The magazine from
NEW JERSEY LAWYER
www.njlnews.com
TRIAL LAW Volume 15, Number 41 October 16, 2006

Arbitrate? Better litigate instead

A strategic and economic decision

By Alan S. Pralgever and Beth P. Zoller

For some time there has been a great debate about whether arbitration or litigation is a more economical, logical and efficient way to proceed. Initially, arbitration had the cachet of being theoretically less expensive, quicker and more equitable. It carried with it the advantages that it was "private" and "confidential," and that decisions were "final," as well as that the arbitrators generally have some familiarity with the field.

However, as many in the legal profession have learned, the contrary is often true: For a number of reasons, arbitration is frequently more expensive, time-consuming, and less-desirable. Certainly, there are a variety of issues to consider, but for several reasons, we believe litigation is often a better approach to dispute resolution.

Cost of arbitration vs. litigation

One arbitration myth is that it is cheaper. In reality it is often more expensive. Depending on the circumstances of the case and complexity of the issues, arbitration is not likely to result in a cost savings to the parties.

1 Depending on the size of the claim, initial filing fees can be several thousands of dollars. By contrast, the filing fees in court are relatively modest.

2 Arbitrator fees can range from $800 to $1,500 a day per arbitration, and three arbitrators often are required at the discretion of the American Arbitration Association or other agencies.

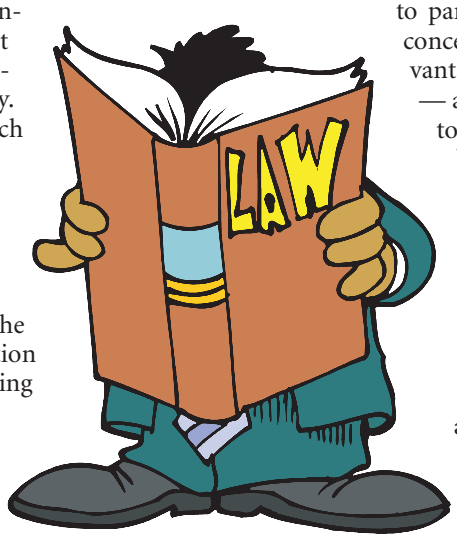
3 The parties have to pay for a court reporter and transcripts in arbitration, which obviously you do not have to do in a trial unless you appeal. Moreover, generally the cost for a daily videotape in court is often just dollars per day on an as-needed basis.

4 You often pay for the rental of a hall or hotel suite for the arbitration, which you do not have to do with court.

5 It often is difficult to coordinate the schedules of the three arbitrators and the parties to secure dates for arbitration hearings, while the court dates are set once discovery is complete.

6 The administrative overhead fees of the arbitration association are considerable, whereas the cost of using the court system is minimal. Often the primary interest of the arbitrators and arbitration forum is to protract, not minimize, hearing time, which is not

true in court before judges with rigorous calendars. Increasingly, arbitrators are retired or at the end of their careers and view their function as a "job" which was not true initially. Therefore, the cost to litigate is often much more economical than in arbitration.



Arbitration scheduling process

Typically, arbitration hearings are spread over time. Hearing dates are scheduled at the convenience of the arbitrators, usually with consideration accorded to the schedules of the parties and their attorneys. Thus, if an arbitration requires two weeks of hearings, those hearing dates may be spread out over a six-month period or longer. It is virtually impossible to work out a schedule for arbitration sessions that involve three arbitrators and one or more adversaries. As a consequence, it often takes months, if not years, to arbitrate a dispute that might represent, at most, a two- or three-week trial in court.

Further, the selection process for arbitrators is often protracted and requires a fair amount of time and consideration. The parties generally need a lawyer on the panel to keep order and direct traffic between the other professionals, lest your arbitration spin out of control. Moreover, relaxed rules and an informal atmosphere may result in delays because the lawyers will continually argue about discovery, evidence and the pace and depth of the issues.

