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The Case Against Arbitration: Do the Doubters Have a Point?

Recently, the American Arbitration Association (AAA) obtained feedback from a number of its primary users throughout the United States that have traditionally used arbitration extensively as a dispute resolution mechanism. Although the AAA received many compliments and accolades, the results also reflected concerns about arbitration that have become more widespread. These can be distilled into three general perceptions: (1) arbitration is becoming more and more like ordinary litigation; (2) it is becoming as expensive as—if not more expensive than—litigation, in large part because of the high fees that arbitrators charge to conduct a case; and (3) in some circles, there is a lack of trust that arbitrators will be willing to make hard, albeit legally justified, decisions, particularly in complex cases. These results are also reflected in a recent survey concerning international arbitration, reported in the January 2011 edition of “Inside Counsel” magazine. Over 50% of in-house counsel interviewed in that survey said they have been “disappointed with arbitrator performance.”

Are these criticisms justified? To answer this question with any degree of accuracy requires some dissection of the factors at play in a complicated arbitration proceeding. As a starting point, one basic premise of arbitration does not seem to be in doubt, at either the international or the domestic level: for better or worse, arbitration remains a method of dispute resolution that carries with it more undefined and uncertain elements than litigation. The arbitration rules—in both international institutions (such as the ICC or the LCIA) and U.S. domestic institutions (such as AAA or JAMS)—have become somewhat more detailed over the years, but they are still purposely very general, allowing considerable flexibility for the tribunal to conduct the arbitration and for the parties to present their positions. The virtue of this somewhat loose structure is that it creates and defines the intended spirit of arbitration—a dispute resolution mechanism not bogged down by the formalities of litigation, which allows the parties and the tribunal to tailor the process in a fair and cost-efficient way, resulting in a reasoned award that, generally, will be more analytical and comprehensive than its judicial counterparts.

The major arbitral institutions of the United States and the world justifiably point to developments that have not only preserved but promoted this spirit of arbitration. Increased selectivity regarding the arbitrators who make up their resource pools, coupled with highly sophisticated training, continuing education, and multi-media publications addressing thorny issues, have produced proactive arbitrators who have implemented the spirit of arbitration in intelligent and often creative ways to resolve disputes. Likewise, arbitration practitioners who have tuned in to and kept abreast of this evolution have themselves embraced innovative, cost-efficient approaches to preparing and presenting an arbitration case.

So what has happened to change the mindset of a statistically significant sampling of sophisticated users of arbitration? Answers may lie in misdirected strategies that both parties and arbitrators might bring to an arbitration.

Problems Created by the Parties

Some problems with arbitration lie at the doorsteps of the parties themselves. As they become more familiar with the arbitration process, parties recognize that they can wield considerable power in shaping an arbitration proceeding to their liking, particularly when opposing parties can forge an agreement on some aspects of the arbitration process. As cases become more complex, with higher stakes, it is a natural reaction for a party to resort to the comfort of traditional litigation proceedings to

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try to increase the predictability of a favorable outcome, or at least to diminish the risks of failure. And there are opportunities to implement such an approach in virtually every phase of the arbitration process.

The Arbitration Pleadings

A “litigation-embracing” strategy can begin as early as the filing of the arbitration pleadings. Every set of international arbitration rules in the world—including those in the United States—is designed to make the initiation of an arbitration proceeding as easy as possible. There are no formal pleading rules, other than very general requirements that require parties to provide only the most basic information necessary to apprise the other side of the type of dispute that is being brought against them. To level the playing field, some rules do not even require the filing of a written response—by not doing so, the respondent simply will be deemed to have denied the allegations of the arbitration demand.

However, as arbitrations become more complex, a claimant tends to feel more compelled to obtain what it perceives will be an advantage by giving the arbitrators a detailed picture of the wrongs that have been committed against it. The tool of choice for doing so will often be an arbitration demand that contains as much detail as—and not uncommonly more detail than—would be set forth in a comparable litigation pleading. Not wanting to be outdone, the respondent typically will follow suit in its answer to the demand. There is nothing inherently wrong or wasteful about this approach. Many arbitration rules, both international and domestic, typically contain provisions that at some point down the line require the parties to specify in detail their claims and defenses, either as part of the terms of reference (ICC rules) or in the form of a detailed statement of claim or damages (AAA, ICDR rules).

