INTO THE ABYSS: THE PITFALLS OF ARBITRATION (Part I)

By: Daniel A. Batterman, Esq.

DISCLAIMER: This article is intended for informational purposes only and does not constitute legal advice. You should not rely or act upon any information contained in this article without seeking the advice of qualified legal counsel.

Arbitration provisions are everywhere nowadays. Employment, franchise, credit card, and countless other contracts have them. Arbitration has become a booming industry, with the American Arbitration Association ("AAA") leading the way. So what is arbitration? It's a form of "alternative dispute resolution" that is a binding legal procedure. It's a private proceeding whereby the parties submit their dispute to a neutral third party for resolution and forego using the court and jury system.

While some have referred to arbitration as the "privatization of justice," the term "justice" should be used loosely. When most people think of justice, they think that the law will be fairly applied by a learned and scholarly person with a strong moral center, and that there will be recourse if mistakes are made. As discussed shortly, an arbitrator—unlike a judge—is under no obligation to even follow the law. So what's "just" and what an arbitrator does may be two totally different things. And there's little you can do about it.

Most states and the federal government have passed laws giving arbitration formal legal status. There are even international treaties that address arbitration. Courts love to enforce arbitration provisions and judges will go out of their way to make a dispute subject to it. Why? Put simply, it means less work for the court. Judges are notoriously overworked. Arbitration allows a court to help clear its crowded docket. Many courts, including the Supreme Court, have stated that public policy encourages resolving disputes through arbitration, even those that are customarily resolved by a court.

The Pros and Cons. Arbitration has its advantages. Disputes can sometimes be resolved more quickly than through litigation. As a result, arbitration may be less expensive than going to court. Some estimates show cost savings of 20% to 50% over litigation. For a small business entering into a contract with a much larger company, this has a great deal of appeal.

If the parties are located in different countries (such as with outsourcing), arbitration may be vastly superior to litigating in a foreign jurisdiction. For example, it's been reported that a contract dispute in India can take up to 20 years to resolve. Arbitration is far quicker. In addition, arbitration is generally a confidential proceeding, unlike in court where most everything becomes part of the public record. This can be important if the dispute involves allegations of fraud or if there's embarrassing information that one of the parties doesn't want disseminated. In addition, the parties have some control over the selection of an arbitrator. In litigation, the parties have almost no control over who the judge will be.

Arbitration, however, has disadvantages which I believe outweigh its advantages in most instances. First, while it may be quicker, this doesn't make it better. Sometimes complex disputes take time to resolve in court because, well, they're complex. Arbitrators are not necessarily the people best suited to deal with these disputes. Einstein said it best: "Make everything as simple as possible, but not simpler." Perhaps an offshoot of this should be: "Resolve disputes as quickly as possible, but not quicker." Sometimes the positions of the parties need to be thoroughly vetted by a court. This can take time.

Arbitration = Arbitrary? This leads to the next disadvantage: An arbitrator doesn't even have to follow the law. Judges, however, are obligated to do so. So how might an arbitrator decide a dispute? Good question. She could just as easily flip a coin or consult an astrologer.

I recall one instance where a former colleague, who serves as an arbitrator in securities disputes, told me that her mother helped her decide a case after she discussed it with her. Scary, isn't it? In addition, unlike judges who issue detailed written opinions, an arbitrator has no obligation to do so. She may simply write a one sentence decision indicating which side won or lost, and that's it. Also, as noted earlier,

arbitration is confidential. When a judge issues an opinion not only is it publicly available, but the judge is required to follow past precedent when the same points arise in litigation (referred to in legal circles as "*stare decisis*"). Arbitrators have no such requirement and can do what they wish. This can yield inconsistent and contradictory results in disputes that are remarkably similar in nature.

This isn't meant to disparage those conscientious arbitrators who do follow the law and draft thoughtful opinions, as many are attorneys and former judges. The point is simply that they don't have to follow it, and there's not much the parties can do. Having a "gut feeling" about a dispute is no substitute for reasoned analysis. I've found areas of the law which are counterintuitive at first until I've had a chance to really think through all of the relevant considerations. Then what seemed counterintuitive yields to a greater understanding of deceptively complicated issues. Arbitrators, especially those who lack legal training, may not have the ability or desire to engage in this type of detailed analysis.

Al Bundy, Arbitrator. Which brings up the next disadvantage: Just about anyone can be an arbitrator. While many are lawyers and judges, people assume that an arbitrator must have a legal background. Not so. A contractor can be an arbitrator. So can a butcher. As can a shoe salesman. While each of these professions undoubtedly brings a certain perspective to this process, is it a perspective grounded in fairness to all concerned? Maybe, maybe not.

I can't complain too much here. I try to make it work to my client's advantage when I can. I recall one arbitration involving a software development dispute where my client and I wanted an arbitrator with a software background. We reasoned that this type of arbitrator would be more helpful to our position and believed that someone with development experience would be more attuned to the difficulties in developing software. One of the arbitrators that we chose (from a AAA list) had the experience we sought.

Was it a good decision? I'll never know. The other side struck him from consideration. I later learned from the other attorney that he had heard "bad things" about the arbitrator, but didn't elaborate. I don't know if this meant that the arbitrator was pro-developer or had other undesirable qualities, but he was ultimately removed from consideration. We eventually decided on a list of arbitrators who only had legal backgrounds. But the fact still remains that anyone can be an arbitrator. Whether or not this works to your advantage requires careful consideration by you and your attorney.

When You're F#%, You're F#**%!** Arbitration's biggest disadvantage is the lack of recourse to the losing—or even winning—party. The decision is typically not reviewable by other arbitrators and is rarely subject to judicial review, and only then in very limited circumstances (such as fraud, corruption, partiality of the arbitrator, or overstepping of authority). If an arbitrator issues a poorly-reasoned decision or is dead wrong, the other side is stuck with it. I've had clients, even large companies, that don't allow arbitration provisions into any contracts because they've been burned in the past by unqualified or biased arbitrators. They would rather let a court decide, which can always be appealed.

Remember, even good judges make mistakes, which is why trial courts have appeals courts. Even appeals courts have appeals courts. In fact, the right to appeal is a cornerstone of our judicial system. Arbitrators, however, are answerable to no one. If they make a mistake which works to a party's detriment, too bad. And while many arbitrators strive to be fair, those who don't are still given the same power to decide important disputes. This bestows a certain amount of undeserved credibility on arbitrators of questionable ability and character. Recourse through the legal system is time-consuming and expensive, but at least it allows all parties to have their say if mistakes are made. And mistakes are often made.

"Don't worry, it's just boilerplate." This is the key point: Pay attention when a contract requires arbitration. It can be a critical term. While some of the shortcomings discussed here (and in Part II) can be addressed in a well-drafted arbitration clause—or even separate agreement—most of the provisions I see tend to be standard boilerplate that contain the most minimal language. These are the ones that can do the most damage. If the other side insists on arbitration and refuses to modify the provision (and many do), then you need to weigh the advantages and disadvantages carefully before entering into the contract. Things could

go wrong. But in today's lawyer-driven world, what are the chances of that happening?

✧ ✧ ✧ ✧ ✧

The Law Offices of Daniel A. Batterman
Old City Hall
45 School Street, 3rd Floor
Boston, MA 02108
617.259.1600
DBatterman@BattermanLaw.com

DISCLAIMER: This article is intended for informational purposes only and does not constitute legal advice. You should not rely or act upon any information contained in this article without seeking the advice of qualified legal counsel.