Rules of evidence, procedure

The typical arbitration hearing is far more informal than a trial. Generally, Rules of Evidence and Procedure are tremendously relaxed —another reason it often does not work. It was usually believed relaxation was a positive not a negative, but experience indicates that arbitrators often apply the Rules of Evidence arbitrarily. Ultimately, that does not benefit either party. Unlike courts, arbitration tribunals are not required to apply court-established procedural or evidentiary rules, unless the parties specifically agree otherwise or unless the arbitrator takes it upon himself to adhere to such rules. Thus, because the evidentiary rules are applied randomly, documents or testimony containing hearsay or incompetent, irrelevant or prejudicial testimony may be admitted. Supposedly, this evidence is given less weight — but once heard it is part of the "collective conscience" and reality of the arbitration panel. The evidentiary rules are important in any proceeding because they exist to protect the reliability of the decision-making. Further, the Rules of Procedure are designed to ensure fairness, prevent surprise and compel disclosure of critical information. In arbitration there is no tried-and-true consistent mechanism to keep the parties on track. Moreover, because arbitrators are not usually bound by the intricate and exhaustive legal rules governing procedural and evidentiary matters, arbitration may lack the legitimacy associated with judicial forums.

Discovery

One of the greatest drawbacks of arbitration is the lack of strict rules concerning discovery. In a lawsuit, the court rules provide for exchange of documents, taking of depositions, parameters for expert opinions and other discovery issues to avoid surprise at trial. In arbitration, arbitrators typically determine the breadth and depth of discovery. This can vary widely from panel to panel. In court, there are a multitude of cases concerning what is discoverable, confidential, relevant, privileged and what needs to be exchanged — and what is not. And you have a "trier of fact" to reasonably decide when discovery is overly broad and burdensome and to eventually call a halt to ludicrous requests. Discovery in arbitration cases can be quite arbitrary and capricious because arbitrators either grant too much or too little discovery. Moreover, discovery continues throughout the arbitration, and there are no consistent rules concerning what the parties must exchange. Countless times in arbitration we've had situations where arbitrators order the exchange of major pieces of discovery right in the middle of the arbitration, making strategy and prosecution or defense of the claims more difficult. This can be particularly problematic for expert witnesses, whose opinions should generally be derived from facts after all discovery has taken place. The lack of consistent rules and timelines for discovery means experts often are shooting at a moving target and moving from matter to matter.

By contrast, discovery in court is monitored, managed and often limited in timeframe, breadth and depth.

Lack of discovery may impede the ability to properly evaluate early settlement case value. Additionally, unexpected results during the arbitration can occur because of inability to procure and/or introduce third-party witnesses or expert testimony. It may be difficult to subpoena evidence from third parties who are not primary parties to the dispute. It may be virtually impossible to compel uncooperative third parties to furnish the arbitration panel with evidentiary testimonial evidence.

In sum, judicial procedure offers greater protection for litigants in many ways.

Arbitrator's experience

The common wisdom was that arbitrators, who have some familiarity with the field in which you are arbitrating, would be the best people to hear your case because they would be the most reasonable.

We have learned in many instances, both in construction and commercial cases, arbitrators familiar with the subject matter can be just as arbitrary and capricious notwithstanding their knowledge of the industry. It is clear that familiarity with industry standards does not insulate a party from many tortured and erroneous decisions. Further, the right to appeal makes the trier of fact aware that a higher authority could overturn his/her decision for not being reasonable. By contract, arbitrators are essentially totally independent because they have no one looking over their shoulders. It is very rare for a court to refuse to confirm an arbitration award; In fact, it is almost automatic. Arbitration associations offer training, but little else concerning control of the exceptionally overbearing arbitrator. This is not a desirable set of circumstances for a litigant in any case.

Experts

Court use of experts is regulated, with experts constrained to opine about issues in a particular way. If not based on fact and/or law, a court can strike all or a portion of an expert opinion or testimony. This control does not exist in arbitration. There's laxity in controlling hearsay, and it is a particularly poignant issue with

regard to experts because generally arbitration panels permit them greater latitude in expressing opinions often not based strictly on the facts.

Moreover, because arbitration panelists believe they have a special expertise in a given area, they are more prone to listen to expert opinions based on hearsay if they substantiate the panelist's own predilections.