The real trapdoor to the process is the tendency to lure the parties—particularly the respondent—into litigation – like pleading motions that clearly are designed to attack a claimant’s case before it ever gets out of the starting blocks, in the hope of at least raising suspicions in the minds of the arbitrators as to its true worth. Such motions often become very expensive and time-consuming endeavors.

Unfortunately, they are almost always unsuccessful. For example, many arbitrators would reject out of hand a motion to dismiss a claim or cause of action (à la Federal Rule of Civil Procedure 12(b)(6)), not only on the grounds that the arbitration rules neither reference nor contemplate such motions, but also because to allow such motions at such an early stage would deprive the opposing party of a fair opportunity to present its case and possibly lead to vacatur of the arbitration award on that basis. Courts have recognized that there is a legitimate, but narrowly-defined, place for motions to dismiss an arbitration: i.e., where the motion in effect serves as a summary judgment or dispositive motion to dispose of claims that are frivolous on their face or clearly beyond the scope of the arbitration panel’s jurisdiction under the parties’ arbitration agreement. Regrettably, motions to dismiss, motions to strike, and other motions directed against the arbitration pleadings are not always so focused. Like their litigation cousins, they attack the unartful articulation of a pleading, claiming, for example, that the demand fails to allege a claim with sufficient specificity. Such motions are doomed to failure before experienced arbitrators, who recognize that an initial demand or request for arbitration was never intended to be the platform for a battle on the highest and best articulation of a claim.

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Discovery

Discovery is the area in which arguably the greatest opportunity for arbitration “abuse” arises.

Document production. There is no question that the exchange of relevant documents—particularly electronically stored information—is critical for a party to have a fair opportunity to present its case and for the arbitral tribunal to be able to render a decision that is rational and comprehensive. Arbitration rules almost universally try to achieve these objectives by providing procedures for document production, either in the form of a voluntary document exchange or authorization of formal document requests, or both.

Yet document production issues continue to increase arbitration costs, almost exponentially in some cases. Broad-based, unlimited litigation-style document requests, which are purposefully based on the very loose definition of potential relevance necessary to compel the production of documents in U.S. court proceedings, are prime contributors to this problem. They ignore the much narrower standard under most arbitration rules that the request: (i) must call for documents that are reasonably believed to exist, (ii) are not in the custody or possession of the requesting party, and (iii) are demonstrably relevant and material to the outcome of the case. Disregard of the more focused arbitration standard can, and frequently does, lead to extended discovery battles on the scope of document production that, regrettably and inappropriately, mirror those common to litigation.

Further, although electronic document exchange is critically important to arbitration (and in modern arbitration comprises the vast majority, if not all, of a party’s relevant documents), many parties struggle to agree on a procedure that will ensure comprehensive production of electronic information. Arbitration rules historically have not provided any guidance on this issue, because they were mostly created before electronically-stored information came into existence. Recently some arbitral institutions have corrected this by updating their rules to address electronic document production. But even the updated rules leave many of the critical details of production in the hands of the parties and the arbitrators. Thus, if parties are uncooperative in agreeing on a retrieval and production process—for strategic or other reasons—and if the arbitrators are uncomfortable with trying to forge a comprehensive process on their own, this produces a fertile ground for inefficient and expensive production procedures and the wasteful discovery battles that frequently accompany them.

Expert witnesses. Expert witness designations by the parties, combined with the exchange of reports, is also a mainstay of both international and domestic arbitration processes. The IBA Rules have a detailed procedure for designating expert witnesses and exchanging expert reports in international arbitrations (IBA Rules, Article 5). In U.S. domestic arbitrations, allowance of expert depositions is a common practice, based on the compelling rationale that a party should not be unduly surprised at the hearing by expert testimony of which the party may have no prior knowledge, or may not have the ability to address without seeing the expert report in advance and being able to retain its own expert to address the relevant opinions and assist in preparing cross-examination. These practices are almost universally perceived as a help, not a hindrance, to an efficient arbitration proceeding.

The problems with experts tend to arise from the parties’ attempts to overuse expert witnesses to render opinions outside the scope of what is appropriate or to present what at the end of the day is essentially cumulative expert testimony. Although this initially may seem to be a good strategy for shoring up a party’s position, in practice it more frequently leads to expensive and time-consuming

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motions regarding the qualifications of an expert or the propriety of expert testimony—most of which are unsuccessful—or to cumulative testimony that the arbitration tribunal simply ignores or possibly excludes altogether.

