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ARBITRATION

Achieving the Perceived Cost Savings and Expedience of Commercial Arbitration

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The inclusion of arbitration clauses in commercial contracts is commonplace in today's business world.[1] The prevailing view is that the inclusion of these clauses will yield a quicker and more cost-effective resolution of disputes than the more conventional climb up the courthouse steps. All too often, however, these perceived cost and time savings are not achieved, leaving parties dissatisfied with their arbitral experience. As CORPORATE COUNSEL recently noted: ''A decade ago, many GCs turned to arbitration in hopes of slicing their companies' soaring litigation expenses; now they're taking a second look at that decision and finding that arbitration isn't the cure-all they'd once envisioned.''[2] Academics who have empirically studied the frequency of use of arbitration clauses in commercial contracts have referred to this as a ''flight from arbitration.''[3]

Rather than abandon arbitration altogether, if cost savings and expedience are truly your goals, they can be achieved through more robust front-end drafting of your arbitration clauses. This article provides a litigator's perspective on six essential terms that you should include in your arbitration clauses and concludes with a model arbitration clause embodying these terms.

ESSENTIAL TERM #1
Insist on a Single Arbitrator

One of the largest and most unnecessary drivers of arbitral expenses is a three-arbitrator panel, yet most complex commercial disputes are submitted to such panels at a collective cost of $1,000 to $2,000 per hour.

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[1] *See, e.g.*, T. Eisenberg et al., *The Flight From Arbitration: An Empirical Study Of Ex Ante Arbitration Clauses In The Contracts of Public Companies*, 56 DEPAUL L. REV. 335 (Winter 2007) (noting that arbitration clauses are present in 37 % of employment agreements, 33% of licensing agreements, and 17% of settlement agreements).

[2] L. Whiteman, *Arbitration's Fall From Grace*, CORPORATE COUNSEL, *available at* http://www.law.com/jsp/cc/PubArticleCC.jsp?id=1152695125655.

[3] C. Drahozal et al., *Is There a Flight From Arbitration*, 37 HOFSTRA L. REV. 71 (Fall 2008).

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Litigants too often agree upon three-member panels based upon the belief that having three arbitrators as opposed to one will yield a more reasoned and accurate ruling; however, this benefit is more than outweighed by its three-fold cost factor.

This is particularly true in the scenario where the arbitration clause specifies that each party shall appoint one of the arbitrators, who in turn shall appoint the third arbitrator.[4] The net effect of such clauses too often creates a scenario where each party selects an arbitrator as their quasi-advocate and the dispute is ultimately decided by a single neutral arbitrator at triple the cost.

The most often cited drawback to using a single arbitrator is the method of selecting that arbitrator. To alleviate this concern, consider requiring the administering organization (American Arbitration Association, JAMS, etc.) to provide the parties a list of five qualified arbitrators and then requiring the parties to rank these candidates numerically, with the highest mutually ranked candidate being selected to preside over the dispute.

ESSENTIAL TERM #2
Limit the Time to the Hearing, the Length of the Hearing, and Time to Decision

Consider including language in your arbitration clauses that dictates (1) the length of time from the filing of the notice of arbitration to the hearing; (2) the length of the hearing itself; and (3) the length of time after the hearing that the arbitrator has to issue the decision.

We have found that most well-managed disputes can be ready for arbitration within ninety days of filing the notice of arbitration. This is a reasonable amount of time for attorneys to prepare without sacrificing the quality of their work product.

Similarly, most arbitration agreements will benefit from a provision limiting the duration of the arbitration hearing, since the arbitrator's fee is determined, in part, by the time spent in the hearing. As a general guideline, few disputes require more than three days of hearing to complete.

After the arbitration hearing, the resolution of the dispute is within the control of the arbitrator. The parties, however, can still impose limitations on the time arbitrators have to reach a decision. Fourteen days from the close of the arbitration hearing should be sufficient time for a single arbitrator to release a brief, but well-reasoned award in most instances.

