WHITHER TO ARBITRATE

By Brad Lambert

When challenged with a contract or commercial dispute, one of the most fundamental early questions confronting the parties is whether to arbitrate the dispute. Arbitration is a popular form of "alternative dispute resolution" in which a privately appointed neutral arbitrator or arbitration panel renders a binding decision, acting much in the same nature as a judge.

Arbitration is frequently – maybe even overwhelmingly - used in employment and securities disputes. In such cases, parties often are bound by contracts requiring arbitration. In other situations, the decision to arbitrate normally arises at two distinct points during your relationship with the other person or entity:

1. When you are entering into a contract or other agreement with that party.
2. After the dispute arises and is headed to court or is in court.

Under either scenario, contracting parties frequently have a window of opportunity to choose arbitration rather than filing or continuing a court case. The willingness of all parties to arbitrate is a key consideration; in the absence of such agreement, the dispute must be pursued in court. It is easier to convince another party to arbitrate when the contract is being negotiated or entered into, since the disputes are only theoretical and not immediate at that point. Once the dispute has arisen, there may be too much distrust and animosity between the parties for them to agree upon much of anything, much less the method of dispute resolution.

Michigan law set both by statute and court decision is friendly to arbitration. Parties are almost always empowered to enter into binding arbitration agreements, and the arbitration decision is enforceable in court absent fraud or a decision that significantly deviates from controlling legal principles or the factual record.

The following discussion breaks down the pros, cons and realities of the most frequently cited characteristics of arbitration. The entries for "pros" and "cons" tend to reflect the conventional wisdom concerning arbitration, while the "realities" state our observations and experience with the same.

Costs

Pros. Arbitration is generally less expensive than taking a dispute to court because discovery is streamlined or prohibited, there are fewer (or no) motions, and relaxed procedural rules. Combine those factors with hearing dates that are more or less guaranteed, and arbitration presents a less costly alternative.

Cons. Unlike court cases, the parties are required to pay the full cost of the arbitrator, arbitration panel and/or the arbitration service. The arbitrators are frequently retired judges who can be expensive. Scheduling conflicts with three arbitrator panels can lead to expensive delays and added costs. A litigious adversary can take advantage of the relaxed rules to impose delays and run up the costs of arbitration.

Realities. Arbitrations can be but are not always less expensive than court cases. The factors noted above and the nature of the case are key considerations in this calculus. Overall, arbitrations present a slight edge, if the case presents one arbitrator or a case type that is frequently arbitrated, such as employment or securities disputes.

Speed

Pros. Arbitration hearings before a single arbitrator are usually scheduled relatively quickly, which is ordinarily appealing to a litigating party.

Cons. One or more parties may not favor a prompt resolution. Even if they do, ill-defined arbitration procedures, coupled with a relative lack of ability to enforce the procedures, enable parties to slow down the proceedings quite easily. Arbitrations involving a three member arbitration panel are often adjourned or rescheduled to fit all three members' schedules.

Realities. This purported advantage is dramatically oversold. Arbitrations are prone to delay (particularly with three arbitrator panels) just like court cases. As with court cases, an adversary determined to slow down the arbitration can usually do so. Generally speaking, one arbitrator – slight edge to arbitration; more than one arbitrator - a draw.

Confidentiality

Pros. Arbitration is a closed proceeding. The parties' ability to maintain the confidentiality of their operations and/or disputes is a major attraction of arbitration.

Cons. It is more difficult to effectively enforce confidentiality requirements in arbitrations.

Realities. This factor significantly favors arbitration.

Qualifications

Pros. Arbitrators frequently specialize by subject matter, thus giving the parties the benefit of the enhanced knowledge and skill base that the typical state court judge (who must hear all kinds of cases) may lack.

Cons. Insider knowledge, experience and connections can work against a party. Moreover, this factor only works for the types of cases where specialized information can be a determining factor. Plus, lawyer arbitrators often lack the judicial temperament judges develop over lengthy tenure on the bench.

Realities. A carefully chosen arbitrator provides better qualifications and insight than many judges, particularly in complex commercial cases presenting specialized topics. Correctly applied, this factor yields a significant edge to the properly chosen arbitrator.

Flexible Decisions

Pros. Arbitrators generally regard the substantive applicable law as a general guide, not binding precedent they must follow. Arbitrators thus have more freedom to make an equitable

decision than a court. A judge and jury must follow the law, even if he, she or they disagree with the results.

Cons. The arbitrator's flexibility in applying the law adds an element of unpredictability to arbitration proceedings.

Realities. In Michigan, arbitrators can be overturned on appeal for failing to follow controlling principles of law; this action of course requires enduring the costs of appeal. Moreover, judges and juries are not fully predictable in and of themselves. This factor is not that significant either way.

Less Formal Rules

Pros. Parties in litigation are bound by the court rules of evidence and procedure. Arbitrators are able to relax or limit the type and amount of discovery, law and motion, and witness testimony in a manner that is appropriate for the dispute.

Cons. Relaxed evidential and procedural rules enable parties to introduce hearsay or confidential evidence that the other party normally expects to be excluded from contested proceedings.

Realities. Relaxed procedural and evidentiary rules are more often a benefit to most parties, provided the arbitrator applies common sense to impose some limits.

Finality

Pros. Generally, arbitration proceedings are final. Michigan courts usually respect and uphold an arbitration award, but can and will overturn arbitration decisions that are nonsensical or depart too much from established law or practice.

Cons. An arbitration award that does not strictly conform to established substantive law may frustrate the parties' reasonable expectations and will not likely be overturned on appeal.

Realities. This factor is pretty close to a draw.

Choosing the Decision Maker

Pros. In court, the judge is assigned on blind draw and the jury is selected from a jury pool over which the parties have no control. The choice of an arbitrator is generally made through a joint process, often from a list of retired judges or attorneys with expertise in the subject matter involved.

Cons. The parties frequently have insufficient familiarity with the arbitrator to make a good and wise selection.

Realities. Arbitrators recognize that they are picked by the parties, and tend to react favorably to the selection. A judge quite naturally sees his or her position as being more authoritative.

Awards

Pros. For the claimant - arbitrators almost always award something. For the defense - arbitration is unlikely to result in inappropriately large judgments which can result from jury trials.

Cons. For the claimant – the claimant is unlikely to receive a large award, or even the amount of recovery sought. For the defense – the defense is more likely to be required to pay something, which may trigger a contractual obligation to pay the other side's attorneys' fees.

Realities. The above discussion is all true – arbitrators tend to see themselves as charged with the responsibility of splitting the difference in some fashion.

Settlement

Pros. Informed parties understand the arbitration award will more likely reflect the middle ground between their positions. This understanding can enhance settlement opportunities.

Cons. Neither side can as readily use the possibility of decision that absolutely favors its side to force a favorable settlement.

Realities. The arbitration versus court case choice has little discernible impact on settlement opportunities.

Summary

The overall answer to the Arbitration vs. Court case question is "it depends," and it depends primarily on the nature of the case and the expectations and strategies of the client. Our firm is not among those who will automatically opt for arbitration whenever the opportunity arises. Arbitration is suitable for some disputes and less so for others.