Depositions. A major concern with discovery or information exchange in arbitration lies in the area of depositions. In the international arena, the subject of depositions is generally irrelevant—there is almost a universal rejection among international tribunals of the distinctly American concept of depositions. Virtually no civil law jurisdictions recognize depositions, and some will either curtail or not even allow lawyer examination of a witness at the trial of a civil case. It is in U.S. domestic arbitrations that deposition practice can tend to run wild, incurring in the process very substantial expenses for all parties. Both the American Arbitration Association rules (particularly the Supplemental Procedures for Large Complex Cases) and the JAMS Rules contemplate the arbitration tribunal allowing some depositions to be taken, and it is becoming more common for the parties themselves to agree to at least a limited number of depositions in the arbitration clause of their contract.

However, as the stakes in a case increase, the natural tendency is for the parties to leave no stone unturned by deposing virtually every lay witness on an opposing party's witness list, and then adding, for good measure, depositions of a number of "persons most knowledgeable" about some issues. Further, many parties will not hesitate in requesting depositions of non-parties to the arbitration, despite rulings in many leading U.S. jurisdictions prohibiting the issuance of subpoenas for depositions of third parties in arbitration proceedings. Domestic arbitrators may, and usually do, make some attempt (most often in the preliminary conference) to limit the number of lay depositions each side may take. However, in complex matters, it is more and more the case that the parties themselves will try to circumvent any such attempts by agreeing in advance—or at the preliminary conference itself—to a high number of depositions. To many arbitrators, party agreement on such issues will trump any contrary, efficiency-driven ideas they may have.

Dispositive Motions

High-risk cases may also spawn dispositive motions, usually in the form of motions to dismiss or for summary judgment. This certainly can be a good thing and has been increasingly embraced by modern arbitration tribunals. The rationale is that if, in fact, a claim can be fairly disposed of through a motion procedure instead of a full hearing on the merits, the goals of arbitration are clearly promoted. Thus, in international proceedings, tribunals tend to be more amenable to deciding as a "preliminary issue" a question that potentially will either dispose of the case or narrow its scope significantly, such as a motion challenging the jurisdiction of the tribunal to decide a dispute or to award certain types of requested damages under the applicable contract provisions. Domestic arbitration panels—following cases such as the landmark California decision in *Schlessinger v. Rosenfeld Meyer and Sussman*, 40 Cal. App. 4th 1096 (2d Dist. 1995), which recognized the propriety of summary judgment in arbitration—will typically allow summary judgment motions but not until (as *Rosenfeld* advised) the responding party has had a fair opportunity to gather all evidence necessary to oppose the motion.

The problem with dispositive motions lies in the not uncommon maneuver of a party that, aware it has no real hope of winning a dispositive motion before the completion of discovery or maybe at all, nonetheless brings such a motion to "educate" and favorably influence the arbitrators before the hearing starts. This strategy can be extraordinarily expensive in complex cases. The soundness of such a strategy is questionable. Good arbitrators have both the desire and the ability to focus on the

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evidence and argument presented at the hearing and will tend to disregard factual presentations made in prior unsuccessful dispositive motions that may or may not turn out to be an accurate reflection of admitted evidence.

Interim Relief

The parties also can dramatically increase the cost of the arbitration by misusing their right to petition arbitrators for “interim relief.” Arbitration rules generally endow arbitrators with broad latitude to grant virtually any type of interim relief they consider appropriate, including injunctive relief, and even give the parties the option of taking requests for interim relief to a court. (See, e.g., ICC Rules, Article 23; AAA Commercial Rules R-34). This can lull the parties into thinking they will be able to persuade arbitrators to, in effect, end the case by granting prohibitory or even mandatory interim injunctive relief, which either gives the opposing party a clear picture of the likely outcome of the case or is so onerous that the other party will have no incentive to continue the arbitration. Aggressive requests such as these can easily become a profit center unto themselves in an arbitration—complete with extensive briefing, discovery, witness declarations and even live testimony to decide the interim issue. However, the end result of this strategy is seldom successful for the moving party. Good arbitrators tend to use their interim relief powers very cautiously, limiting relief to that necessary to preserve the status quo and to ensure fairness of the arbitration process—for example, by taking steps to preserve assets and/or prevent diminution of their value, or by requiring a party to post security for its share of the costs of the arbitration if there is a chance the party might not be able to pay at the end of the day. However, the same degree of caution is also used by arbitrators to avoid any prejudgment of the dispute on the merits prior to the hearing. This usually translates into denial of aggressive requests for injunctive relief under the judicial standard (reasonable probability of success on the merits, irreparable harm, and balance of equities). Thus, the considerable financial and legal resources a party can expend by trying to obtain punishing and perhaps dispositive interim relief may well go for naught.

