“The Use of Arbitration Provisions in Contracts,” co-author, Gray Plant Mooty In-House Litigator

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Introduction

Arbitration was once seen as the darling of dispute resolution. Compared to litigation, arbitration was to be an inexpensive, more efficient, and less antagonistic route to settle conflict. Lately, this darling has lost some of its luster. Some authors have written about a “flight from arbitration” spurred by arbitration’s much-touted benefits not having materialized. Members of Congress recently have targeted the Federal Arbitration Act for significant revision, with lawmakers introducing bills to alter the arbitrability of claims in the United States. To add more fuel to the controversy, National Arbitration Forum, described as the “country’s largest arbitrator of credit card and consumer collections,” was forced to shutter its consumer arbitration program after Minnesota Attorney General Lori Swanson sued the company. Some businesses have even lost their desire to arbitrate and actually prefer litigation in the courts.

All this leads to a basic question: Is there any value left to the use of arbitration provisions? As a party drafting a contract, entering into a contract, or wondering about an existing contract with an arbitration provision (which includes just about everyone), there are a number of legal and practical considerations that you must evaluate to determine if it makes sense to agree to arbitrate. These considerations include whether such a provision will be enforceable, whether it will achieve its intended goal, and if arbitration is a suitable alternative from a practical and public relations perspective. In order to answer these questions, it is important to understand the past and present of arbitration provisions.

The Original Rationale of Arbitration and Where it Has Fallen Short

The appeal of arbitrating disputes, at least among arbitration’s supporters, is the element of order that arbitration could bring to a dispute. In theory, the pros of using arbitration include: incurring lesser costs when compared to litigating the same dispute; quicker resolutions than typically can be obtained in the courts; avoidance of “runaway juries” and reliance instead on an arbitrator or panel of arbitrators more experienced in the business issues involved; maintenance of confidentiality throughout the dispute; retention of the ability to control the process of arbitration rather than ceding such control to a judge; and creating less confrontation and thus less divisiveness in the arbitration proceeding as compared to litigation.

In practice, some parties have experienced the exact opposite effect, finding that the costs of arbitration are just as significant (if not more so), the procedures in the arbitration are significantly more protracted or limiting, and the outcomes may be decided by a runaway arbitrator whose decision in most cases cannot be overturned.

Many of the problems experienced with arbitration can be resolved through more careful drafting of arbitration provisions, which in part depends on a better understanding of the arbitration options available to parties. There are a variety of organizations that provide arbitration services. The services provided can simplify the search for an arbitrator, help organize the process, and arm the parties with a predetermined set of arbitration procedural rules to follow. Whether you select an arbitration administration provider or seek out an arbitrator independently, it is important to understand and consider modifying the procedures under which the parties will operate in the arbitration. Filings, motions, and discovery can be expanded or curtailed as is appropriate in the particular situation.

Practically speaking, if you are seeking to use discovery and motion practice similar to what is used in state and federal courts, you should be asking yourself if the remaining benefits of arbitration are sufficient to justify not proceeding through the courts, since a speedy resolution likely will not be possible and the costs may approach that of a typical civil court case. Lastly, parties must decide if they are satisfied with having only one bite at the apple. In the end, arbitration, if not about a speedy and inexpensive means to resolving a dispute, is about the immediate finality of the dispute. Parties inclined to appeal an unfavorable judgment should choose to go to court and not arbitration.

Current Developments in Arbitration Law

Pre-dispute arbitration provisions are encountering ever more scrutiny. As mentioned, Congress is considering a number of modifications to the Federal Arbitration Act, and each modification, at least in part, addresses the issue of pre-dispute arbitration provisions. The Arbitration Fairness Act of 2009, if enacted, would invalidate pre-dispute provisions in the employment, consumer, and franchise law context. Similarly, the Fairness in Nursing Home Arbitration Act of 2009 would prohibit such provisions in nursing home contracts. The Consumer Fairness Act of 2009 would retroactively deem pre-dispute arbitration provisions as unfair and deceptive trade practices toward consumers.

Whether any legislation will be enacted before the end of the congressional session remains to be seen, but mandatory pre-dispute arbitration provisions are clearly now a target. However, they are not the only targets. Some courts have taken issue with class action waiver clauses in arbitration provisions and found authority supporting the judicial review of arbitration rulings and awards. The arbitration regime is likely to experience a definite weakening of the power drafting parties previously possessed in keeping disputes out of court.

Why (and When) Should Arbitration Provisions Be Used

In light of the legal and legislative moves impacting the use of arbitration, is arbitration still a viable dispute resolution mechanism? Despite the recent developments, the answer remains "Yes." In the absence of legislation barring its use, mandatory pre-dispute arbitration provisions still can be useful in circumstances where both parties' interests align. If parties agree that speed, cost savings, and finality are important, both parties will likely be amenable to using arbitration. In the non-negotiated contract context, such as with consumer contracts, look for ways to structure arbitration provisions so that the non-drafting party has some level of choice in deciding whether to engage in arbitration. Perhaps a solution can include redrafting arbitration provisions to shift from mandating arbitration to providing an option for alternative dispute resolution and incentivizing the choice of arbitration over litigation (for example, by covering filing fees and most or all of the arbitrator's fees, and alternatively, seeking attorneys fees, costs, and disbursements in the event of a successful litigation).

In the end, it is important to realize that arbitration is not a one-size-fits-all solution. In some situations, arbitration will be appropriate and naturally lead to the desired result—an efficient, inexpensive, and immediate conclusion. In some cases, litigation is better than arbitration. By taking the time to size up the issues and determine which are best resolved in arbitration, you will find that when you call on the darling of dispute resolution, the luster still can shine through.