration is completed. Under the latter scenario, the parties run the risk of having a full arbitration, an appeal on the question of arbitrability, and potentially a second trial if the party challenging the arbitration succeeds.

The financial costs of arbitration are out of control. Since arbitration takes longer than litigation to complete, there are little, if any, savings in attorney's fees. Arbitrators, unlike judges, do not have the ability, the power or institutional mechanisms to order mediation, to compel insurers to participate, or find other ways to produce an early settlement. The countervailing cost savings in not having to do jury instructions, special verdict forms and motions in limine are not enough to offset the additional costs of arbitration.

And the added costs of arbitration may be staggering. In Minnesota state court, the filing fee for a complaint seeking damages in any amount is $320. In federal court it is $350. For comparison purposes, the initial filing fee with the AAA for a claim ranging from $300,000 to $500,000 is $4,350. There is an additional final fee of $1,750. If the claim is larger than $500,000, the filing fee is even larger and has to be negotiated with the AAA. But the filing fee is merely the tip of the iceberg. The costs of a three person arbitration will dwarf the initial filing fee. Most arbitrators in a business litigation context charge between $250 and $600 per hour. Multiply that cost by three and then total up the hours that it will take the three arbitrators to decide motions and hear the case. So, for example, in a recent three person AAA arbitration, the AAA asked the two opposing parties to each make an advance payment of $125,000 ($250,000 total) to cover the estimated arbitration fees for arbitrators for discovery and other motions and a two-week trial. A two-week trial in court, by comparison, would have resulted in minimal additional administrative costs to the client.

There also are other factors that militate against arbitrating an important business dispute. For example, unless the arbitration clause so specifies, there is no requirement that arbitrators provide a reason for their decisions, nor are they required to follow existing law or to even be familiar with the law. Since the arbitrator does not have to provide a reasoned award, if the arbitrator makes a mistake on the facts or the law, the parties generally are not made aware of it. Not that it would matter. An arbitrator's decision, no matter how bad, is typically not appealable except in instances of fraud, bias or corruption. And proving fraud, bias or corruption is an almost insurmountable task.

Arbitration clauses have their place in certain contracts because, properly worded, they can provide a significant advantage to the party with the greater economic leverage. However, the view that arbitration is quicker, more efficient or more economical than litigation is simply not accurate in the business litigation context.

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Joe is a member of the American College of Trial Lawyers and the International Academy of Trial Lawyers. He and his firm focus on trying business lawsuits. In addition to having a significant number of highly publicized defense verdicts, he and the firm have many significant plaintiff verdicts, including one of the largest reported jury verdicts ($130 million) on behalf of a plaintiff in a business litigation matter (PDG vs. American Dental Partners).

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