Overpreparation for Arbitration Hearing

The parties’ resort to litigation-like practices to ease their apprehension about the outcome of an arbitration is perhaps most pronounced in preparation for the arbitration hearing. In complicated arbitrations, parties sometimes file extremely lengthy, comprehensive and fact-intensive pre-arbitration briefs—going far beyond those that would be filed (or allowed under rules on page limits) in litigation. Although pre-arbitration briefing is indisputably helpful to the arbitrator(s), a compendium of all the evidence and legal arguments is much more than is needed or useful on the eve of the hearing. The typical mindset of a good arbitrator in a complicated case is to reserve all judgment until the evidence is in, which essentially requires disregarding painstaking factual analyses in a pre-arbitration brief in favor of focusing on the evidence as presented at the hearing.

Pre-hearing preparation also tends increasingly to be intertwined with litigation-style pre-trial motions, the primary culprit being motions *in limine* to preclude evidence from being admitted at the hearing. No rule of any recognized arbitration institution says anything about motions *in limine*, although some do articulate the power of the arbitrators to determine the admissibility of and exclude evidence where appropriate. (E.g., UNCITRAL Arbitration Rules, Article 27; ICDR International Dispute Resolution Procedures, Article 20; AAA Commercial Rule R-31). Such language may in essence be the springboard for such motions. But the overwhelming problem with motions *in limine* is that they often ignore the basic premise of arbitration that strict rules of evidence do not apply. Further, a refusal by the

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arbitrators to hear relevant evidence is one of the few grounds for vacatur of an award in both international and domestic arbitrations (e.g., 1958 New York Convention on the Enforcement of Foreign Arbitral Awards, Article V.1(b); Federal Arbitration Act, 9 U.S.C. Section 10(a)(3)), because it can be characterized as a party having been deprived of a fair opportunity to present its case. For these reasons, good arbitrators seldom grant motions *in limine* or similar exclusionary motions except in extreme cases, such as the protection of attorney-client privilege or to counter the attempt to bring in evidence or witnesses contrary to a stipulation of the parties or a prior order of the tribunal. Other evidentiary issues, however, can just as easily be handled when the evidence is presented during the hearing. The argument that motions *in limine* are preferable, because the arbitrators are unable to “unring the bell” in their minds once they hear the evidence, generally underestimates the high level of sophistication and experience of arbitrators overseeing a complex proceeding.

Problems Created by the Arbitrators

Despite all the tactics for arbitration abuse available to the parties, the main problem with runaway arbitrations in many cases may lie just as much—or more—with the arbitration tribunal itself. The fact is that where the parties try to venture beyond the relevant arbitration rules into new territory that promises to increase the time and expense of an arbitration proceeding dramatically, they can do nothing unless the arbitrators allow it. Yet many arbitrators—even at the highest levels—can be overly deferential to the parties as to how an arbitration should be conducted.

There are a number of possible explanations for this. The arbitrators may be overly sensitive to the premise that their jurisdiction derives from the agreement of the parties in the arbitration clause itself, and they may on that basis accept as gospel any procedure on which the parties both agree, or even one that one party requests and the other party does not oppose. Arbitrators also tend to be—and rightly so—keenly aware of possible grounds for vacatur of an arbitration award, which can be fairly summarized on both the international and domestic levels as events or actions that preclude a party from having a fair opportunity to present and have its case decided. To protect against vacatur on those grounds, arbitrators will sometimes step into the background, allow the parties to take a run at any number of the extraordinary procedures mentioned above, and make their views known only in the decisions on those procedures.