ESSENTIAL TERM #3
Adopt a Notice Pleading Standard for the Notice of Arbitration

Under the prevailing arbitration rules, a party can initiate an arbitration proceeding simply by providing written notice to the opposing party of their intention to arbitrate.[5] Rather that a multi-page complaint with numbered paragraphs describing the aggrieved party's claims—to which the opposing party must respond, admitting or denying each paragraph therein—an arbitration can be commenced with a single narrative paragraph to which no response is required. Arbitral rules permit the demand for arbitration to be less specific than a complaint in a federal court action and do not require the respondent to file an ''answer.''[6] This often encourages counter-productive gamesmanship and leaves respondents guessing as to precisely what causes of action they are defending against.

To combat this, we recommend adopting a notice pleading standard (the standard used in federal court) where respondents will be more likely to understand the claims they are defending and claimants will receive an answer admitting or denying those claims, presumably narrowing the factual issues in dispute for hearing.

ESSENTIAL TERM #4
Limit Discovery

Expansive discovery is the single biggest driver of litigation expense—arbitrations are no exception. As Paul A. Henmueller, Assistant General Counsel at Aon Corporation, noted: ''Time after time, the justifications for ADR—that it is quicker and less costly than litigation—implode under the weight of discovery run amok.'' To lessen this discovery burden, opt for mandatory disclosure of all documents relevant to any claim or defense in the action within 45 days of the service of the notice of arbitration, regardless of whether the documents are helpful or hurtful to the producing party. Mandatory document disclosure removes the need for parties to draft discovery requests, respond to discovery requests, and brief motions to compel. Of course, if either party abuses its disclosure obligations, the opposing party would be free to seek relief from the arbitrator.

In addition to limiting written discovery, also consider limiting deposition discovery by providing, for example, that no more than 10 hours of deposition testimony may be elicited by each party. Rather than limiting parties to a fixed number of depositions, limiting them to a fixed number of hours promotes efficiency, while also providing parties the flexibility to allocate those hours among the case's key witnesses as they see fit.

According to Henmueller, these ''affirmative obligations for bilateral exchanges of all information that may be pertinent to the dispute and a fixed, reasonable 'bucket' of deposition hours will force the parties and their counsel to focus on a reasoned and efficient joining of the issues—avoiding needless delay, expense and brinkmanship.''

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[4] M. Domke et al., DOMKE ON COMMERCIAL ARBITRATION § 24.4 (3d. ed. 2010); *see generally* Robert L. Ebe, *The Nuts and Bolts of Arbitration*, 22 FRANCHISE L.J. 85, 86-89 (2002) (providing a detailed summary of the process for choosing arbitrators).

[5] *See, e.g., American Arbitration Association, Commercial Arbitration Rules R-4 (2009)* (accepting ''a statement setting forth the nature of the dispute, the names and addresses of all other parties, the amount involved, if any, the remedy sought, and the hearing locale requested'' as sufficient to initiate arbitration); JAMS, COMPREHENSIVE ARBITRATION RULES & PROCEDURES Rule 5 (commencing an arbitration after receiving written evidence of the parties' intent to arbitrate the dispute).

[6] Domke, *supra* note 1, § 18:2 (citing *Executone Info. Sys. V. Davis*, 26 F.3d 1314 (5th Cir. 1994), and *Valentine Sugars, Inc. v. Donau Corp.*, 981 F.2d 210 (5th Cir. 1993)).

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ESSENTIAL TERM #5
Authorize Arbitral Sanctions

A court's ability to issue discovery sanctions and hold parties in contempt of court serve as an important deterrent for litigant misconduct. Absent a specific contractual provision granting them such authority, arbitrators are relatively powerless to address misconduct, including dilatory behavior. Consider adopting a provision that would empower arbitrators to impose sanctions upon a party in an amount up to the amount in controversy.