Summary judgment motions

In litigation one can make a pretrial motion such as one for summary judgment, partial summary judgment or to dismiss frivolous or unmeritorious claims. This is a definite strategic advantage: Cases often settle once a summary judgment motion is made because the weaknesses of your opponent's case are amplified. Even if you do not succeed in the motion itself, settlement may result from the pressure of making such a motion. Litigants often settle before summary judgment motions are heard to avoid the risk of loss. Though this option theoretically exists in arbitration, it is rarely if ever used because arbitration panelists do not like motions for summary judgment. So, valid legal defenses that could be successful in litigation may be unsuccessful in arbitration if they go against the arbitrators' opinion. Thus, arbitration can be frustrating if the respondent has strong legal defenses for having the case dismissed at an early stage. An arbitrator will rarely dismiss a case before the hearing because a losing plaintiff may challenge such premature dismissal as a denial of a fair arbitral hearing. Strategically, it is much better to be able to make a motion for summary judgment in court.

Not subject to review?

Arbitrators are given tremendous latitude in their procedures and judgments and absent outrageous conduct, the courts will not review their actions. While in civil courts the judges are held to strict application of the law as well as the complex procedures and rules of evidence, such strict compliance is not required of arbitrators who may use any and all equitable procedures or common sense and fairness to determine how they will hear a matter. This gives the typical arbitrator far more power than the average judge.

Once a panel is selected, the arbitration association has little control or oversight over the panel. Therefore, it is imperative that the parties carefully select the arbitrators who will hear the case. You must carefully check the potential arbitrator's background and reputation because once chosen, arbitrators are nearly impossible to remove.

Further, important rights are relinquished when parties waive access to the courts, such as the presence of a reviewing court to keep the adjudicator on the straight and narrow. Judges normally are more experienced in acting in an objective and equitable manner, and are more familiar with prevailing law. Arbitrators are allowed to exercise much more discretion than a judge or jury, and thus may be subject to more outside influences and bias. They often take too much personal knowledge and experience into account without fully knowing if it applies to the dispute. Arbitrators generally are not accountable to any supervisory authority.

Unlike judges, arbitrators do not have to follow the law and are not required to give findings of fact and legal conclusions, unless both parties request same. Arbitrators may generally make any award that is "just and equitable." Thus, they frequently disregard the law or contract if they believe it is appropriate to do so because of industry standards or otherwise.

Following precedent

Arbitration awards generally are not reported, except for some securities and labor arbitrations. Such awards do not bind any person other than the parties, and arbitrators are not constrained to follow the law and established precedent. There is really no record to go on and no guarantee the law will be properly applied to the facts. Thus, arbitrators may not adhere to the law and cases may be decided solely on the facts with the law disregarded. The arbitration process often yields less predictable results with no uniformity of decisions.

Privacy advantage

There is one strategic advantage to arbitration: it's private. Arbitrations do not appear on court dockets and are not part of public records. This may be critical if the arbitration concerns information your client wants to keep private or from competitors. However, these issues often can be overcome in court by way of confidentiality agreements and protective orders. Ultimately, however, courts are reluctant to seal records. If there is going to be a trial, trade secret and intellectual property information may be revealed in some form.

Other technical considerations

There are various other technical considerations favoring the judicial forum.

- Lack of jury: Having a dispute resolved by a jury of your peers is a valuable right that should not be underestimated.
- Different remedies and relief: Parties may be unable to collect punitive damages and/or attorney fees, or get specific performance.
- "Splitting the baby": Arbitrators tend to award something (if not fully half) to each party. Attorneys and professionals who serve as arbitrators may rely on their arbitration work as a source of income and may be careful to avoid being pegged as too one-sided.
- Public interest not considered: A submission to a judicial forum ensures the relevant principles and rules will be applied in a matter faithful to the proper enforcement of such law and legislative purpose.
- Voluntary nature: In the arbitration tribunal, there are no means of joining third parties, unless the parties consent.
- Subpoena power: Arbitration subpoenas must be enforced in court.