However, there unquestionably are a number of tools available to arbitrators—many of them referenced in the applicable arbitration rules—to help ensure that pre-hearing procedures, and the hearing itself, will not be unduly drawn out and expensive without sacrificing the sacrosanct principle of a fair arbitral process. Proactive arbitrators will judiciously use motions to dismiss and motions of summary judgment as tools to resolve a matter when it is appropriate to do so, and in some circumstances may even properly suggest the possibility of such motions to the parties with regard to key issues. Likewise, a proactive arbitrator will not shy away from challenging the parties’ rationale for discovery if it seems excessive, and will work with the parties to customize a more streamlined discovery plan tailored to the legitimate pre-hearing need of the parties that at the same time conforms with the spirit of arbitration. In U.S. domestic arbitrations, rational limits can be set on deposition discovery, both in terms of number of deponents and time limits. The best arbitrators will extend their discovery responsibilities to the complexities of electronic information production, jumping into the trenches to help fashion a fair and efficient process that may creatively borrow guidelines from other arbitration rules not applicable to the case at hand or even from e-discovery developments in the judicial arena. Even in cases where dispositive motions might not be in order, a proactive arbitrator will

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invite the parties to identify, and perhaps even suggest themselves, possible issues that could narrow the focus of an arbitration dispute through a bifurcated hearing. Finally, proactive arbitrators can and do offer valuable guidance to the parties in advance—as early as the first preliminary hearing—for procedures to maximize the efficiency of the proceeding. Proper timing of dispositive motions can be determined, motions in limine can be rationally circumscribed, and page limits can be set on briefing, to name only a few possibilities. Arbitrators should also be favorably disposed to creative processes during the hearing that will increase efficiency while protecting fairness. For example, testimony from a third-party witness who is outside the arbitration’s subpoena power could be arranged effectively and cheaply (in today’s technology-driven world) by videoconference, in lieu of a protracted and possibly unsuccessful effort to force the witness to be deposed. In U.S. domestic arbitrations, the prudent use of depositions for the purpose of taking evidence from nonparty witnesses is also a possibility. The California Arbitration Act, for example, allows for such a procedure for a witness who cannot be compelled to attend the hearing, if “exceptional circumstances” make it desirable to do so “in the interests of justice and with due regard to the importance of presenting the testimony of witnesses orally at the hearing.” (Cal. Civ. Proc. Code §1283). Arbitrators, and parties, are also empowered to consider more extensive use of written witness statements in lieu of direct examination, which can shorten the hearing considerably. Witness statements are in fact the rule in international arbitration proceedings. U.S. domestic arbitration rules provide the same option to the parties and arbitrators. The AAA Commercial Rules (R-32(a)), for example, give the arbitrator the discretion to receive witness testimony by “declaration or affidavit.”

Arguably the single most effective tool to insure the efficiency of the hearing is the use of a time clock. Although some arbitrators are reluctant to impose this restriction out of concern that it may jeopardize the ability of the parties to present their cases fairly, the “time clock” procedure has never been a basis for vacatur of an arbitration award in any reported court decision—state or federal—in the United States. To the contrary, the procedure almost invariably plays out as an inverse function of Parkinson’s Law—the parties will make adjustments to do whatever they must to present their cases in the time allowed.

Arbitrator Distrust

It is quite clear that the driving factor for whether a party ends up trusting an arbitrator is not simply whether it won or lost its case—if this were so, any survey regarding arbitrator trust would probably always generate a distrust quotient of around 50%. The more rationale conclusion is that, regardless of the result, a party’s distrust of an arbitrator actually springs from the handling of the arbitration process. Great arbitrators will strive for a result where all parties to a dispute—winners and losers—come away with a respect for the arbitrator (and the process) because of (i) the fair and cost-efficient manner in which the pre-arbitration procedures, and especially the hearing itself, were conducted, and (ii) the high quality of the award, not so much because of what it gave to or took away from any party but because of the careful and complete analysis of evidence and legal arguments—addressing each substantive issue that the parties brought to the table and that gave rise to the relief awarded.

Adopting a proactive approach to achieving these objectives in an arbitration through, among other things, the procedures discussed above, is key to eliminating arbitrator distrust.

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Conclusion

Unduly expensive and time-consuming arbitrations, with disappointing results, do not just happen randomly. They are invariably the creation of actions by the parties and/or inaction by the arbitrators, usually in some combination. Likewise, a successful arbitration—in terms of efficiency, cost and a fair and rational outcome—is the responsibility of all the participants. In the regrettable situation where an arbitration has morphed into expensive litigation by a different name, one cannot fairly point a finger at the inherent characteristics of arbitration, the arbitration rules or some amorphous concept. The more accurate attribution must rather be to the parties, their advocates, and even the arbitrators, who at the end of the day really have no one to blame for a cumbersome, costly and/or unfair arbitration process but themselves.