ESSENTIAL TERM #6
Ease the Confirmation Process

Designing the arbitration agreement to reach an expedient and cost-effective judgment is wasted if there is a delay in confirming and enforcing a favorable judgment. To streamline the confirmation process, the arbitration agreement should specify which court(s) have jurisdiction to enter the award. Consider vesting every district court in the United States with the jurisdiction to confirm and enter judgment on the arbitration award. This will permit the prevailing party to directly petition the district court where the opposing party resides, avoiding the cost of enforcing the judgment through courts in multiple districts.

CONCLUSION

The key to keeping arbitration cost-effective is to have realistic expectations about what arbitration can accomplish and to set these expectations in the arbitration agreement. In drafting the arbitration agreement, the parties should carefully consider the potential disputes that may arise and tailor their arbitration agreement to meet their needs. Arbitration is of course a creature of contract—if your desire is expedience and cost savings, you should take full advantage of the opportunity to craft the arbitration process in a manner that will accomplish these objectives.

MODEL ARBITRATION CLAUSE

Arbitration. Any dispute, claim, or controversy arising out of or relating to this Agreement or the breach, termination, enforcement, interpretation, or validity thereof, including the determination of the scope or applicability of this Agreement to arbitrate, shall be determined by arbitration consistent with the following:

(a) *Arbitration Rules*. The arbitration shall be conducted in accordance with [AAA or JAMS] rules.

(b) *Selection of Arbitrator*. Within seven days of the service of the notice of arbitration, the parties shall mutually agree upon a single arbitrator. If at the conclusion of those seven days, the parties have not agreed upon a single arbitrator, the parties shall petition the organization administering the arbitration to provide a list of five qualified arbitrators with experience presiding over claims substantially similar to those pled in the notice of arbitration. Within five days of receiving the list of qualified arbitrators, each party shall submit to the administering organization a numerical ranking of their preference as between these five arbitrators. The highest mutually ranked arbitrator shall preside over the parties' dispute.

(c) *Venue*. The arbitration shall take place in a neutral location in Chicago, Illinois.

(d) *Duration*. A hearing shall be held within 90 days of the filing of the notice of arbitration. Such hearing shall last no more than three business days. Within 14 days of the conclusion of the hearing, the arbitrator shall issue a brief, but reasoned award.

(e) *Governing Law*. Any arbitral dispute amongst the parties shall be governed by the substantive laws of the State of Illinois.

(f) *Pleading*. To instate an arbitration under this paragraph, a notice of arbitration must be filed and personally served upon the opposing party. This notice shall contain a short and plain statement of the claim(s) for relief sought. In response, the responding party may assert a counterclaim but must file an answer to the notice of arbitration admitting or denying all facts and allegations contained therein and asserting any affirmative defenses.

(g) *Discovery*. Within 45 days of service of the notice of arbitration, the parties shall mutually exchange all documents which they reasonably believe are relevant to any claim or defense in the action, regardless of whether such documents are helpful or hurtful to the producing party's case. No document requests, interrogatories, or requests to admission shall be permitted. Each party shall be entitled to take up to 10 hours of deposition discovery.

(h) *Sanctions*. Upon motion or at the arbitrator's discretion, discovery sanctions may be awarded in an amount up to the amount in controversy for failing to comply with the mandatory disclosure obligations or engaging in other dilatory or unethical practices.

(i) *Costs*. The prevailing party, as determined by the arbitrator, may be awarded all reasonable costs and fees of the arbitration including, without limitation, the arbitrator's fees and reasonable attorneys' fees, at the sole discretion of the arbitrator.

(j) *Confidentiality*. Except as may be required by law, neither a party nor an arbitrator may disclose the existence, content, or results of any arbitration hereunder without the prior written consent of both parties.

(k) *Confirmation*. An award issued by the arbitrator pursuant to this arbitration agreement may be confirmed in any United States district court with the jurisdiction to confirm and enter judgment on the arbitration award.

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