

# Limits On Arbitration Would Burden Courts And Taxpayers

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The most important thing for corporate counsel to know about contractual arbitration this year is that lobbyists for trial lawyers and related interest groups are trying their best to make it disappear. The venue for these arguments has moved in recent years from the Supreme Court down East Capital Street to Congress, where several bills have been introduced that would ban contractual arbitration in various contexts. Some of these bills directly focus on proscribing arbitration,<sup>1</sup> while others hide anti-arbitration provisions within substantive legislation that has a larger purpose.<sup>2</sup>

Most corporate attorneys understand the benefits conferred by the ready enforceability of pre-dispute arbitration agreements and limited judicial review provided by the Federal Arbitration Act (FAA). Simply stated, the FAA provides dependable access to a viable alternative to court litigation. It is worthwhile listing arbitration's major benefits here in order to recall why it is a system worth defending in Congress:

*Arbitration produces the same substantive outcomes as court.* Data shows that decisions on the merits are very similar in arbitration and in court.

*Arbitration is faster.* Average case durations are months and even years shorter in arbitration.

*Arbitration is simpler.* Streamlined processes, particularly with regard to discovery and evidentiary issues, reduce procedural wrangling.

*Arbitration is more flexible.* Parties can customize by agreement (think telephonic hearings or web conferencing, for example) and as appropriate for the transactions involved.

*Parties choose their arbitrator.* Sometimes an arbitrator with specific expertise is desirable, and arbitration makes such an appointment possible.

### Cost Savings For Parties

One important attribute not listed above is the fact that arbitration's speed and simplicity means that it is less expensive for the parties than is court litigation. Surveys of arbitration participants consistently show that they spend less money resolving disputes in arbitration than in court.<sup>3</sup> This is no surprise because when lawyers are on the clock, expense is largely a function of speed. When arbitrators decide cases months and even years faster than the dispute would have been decided in court, this corresponds to months and years less billing by litigation counsel for all sides.

The flexibility of arbitration also generates cost savings. For instance, whereas court proceedings require an in-person appearance and the billing entry that goes with it, arbitration allows parties to resolve any aspect of a dispute without making an in-person appearance. Arbitration thus enables parties to avoid billing for time that their attorney must spend traveling to the courthouse or sitting in a courtroom waiting to rehash an argument

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that has already been set forth in a written memorandum.

### Cost Savings For Businesses And Consumers

The cost savings of arbitration accrue not only to the parties but also to the marketplace because the business's costs savings are ultimately passed on to the consumer in the form of reduced prices or to the employee in the form of increased wages. The debate over arbitration usually fails to account for these indirect benefits. It is important to point out that these indirect benefits are contingent on the enforceability of pre-dispute agreements to arbitrate because it is assent to a pre-dispute arbitration agreement that lowers overall dispute resolution costs and thus enables businesses to offer lower prices and higher wages.

In other words, post-dispute arbitration agreements benefit only the disputing parties, while pre-dispute arbitration agreements benefit all of the parties who agree to the arbitration terms.<sup>4</sup> Of course, post-dispute arbitration agreements are more myth than reality anyway, as parties engaged in adversarial posturing after a dispute has arisen will rarely agree on anything, much less a cheaper dispute resolution forum that will reduce costs for one's opponent. The irony is that post-dispute arbitration is the only variety that is embraced by the special interest groups backing the current crop of anti-arbitration bills.<sup>5</sup>

### Taxpayer Savings Are Substantial

While direct cost savings experienced by arbitrating parties is generally understood and indirect cost savings experienced as lower prices is easy to understand, aggregate cost savings to taxpayers as a result of parties choosing to resolve disputes in arbitration is almost never mentioned. Arbitration clearly reduces the burden on crowded court dockets by removing classes of commercial cases that would otherwise compete for scarce judicial resources.

In order to estimate the amount of cost savings that is realized by state court budgets, state treasuries and, ultimately, by taxpayers for each civil case that is resolved in arbitration instead of in court, it is first necessary to calculate the amount of money that is allocated in a given state for the resolution of civil cases. A few states make the requisite budget information available and relevant figures are presented below.

One of those states is New Jersey, where \$571,750,000 was appropriated for the judiciary in 2006.<sup>6</sup> Importantly, New Jersey also discloses that \$130,112,080 of this amount was allocated to its civil courts.<sup>7</sup> Given that 100,332 civil cases were resolved in New Jersey in 2006, simple division produces an estimated average cost of resolving a civil case in court of \$1,296.81. However, this figure underestimates the average cost of resolving a contested case, because it includes cases resulting in default judgments, dismissal for want of prosecution, settlements without judicial action, and settlements through ADR. Excluding these "minimal judicial action" cases from the analysis produces an estimated average cost of resolving a contested civil case of \$3,112.36.<sup>8</sup>

Suffolk County in Massachusetts provides another example of a jurisdiction that separately reports its budget allocation to civil courts. In 2005, the county appropriated \$2,974,243 to its civil courts and the courts disposed of 5,931 cases.<sup>9</sup> However, only 667 cases involved jury trials or extensive judicial involvement. Even after accounting for the revenue collected in the form of filing fees, the estimated average cost of resolving a contested civil case comes to \$2,290.69.<sup>10</sup>

Finally, the state of Colorado appropriated \$337,074,194 for its judiciary in 2006, an estimated \$45,869,056 of which was allocated to the civil courts.<sup>11</sup> Taking into consideration an estimated revenue figure based upon complaint and answer fees, and imputing a 33.3 percent figure for cases requiring extensive judicial involvement (based upon New Jersey's data) produces an estimated average cost of resolving a civil case of \$1,531.<sup>12</sup>

### Anti-Arbitration Legislation Has a Fiscal Impact

The point here is not that the average cost of resolving a civil case in court is \$3,000 or \$2,000 or \$1,500. The lack of granularity in reported budget allocations makes a precise estimate impossible. Despite the lack of precision, this data tells us that the cost of civil justice as delivered by the taxpayer-supported court system is substantial. The reality is that arbitration costs parties less than court litigation, despite the fact that the court system is heavily subsidized by taxpayers.