Final, binding nature

One of the most compelling reasons to litigate is that you cannot appeal arbitration decisions as they are "final and binding." *Levine v Wiss & Co.,* 97 N.J. 242 (1984). While it ensures finality, there is legitimate concern of possible abuses

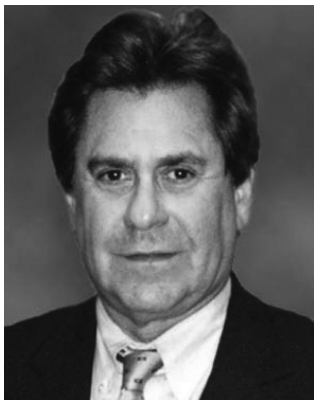
and mistakes of law. There really is no guaranteeing legal principles are faithfully and correctly decided.

In New Jersey there is a great amount of case law on this issue. The problem is you cannot appeal to a higher authority if the arbitration panel has made a mistake or error in law. In *Perini Corp. v. Greate Bay Hotel & Casino, Inc.*, 129 N.J. 479 (1992), the New Jersey Supreme Court indicated the correct standard to review and vacate an arbitration was where the arbitrator's award embraced egregious mistakes of law or made a mistake with respect to an undebatable point of law. However, just two years later in *Tretina Printing Inc. v. Fitzpatrick and Associates Inc.*, 135 N.J. 349 (1994), the court reversed its prior decision, curbing the court's authority to vacate arbitration awards and holding arbitration awards "final" and not subject to judicial review "absent fraud, corruption, or similar wrongdoing" on the part of the arbitrator.

The Federal Arbitration Act (FAA) states that where the parties have agreed that judgment shall be entered pursuant to the decision of the arbitrator, the court must grant the order unless: (1) "the award was procured by corruption, fraud, or undue means"; (2) there is "evident partiality or corruption" by the arbitrator; (3) the arbitrator was "guilty of misconduct" or "any other misbehavior by which the rights of any party have been prejudiced"; or (4) the arbitrator exceeded his or her powers or failed to reach a "mutual, final, and definite award." See *United Transp. Union Local 1589 v. Suburban Transit Corp.,* 51 F.3d 376 (3d Cir. 1995).

The New Jersey Arbitration Act, N.J.S.A. 2A:24:8, provides that a court shall vacate an arbitration award: "(a) where the award was procured by corruption, fraud, or undue means; (b) where there was other evident partiality or corruption of the arbitrators; (c) where the arbitrators were guilty of misconduct" … "or of any other misbehaviors prejudicial for rights of any party; (d) where the arbitrator exceeded or so imperfectly executed their powers that a mutual, final, and definite award upon the subject matter submitted was not made." This means an award may be vacated only where the arbitrators have been arbitrary and capricious — when the award was procured by corruption, fraud, or undue means and ordinarily encompasses situations in which the arbitrator has made acknowledged mistake of fact or law or mistake that is apparent on the face of the record.

So once a decision is rendered in a binding arbitration, the parties are generally stuck with the decision, and there is virtually nothing you can do about it because the possibility of appeal is strictly limited. Further, the lack of post-trial motions and appeal rights in arbitration also impacts a party's leverage to resolve a matter for less than the award. As a consequence, arbitrators have a significant amount of power and often do not exercise that power properly.



Alan S. Pralgever is a partner in the business litigation practice group at WolfBlock Brach Eichler in Roseland. Reach him at apralgever@wolfblock.com or (973) 228-5700. Beth P. Zoller, an associate with the firm, assisted with the article.

Conclusion

We do not believe arbitration is faster, cheaper or more effective than litigation. Experience has demonstrated arbitration is often more expensive, takes longer and is a less effective vehicle for resolving disputes than litigation. Arbitration is often arbitrary and capricious and the arbitrators have ultimate control without having to answer to forum, but the arbitration association with which they work. Arbitrators really have free reign to be arbitrary. The fact that arbitration is "final and binding" creates a distinct disadvantage to the losing party if an error of law or fact has occurred.

We suggest that you carefully consider eliminating the arbitration clause in the contract drafting stage.