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CLIENT MEMORANDUM

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THE PROS AND CONS OF ARBITRATION

By Darryl J. Horowitz

Because of the increase in cost of litigation, and the more frequent use of arbitration clauses in all forms of contracts, arbitration is used with increasing frequency.

Although arbitration is an excellent choice in many instances, it may not be right in every case. This article will discuss the pros and cons of arbitration so that you may know whether it is right for you.

What Arbitration Is

Arbitration is the use of a neutral third party to listen to evidence and render a binding award which generally is not reviewable upon appeal. It is generally initiated by one party to an agreement which requires disputes to be resolved by arbitration. Parties can also agree to arbitrate their disputes regardless of any contractual obligation.

Benefits of Arbitration

The benefits of arbitration are many. Some of the more pertinent benefits are described below:

1. **The proceedings are private.** Generally, cases filed in the court systems are a

matter of public record.¹ Because arbitrations are conducted pursuant to agreement by the parties, the parties can control the privacy of the proceedings. Thus, disputes that may have a negative impact if disclosed to the public can be more effectively controlled. Moreover, if an adverse award is rendered, such information can also be limited to the public.

2. **Speed to final resolution.** Depending on the size and complexity of your claim, the time between filing of an arbitration claim and its final resolution can be quicker than proceeding through the court system. In many counties, trials of civil matters can be delayed months, if not years, due to shortages of judges and lack of courtrooms because the courtrooms are needed for other specialty courts, such as criminal courts, family courts, probate courts, drug courts, etc. Even though courts endeavor to have most civil cases resolved within twelve months after their filing, the fact is that it is often difficult to get your case heard due to lack of courtroom availability, even once you are assigned a trial date. The same holds true with federal courts, which often are burdened by a high number of cases and the need for judges to attend to other non-civil matters, such as prisoner

¹ An exception exists where the parties obtain a court order allowing the court file to be sealed due to privacy issues.

claims, criminal matters, naturalization proceedings, immigration matters, etc. In most instances, the parties and the arbitrator agree upon a date early on in the arbitration process (normally in a pre-hearing conference attended by all parties and their counsel). Depending on the complexity of the case, cases can be heard within six to nine months from the date of their filing.

3. Certainty of the award. Under most circumstances, arbitration awards are final and binding on the parties. They can be enforced judicially by the use of a petition to confirm arbitration award. The grounds upon which a court can review a decision by the arbitrator are extremely limited. They include undisclosed bias or conflict of interest on the part of the arbitrator, an error in the calculation of the award which is apparent from the face of the award itself, or a manifest disregard of the law. Although these grounds appear to be broad, they are not, and courts have held that even where an arbitrator incorrectly applies the law, or disregards certain evidence in coming to his conclusion, the court will not disturb the arbitrator's opinion and overturn an award.² Thus, once the arbitrator issues an award, it is generally binding on the parties.

4. Discovery is limited. One of the most expensive parts of most lawsuits is the discovery process. Parties, under the guise of attempting to uncover information regarding the other party's claims, often misuse the discovery process, claiming that whatever response is provided is not enough. Motions to compel and numerous depositions only increase the cost of litigation and, despite recent changes in the federal rules of civil procedure which limit depositions, costs can still be prohibitive.

Most arbitration agreements limit the amount of discovery that can be conducted. The arbitration rules of the AAA similarly limit discovery in most actions to the mutual exchange

² See e.g., *Moncharsh v. Heily & Blase* (1992) 3 Cal.4th 1; *Hightower v. Superior Court* (2001) 86 Cal.App.4th 415; and *Muldrow v. Norris* (1852) 2 Cal. 74.

of documents, what is agreed upon by the parties, or what is ordered by the arbitrator.³ Other organizations that conduct arbitrations have similar rules,⁴ and even where contracts provide that discovery is unlimited, arbitrators can, in the exercise of their discretion, significantly limit any discovery to be conducted. Thus, discovery costs may often be less in arbitration than in court.

5. Arbitrations are less formal. Although arbitrations can be held in an empty courtroom, should one be available, they most often take place in a conference room in an informal and relaxed setting. The parties have the ability to determine when breaks are scheduled and the hours of the hearing. They generally are not interrupted by other courtroom proceedings which may take precedence and which may otherwise interrupt the flow of the arbitration.

