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## ALL CONTRACT ARBITRATION PROVISIONS ARE <u>NOT</u> CREATED EQUAL:

## SEVEN PITFALLS IN AGREEING TO ARBITRATION

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Someone very smart once observed, "There are no perfect solutions; each solution creates new problems."

Litigation is slow, frustrating and expensive. And, when anything is slow, frustrating and expensive, people invariably attempt to come up with alternatives. That is the American Way. Arbitration is the best known alternative to having a dispute resolved by litigation. In arbitration, the people involved in a dispute do not use the courts (the government-supplied dispute resolution system with published rules and judges paid by the taxpayers), but rather use a private system where the judges are called arbitrators and there are few rules. The hope is that this private system will be quicker and cheaper (the lack of rules is hoped to make it simpler) and somehow fairer.

Anyone comparing the merits of these two systems should keep in mind that all dispute resolution systems can be evaluated on a continuum. At one end is the system that achieves the highest level of "justice." Presumably, each side has the best lawyers, who put in as much time as required to leave no stone unturned and are governed by a set of rules known to everyone in advance and applied fairly to both sides. The case is then presented to a very wise judge, whose decision is then appealed to the highest court where it is reviewed by the wisest judges. Of course, this may produce high quality justice, but it is very slow and incredibly expensive.

At the other end of that spectrum is a system where the two participants pick their favorite professional basketball team and the two teams play a game with the winner indicating the winner of the dispute. This is not high quality justice, but it is quick and cheap. In fact, the people involved could charge admission and might make a profit on their dispute.

All other systems are somewhere in the middle.

Arbitration is not a cure-all to the problems, frustrations and expense of litigation – arbitration can be long, frustrating, unpredictable, expensive and actually discourage compromise, as opposed to encouraging it. Yet, it can have advantages, and many people pursue it as an option. In fact, many contracts require arbitration as the means to resolve a dispute. But, just like people and snowflakes, arbitration clauses are not all the same. In fact, some disputes may be unwinnable because the arbitration clause that describes how the arbitration will proceed prevents one side from ever having a real "day in court."

## What are these provisions and why are they important?

1. The Choice of Arbitrator. Rarely does one side get to pick its best friend. But often the fine print requires that the arbitrator be chosen from a group that will have a bias in favor of one party. Insurance policies sometimes require that the arbitrator have many years of experience in the insurance industry. This results in arbitrators who are or were insurance company executives who will probably be sympathetic to an insurance company's point of view. When the dispute is between two insurance companies, this makes a lot of sense. But, when the dispute is between an insured and an insurer, the insured likely faces an uphill battle. Another example is contracts about real estate brokerage commissions which require that the arbitrator be a licensed real estate broker - someone who is unlikely to be sympathetic to the person who does not think the commission is due.

- 2. The Amount of "Discovery". One of the common complaints about litigation is that there is too much discovery and that the expense of that phase of the case precludes anyone but millionaires from being able to afford the process. This, of course, is sometimes true. But, there can also be too little discovery. In many disputes, all of the "facts" are known only to one party and without discovery the other side cannot effectively get at the truth. Consider a dispute where the underlying issue is the value of a business. No one can value a privately held family business without detailed knowledge of the internal workings of the business and its plans and forecast. Are profits being artificially diminished because someone is on the payroll (mom, for instance) who is not really working but being paid for some tax reason? Are profits being artificially increased by some employees (one of the kids) being paid less than their market price because they are willing to work for less since they expect to someday inherit the business? Are pessimistic projections about next year's sales to a critical customer being done to lower the estimated value? There is no way for someone to know this without access to all the company's information, and there is no way to get such access without full discovery.
- 3. <u>The Location</u>. If a Chicago company enters into a contract with a company from a small city (Des Moines) and the arbitration is to occur in Des Moines, the big city company (which might be the smaller company) will have an uphill battle. It will need a new lawyer in Des Moines, and the arbitrator probably went to grammar school, high school or college with the other side's lawyer. Also, the Des Moines company may have a large philanthropic local face that no one, including your own lawyer, wants to make frown.
- 4. The Timing. Timing is everything! This is also true in disputes. Arbitration is almost always faster. But, that is not always good. If someone is trying to get money from you, you would be smart to delay as long as you can. With luck, you might be able to delay forever. If you anticipate that a dispute will involve a demand for you to pay more than you want, speed is not your friend, and neither will be arbitration. If an arbitration hearing will be held within 3 months, the Claimant can get an enormous advantage by preparing his or her case prior to filing and then start the clock after he or she is ready.
- 5. <u>Creating an Atmosphere for Compromise</u>. Most judges are acutely aware of the unpredictability of litigation and will take steps to create an atmosphere in which the parties will settle (settlement is just a lawyer's word for voluntarily compromise). Arbitrators are normally neither good at this, nor interested in it. Most judges and lawyers agree that settlement is a good thing. In disputes, just as in stories, there are always two sides. No case is a "sure thing" or a "slam dunk." Most lawyers agree that "slam dunk" means you have an 85% chance of winning at best. The odds never get better because anything can happen and will. Every trial involves a serious risk of loss. If someone has a 60% chance of willing and is offered 65% of their claim, it would seem rational to settle and not risk losing everything in order to get the extra 35%. But, it is very hard in arbitration to create an atmosphere where both sides are willing to be honest and candid with each other and make decisions based on rational analysis and not on emotion. Also, the litigation process presents tools a well trained lawyer can use to create beneficial compromises. These tools are often unavailable in arbitration.
- 6. <u>No Appeal</u>. The rules about appeal in arbitration are very simple. It is almost never possible! Arbitrators, like judges, make mistakes. They may be biased, they may not understand the law, they may be preoccupied and simply not be listening one day. But, in arbitration, unless you can prove bias (which is very hard to do since no one ever admits it), there is no real possibility of appeal no matter how big the mistake.
- 7. Few Rules and Little Law. Because the opportunity to appeal is limited, there is often no remedy if arbitrators do not correctly understand or apply the law. And, many arbitrators are not trained to understand the law. Regardless of what anyone thinks, the "law" is complicated and not something amateurs or even inexperienced lawyers can decipher accurately. If it were clear or easy, there would not be the need for so many lawyers and judges, and there would be far fewer examples of appellate courts reversing trial judges or the supreme court reversing both the trial judge and the appellate court. One may not like the rules, or the law, but having a judge who is sworn to follow both, and who can be reversed if he or she doesn't, does go a long way to creating a level playing field.

This list is not designed to persuade anyone to avoid arbitration. Rather, it should be a checklist of things one should negotiate before entering into an agreement that has an arbitration clause. No matter what anyone says, arbitration provisions in contracts are NOT meaningless "boilerplate." On the contrary, they may have critical importance to how a dispute is resolved. Consulting a lawyer about each such clause before it is signed is a wise investment.

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