Armed with this information, we can begin to view the current crop of anti-arbitration legislation in a new light. Arbitration opponents argue their case as if the public court system is a cost-free resource available at unlimited capacity. In reality, any legislative restrictions on contractual arbitration will necessarily produce an increased burden on the court system that will require increased budget allocations to the judiciary. Legislators and policymakers considering measures that would hinder private arbitration need to understand – and account for – their significant fiscal impact.

This fiscal impact can be conceived in the abstract as thousands of dollars per case multiplied by thousands or tens of thousands of disputes every year that would otherwise be resolved in arbitration. Or the impact can be conceived more concretely as new judges and staff to be hired with wages, benefits and pensions to be paid; new courthouses to be

built and furnished; and additional administration required to manage it all.

### Conclusion

The anti-arbitration bills that are circulating through Congress threaten to deprive businesses and consumers of arbitration as an expeditious and cost-effective alternative to court. In shaping the debate on this issue, those who favor innovation and autonomy in the area of dispute resolution need to articulate the far-reaching benefits of arbitration. Specifically, we must ensure that the indirect benefits of arbitration – whether in the form of reduced prices or a lesser tax burden – do not go overlooked because these benefits are not discernible in the absence of an in-depth analysis, and the special interest groups promoting these bills have every incentive to eschew in-depth analysis in favor of anecdote.

Arbitration's efficiency is among its most important benefits for the businesses and consumers who agree to arbitrate disputes. And the fact that parties choose to arbitrate commercial disputes significantly benefits taxpayers. Ironically, this same efficiency represents a direct threat to the trial lawyer lobby and other special interests who stand to benefit by driving more disputes into an overburdened judicial system. Let's choose the parties – and the taxpayers – over the lawyers and preserve the private arbitration system against these challenges.

<sup>1</sup> Arbitration Fairness Act of 2007, H.R. 3010, S. 1782, 110th Cong. (2007) (would prohibit pre-dispute arbitration agreements in consumer, employment and franchise contracts); Consumer Fairness Act of 2007, H.R. 1443, 110th Cong. (2007); Fair Arbitration Act of 2007, S. 1135, 110th Cong. (2007) (would require a reasoned award and an opt-out provision for small claims courts).

<sup>2</sup> Predatory Mortgage Lending Practices Reduction Act, H.R. 2061, 110th Cong. (2007); Mortgage Reform and Anti-Predatory Lending Act of 2007, H.R. 3915, 110th Cong. (2007); American Homebuyers Protection Act, H.R. 1519, 110th Cong. (2007); Reservist Access to Justice Act of 2007, H.R. 3393, 110th Cong. (2007).

<sup>3</sup> See, e.g., Ernst & Young, Outcomes of Arbitration, 11-14 (available at [www.adrforum.com/control/documents/ResearchStudiesAndStatistics/2005ErnstAndYoung.pdf](http://www.adrforum.com/control/documents/ResearchStudiesAndStatistics/2005ErnstAndYoung.pdf)); U.S. Chamber Institute for Legal Reform, Arbitration: Simpler, Cheaper, and Faster Than Litigation, 22 (available at [www.adrforum.com/control/documents/ResearchStudiesAndStatistics/2005HarrisPoll.pdf](http://www.adrforum.com/control/documents/ResearchStudiesAndStatistics/2005HarrisPoll.pdf)).

<sup>4</sup> See Stephen J. Ware, Consumer Arbitration as Exceptional Law, 29 McGeorge L. Rev. 195, 213 (1998) for a more complete analysis of the pre-dispute versus post-dispute arbitration agreements.

<sup>5</sup> For example, the proposed Arbitration Fairness Act would amend the FAA to permit enforcement of only post-dispute arbitration agreements in consumer, securities, employment and franchise cases. See H.R. 3010; S. 1782.

<sup>6</sup> New Jersey budget information is available at [www.state.nj.us/treasury/omb/publications/07budget/pdf/98.pdf](http://www.state.nj.us/treasury/omb/publications/07budget/pdf/98.pdf).

<sup>7</sup> This figure includes estimated proportional allocations of non-apportioned budget items such as trial court services, court reporting, information technology and administration.

<sup>8</sup> It is estimated that 80 percent of judicial costs are expended on cases requiring judicial interaction, which includes 33.3 percent of the cases reported here, with those cases involving minimal judicial action accounting for 20 percent of the costs.

<sup>9</sup> Suffolk County budget information is available at [www.mass.gov/legis/laws/sezslaw05/sl050045.htm](http://www.mass.gov/legis/laws/sezslaw05/sl050045.htm).

<sup>10</sup> Estimating \$1,423,440 in revenue from \$240 Superior Court filing fees for 5,931 cases leaves \$1,550,803 to be divided by 677 "high judicial involvement" cases. We assume here that the low judicial involvement cases are self-supported by filing fees.

<sup>11</sup> Colorado budget information is available at [www.state.co.us/gov\\_dir/leg\\_dir/jbc/FY06-07BIB.pdf](http://www.state.co.us/gov_dir/leg_dir/jbc/FY06-07BIB.pdf).

<sup>12</sup> This figure also assumes that low judicial involvement cases are self-supported by filing fees.

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