6. The rules of evidence are relaxed. The rules of evidence are mandated for use in the court system. They can limit the amount of evidence that can be submitted and considered by the fact finder, whether it be the judge or the jury. Though they were enacted to safeguard the system from abuses, they can sometimes prevent probative and necessary information from being submitted to the fact finder. In arbitration, the arbitrator generally has great discretion as to what evidence can be submitted.⁵ In many instances, even hearsay evidence can be introduced. That is not to say that evidence which would be considered questionable in court will be given the same weight as all other evidence, because generally

³ See e.g., AAA Construction Industry Arbitration Rules, Rules R-10 and F-8.

⁴ See e.g., JAMS Comprehensive Arbitration Rules, Rule 15.

⁵ See e.g., AAA Construction Industry Arbitration Rules, Rules R-31 and R-32, and JAMS Comprehensive Arbitration Rules, Rule 20(d).

it is not.⁶

7. Arbitration may be less expensive. Because discovery is limited in arbitration, and because a jury is not empaneled, costs to conduct an arbitration may be significantly less than a trial. The informality of the proceeding allows witness presentation to go faster. Moreover, because the parties can determine the time of the hearing, the hearings can be coordinated so that more evidence can be introduced than in trials, where courts usually have to conduct other business during the pendency of your trial.

8. You can select the arbitrator best suited to your case. In court, the luck of the draw will determine which judge will hear your case. If your matter is to be heard before a jury, you will have limited control over the jury that is ultimately selected, as well. In other words, once your case is placed into the court system, the court system rather than you will have control over who hears your case.

In arbitration, the parties have a great deal of control over who will hear their case. Although most entities which provide arbitrators have rules under which an arbitrator will be selected if the parties cannot agree on an arbitrator, the parties can agree on their own as to which arbitrator will be used. Thus, where the parties are involved in a breach of contract claim, the parties can agree upon an arbitrator with experience in contract disputes, or even a retired judge who has heard similar claims.⁷ The same holds true if you have a particularly complex dispute; many dispute resolution services, such as AAA and JAMS, have special complex dispute

⁶ In most instances, all evidence is admitted in an abundance of caution. One of the grounds for reversal of an arbitration award is the failure of the arbitrator to permit all relevant evidence to be submitted. Allowing all evidence to be admitted, whether or not one party believes it is relevant, will aid the arbitrator in eliminating this potential ground for reversal.

⁷ With more and more frequency, experienced judges are retiring to serve as arbitrators and mediators.

panels who have received additional training in arbitrating complex disputes.

There are, of course, other benefits to arbitration; the above only highlights some of the more important considerations.

Detriments of Arbitration

Although in many instances the benefits of arbitration outweigh any detriments, there are factors to consider which may lead you to the conclusion that arbitration is not best for you. These will be discussed here.

1. There is no right to a jury. In arbitration, the arbitrator, rather than a jury, will hear your case and render an award. Although many may believe it is more difficult to convince a jury of the rightness of their position, others believe that juries, properly instructed by a court, provide a more fair and just resolution to a dispute. Some also believe that it is easier to convince a jury to issue a higher award than it would be to convince an arbitrator to issue such an award. Thus, if you have a particular claim that you believe a jury might favor more than an arbitrator would, arbitration may not be right for you.

2. Expenses for an arbitration can be high. Although discovery is limited in arbitration, thereby potentially reducing attorneys' fees, the actual costs for an arbitration may be substantially higher than those associated with a court proceeding.

In court, you pay one standard filing fee for filing your lawsuit (as well as a standard filing fee for responding to a lawsuit), as well as a separate fee for serving the lawsuit and any motions that you may file. The fee for filing a complaint, however, is generally less than \$200, and no more than \$100 for any particular motion. In addition, where a motion is filed in relation to discovery, the court may award the reimbursement of attorneys' fees to the prevailing party (under appropriate circumstances), thereby allowing a party to recover some of its fees and

costs during the pendency of the action.⁸

The filing fee for arbitration is, unfortunately, much higher for most agencies. While some agencies do not charge a specific file set-up fee, the American Arbitration Association and Judicial Arbitration Service (as well as other well established agencies) do charge such a fee. Most minimum fees are much higher than the \$200 fee to file in court.⁹

In addition to paying the filing fee, however, most arbitrators charge an hourly fee for any hearings that are conducted, at rates ranging from \$100 per hour (for inexperienced arbitrators) to higher amounts (for experienced arbitrators) – up to \$400-500 per hour for well-renowned arbitrators. Many even charge a minimum per diem which can run thousands of dollars for a half day of hearing. Though these fees are split between all parties, the fees for the arbitrator alone can make it difficult to justify arbitrating a dispute.

In one recent case where our client was attempting to recover significant damages for construction defects, the arbitration provider requested a deposit in excess of \$9,000 for the arbitrator's fee and related expenses alone. This assumed an eight-day hearing. A longer hearing would have cost more money.

In another matter, in addition to requesting over \$3,000 for our client's one-half portion of the arbitrator's fees, the arbitration provider also requested \$750 for arbitration expenses; this after our client had paid over \$1,500 for the filing fee of the arbitration claim. This may cause some people to be unable to pursue their claims because they cannot afford the costs of the arbitration. Courts so far have not been inclined to help those who cannot afford arbitration but are instead deciding these issues on a case-by-case basis.

⁸ See e.g., Code of Civil Procedure § 2024, etc., providing for sanctions to a party who acts without substantial justification in discovery.

⁹ The minimum filing fee for the AAA is \$500 for a case with a value up to \$10,000, with a fee of \$7,000 for cases with a value of \$1-5 million.

3. The rules of evidence do not apply. One of the benefits to arbitration noted above is that the rules of evidence are often more lax in arbitration than in trial. This, however, can also work as a detriment. Because arbitrators are the sole judge of what evidence is relevant and thus should be considered, a party may be able to have evidence admitted in arbitration that would otherwise be excluded at trial, and thereafter considered by the arbitrator who places a greater amount of weight on the evidence than should be provided. Where the arbitrator uses this evidence to rule against you, it can be particularly damaging to your cause because, as noted above, the decision of an arbitrator is hard to reverse.

4. The decision of the arbitrator is binding. In a court proceeding, when a judgment is entered against the weight of the evidence, or an error in law is made, an appeal can be had and, if well taken, a new trial order. Similarly, excessive judgments can be reduced. In arbitrations, however, the rights to an appeal are severely limited. Only in the most egregious cases will the decision be reversed. Because not all arbitrators have the same level of experience or training, and because their discretion is essentially unchecked, in cases where there are complex legal issues, court may be preferable to arbitration.

5. Awards in arbitrations may be inconsistent. Although most arbitrators work hard to render fair and just decisions, there is no legal requirement that arbitrators follow the law or render a decision based solely on the evidence in the applicable law. Instead, they are free to fashion any relief they deem falls within the ambit of the arbitration agreement. This has fueled the perception that arbitrators “split the baby in half” trying to appease both parties.

While courts are required to follow precedent based on prior cases so that consistent rulings can be expected, arbitrators are not bound by the same rules of precedent. Though, as noted above, most arbitrators do follow the law, there is no requirement that they do so. Thus, one arbitrator presented with one set of facts may rule one way, and a second arbitrator, with the same or similar facts, may rule another way; and

you are stuck with the decision because of your limited right to appeal.

Which Is Right For You?

Whether arbitration is right for you depends on the particulars of the dispute. It has been my experience that litigants are most concerned with having a neutral third party, whether it be a judge, jury, or arbitrator, hear all the facts relating to their claim and decide who is right, win or lose. Because the large majority of arbitrators take their job seriously and work hard to render fair, just, and equitable decisions based on applicable law and the facts, parties are becoming increasingly comfortable with arbitrating their disputes. This is true, win or lose. There are, nevertheless, those cases where arbitration simply is not in the best interest of the parties and, for the reasons described above, as well as others, the parties would rather proceed to court. As such, before making any decision,

you should consult with your legal counsel as to what is right for your case.

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